# (Why) Was the World Bank Supposed to Be a Nonpolitical Organization? An Interpretation of the Original Meaning and Rationale of Article 4(10) of the Articles of Agreement of the International Bank for Reconstruction and Development, 1941–1948

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# (Why) Was the World Bank Supposed to Be a Nonpolitical Organization? An Interpretation of the Original Meaning and Rationale of Article 4(10) of the Articles of Agreement of the International Bank for Reconstruction and Development, 1941–1948

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The Bank and its officers shall not interfere in the political affairs of any member; nor shall they be influenced in their decisions by the political

* *A note on primary sources*: This article makes use of materials from various collections of primary sources (in addition to the online archive of *The New York Times*). The first and second are available online and consist of materials relating to Bretton Woods. They have been established and are hosted by the St Louis Federal Bank in Missouri (https://fraser.stlouisfed.org ) and the New York Center for Financial Stability (http://www.centerforfinancialstability.org/brettonwoods_docs.php ). I am grateful to my Amsterdam colleague Dr. Hege Elisabeth Kjos for drawing my attention to these online collections. The third collection is available in the National Archives in The Hague, The Netherlands (nr. 2.21.408), and consists of the materials of J.W. Beyen (1897–1976). Beyen was financial advisor to the Dutch government in exile in London during the Second World War. He attended meetings on postwar planning in London with the British and other governments. He was also the Dutch delegation leader at the conferences in Atlantic City and Bretton Woods and at the inaugural meeting of the governors of the Bank in Savannah, Georgia. Beyen was appointed executive director of the World Bank in 1946 and also of the IMF in 1948. In 1952, he became Dutch minister of foreign affairs. The fourth collection is also at the Dutch National Archives in The Hague (nr. 2.05.75) and is the archive of the Dutch Ministry of Foreign Affairs. Last but not least, I have benefitted greatly from the World Bank Oral History Program, which began in 1961, and is a collection of over 140 lengthy interviews with Bank staff, including many senior staff of the late 1940s. It is available at www.worldbank.org. In addition, I have made use of the detailed World Bank Historical Chronology, produced by the World Bank Group Archives, available at www.worldbank.org.

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> character of the member concerned. Only economic considerations shall be relevant to their decisions, and these considerations shall be weighed impartially in order to achieve the purposes stated in Article I.
>
> ARTICLE 4 (10), ARTICLES OF AGREEMENT OF THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (1944)

> Mr. Morgenthau: I would have given anything if you had been with us at Bretton Woods. It would have been most helpful.
> Senator Taft: I think you would have regretted it in the end.
>
> BRETTON WOODS AGREEMENT ACT. HEARINGS BEFORE THE COMMITTEE ON BANKING AND CURRENCY UNITED STATES SENATE, SEVENTY-NINTH CONGRESS, FIRST SESSION ON H.R. 3314, 1945, P.17 (TUESDAY, 12 JUNE 1945)

## Introduction

The World Bank is supposed to be a nonpolitical organization. It must decide on economic grounds to achieve its two overall purposes, reconstruction and development. This nonpolitical mandate has always been central to the Bank's legal justifications of its activities, its internal guidance notes and operational policies for staff, and its self-image as a specialized international financial institution. It has also played a pivotal role in legal and public debates about the Bank. It is, from a legal point of view, the yardstick with which to assess whether the Bank is pursuing its mission, forsaking its mission, or suffering from mission creep. But what does it mean? What is its rationale?

Consider some examples. In the early 1960s, the UN General Assembly issued resolutions which requested the Bank to refrain from granting financial or technical assistance to South Africa and Portugal because of apartheid and colonialism, respectively. The Bank responded that it had no authority under Article 4(10) to act on this request because of its political character. The Bank, as its then president, George Woods, wrote, will 'continue to treat requests for loans from these countries in the same manner as applications from other members'.[1] Hence, in 1966 the Bank extended a $ 10 million loan to the South

1 Samuel A. Bleicher, 'UN v. IBRD: A Dilemma of Functionalism', *International Organization* Vol. 24, No. 1 (1970), pp. 31–47, at p. 33.

African Electricity Supply Commission and two loans totalling $ 30 million to Portuguese companies. Recently, in February 2014, the Bank decided to put on hold a loan to Uganda after the government had introduced an anti-gay law which can imprison for life those convicted of homosexuality. Institutionalized discrimination against homosexuals, President Kim explained in an Op-Ed in *The Washington Post*, is 'bad for people and for societies' and 'is *also* bad for economies' because it prevents productive people from fully participating in the workforce.[2] Does the Bank here respect the injunction in the Articles of Agreement that 'only' economic considerations shall be relevant to its decisions? Why was this reasoning not applied to apartheid in the 1960s? Does institutionalized discrimination against homosexuals have worse effects on the poor than institutionalized discrimination against women under Islamic law in many countries which are Bank members?

Matters do not become simpler when the overall purposes of development and reconstruction are thrown into the equation. For example, in the late 1990s the Bank adopted the Comprehensive Development Framework (CDF), which essentially means that development cannot simply be equated with economic growth, but is a process with many components, such as gender equality, governance, education and health.[3] Now suppose that the Bank considers supporting two projects on the grounds that these will increase labour participation of the poor.[4] One aims to provide more security in the neighbourhood because the high level of crime deters poor people to go to or return from work late at night. The other focusses on domestic violence because it leads to poor women showing up late at work or miss work. Further research, however, indicates that domestic violence does not have a special effect on employment; other poor women have the same problems with maintaining their jobs. It also shows that many poor in the crime-ridden neighbourhood are eager to take high-risk jobs in private security or mining. What is the Bank supposed to decide in such cases? Not to support the projects because the economic rationale is weak or absent? Or to support the projects because they promote development, comprehensively conceived? As Bank-historians Edward S. Mason and Robert E.

2 Jim Yong Kim, 'Discrimination Carries a High Price', *The Washington Post*, February 29, 2014.

3 Joseph E. Stiglitz, 'Participation and Development: Perspectives from the Comprehensive Development Paradigm', *Review of Development Economics*, Vol. 6 (2002), pp. 163–182; John Pender, From 'structural adjustment' to 'comprehensive development framework': conditionality transformed?, *Third World Quarterly*, Vol. 22, No. 3 (2001), pp. 397–411.

4 The examples are taken from Christopher Stone, *Crime, Justice and Growth in South Africa: Towards a Plausible Contribution from Criminal Justice to Economic Growth* (Center for International Development, Harvard University, South Africa Growth Initiative, Working Paper No. 131, 2006), pp. 8–12.

Asher dryly observed, 'the wording in Article IV, section 10 … presents certain difficulties of interpretation'.[5]

Ibrahim F. Shihata, the Bank's General Counsel from 1983 to 1998, once attempted to address these difficulties by providing a literal interpretation of the Bank's mandate.[6] It clarified matters somewhat. Shihata found that Article 4(10) prohibits the Bank from extending or withholding support because of the form of government of a country; the Bank can do business with monarchies, democracies, oligarchies, dictatorships, and other forms. It also does not allow the Bank to favour or support one political party or faction or person over others in elections or political contests or power struggles; the Bank deals with whatever government is in charge. Nor can it support one ideology over others. Finally, the Bank cannot act on behalf of donor countries in influencing the political orientation or behaviour of client countries. Excellent as these findings are to start a conversation, they are incapable, in most cases, of ending them. It is useful to interpret Art 4(10) as requiring ideological neutrality, but it is debatable whether that is compatible with freezing support following the adoption of anti-homosexuality legislation. The findings shed no light on such issues as whether the Bank should support activities which do not have an economic rationale but are justified in terms of comprehensive development. Shihata, of course, knew that the value of literal interpretation was limited. 'The "teleological" approach to interpretation', he wrote, 'has long been found to be most appropriate for charters of multilateral institutions such as the Bank'.[7] This position has been endorsed by subsequent General Counsels.[8]

5 *The World Bank Since Bretton Woods; The Origins, Operations and Impact of the International bank for Reconstruction and Development and the Other Members of the World Bank Group: The International Finance Corporation, the International Development Association and the International Centre for Settlement of Investment Disputes* (Washington DC: The Brookings Institution, 1973), at. p. 28.

6 Ibrahim F. Shihata, 'Issues of 'Governance' in Borrowing Members: The Extent of their Relevance under the Bank's Articles of Agreement', in: idem, *The World Bank Legal Papers* (The Hague: Martinus Nijhoff Publishers, 2000), pp. 245–282.

7 Idem, at p. 246. See also Ibrahim F. Shihata, 'Techniques to Avoid Proliferation of International Organizations: The Experience of the World Bank', in N. M. Blokker & H. G. Schermers, *Proliferation of International Organizations: Legal Issues* (Alphen aan den Rijn: Kluwer Law International, 2000) pp. 111–134, p. 133; Ibramhim F. Shihata, 'Interpretation as Practiced by at the World Bank', in Shihata, *World Bank Legal Papers*, pp. xliii–lx, at lviii.

8 Ana Palacio, the previous General Counsel, explained:

> "The Bank's Articles, including its purposes, must be interpreted in a dynamic, reasonable, and responsible way that takes into account the changing nature of development and the interests of the Bank's membership. This interpretative approach has been consistently

If the Bank's mandate must be interpreted dynamically to respond to changing needs and views of its members, historical analysis is indispensable. How else can judgments be made about whether present circumstances, challenges, ideas and interests are so much different that they call for an amended interpretation of the mandate? Yet while the Bank's mandate has been debated vigorously at various points in time, a history of the interpretation of the Bank's mandate does not exist.[9] As a result, assessments of whether the Bank is respecting or violating Art 4(10), however well-argued and well-informed, always have an aura of arbitrariness, because a baseline of the evolution of the meaning and rationale is lacking. This paper aims to be a modest step towards a historical understanding of the interpretation of the Bank's mandate. It offers an interpretation of the original meaning of Article 4(10), that is to say, the meaning it gradually acquired from late 1941 to 1948, i.e., from the first signs of life of the Bank until the moment when it made its first decisions on loans. In this period, the initial meaning and rationale of the political prohibition clause gradually crystallized.

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> applied over the years to enable the Bank to respond to a variety of new demands for international development assistance and expertise. It has also allowed the Bank to make new interventions through policy changes in response to the evolving needs of its member countries and the broader development agenda, while acting within its mandate as defined by the purposes in the Articles."

See Senior Vice President and Group General Counsel, 'Legal Opinion on Peace-Building, Security, and Relief Issues under the Bank's Policy Framework for Rapid Response to Crises and Emergencies' (22 March 2007) ('Legal Opinion on Peace-Building, Security, and Relief Issues'), annexed to the World Bank publication *Toward A New Framework for Rapid Bank Response to Crises and Emergencies* (World Bank, Washington, D.C., 2007), which is available at: <http://siteresources.worldbank.org/PROJECTS/Resources/40940–1205169918173/Rapidresponseboardpaper.pdf>, p. 38; see also the current General Counsel, Anne Marie Leroy, in: 'Strengthening the Bank's Internal Rule of Law' in the *Legal Vice Presidency Annual Report FY 2011*, 'The World Bank and the Rule of Law', in *Legal Vice Presidency Annual Report FY 2011*, (World Bank, Washington, DC, 2011) ('Legal Vice Presidency Annual Report FY 2011') p. vi, available at: <http://documents.worldbank.org/curated/en/2011/01/15488410/legal-vice-presidency-annual-report-fy-2011-world-bank-rule-law > , pp. 52–66, at p. 55.

9 For classic papers on this issue, see Daniel D. Bradlow, 'The World bank, the IMF and human rights', *Transnational Law and Contemporary Problems*, Vol. 6., No. 1 (1996), pp. 47–90; John D. Ciorciari, 'The lawful scope of human rights criteria in World Bank credit decisions; an interpretive analysis of the IBDR and IDA articles of agreement, *Cornell International Law Journal*, Vol. 33 (Spring 2000), pp. 331–372; Victoria E. Marmorstein, 'World bank power to consider human rights factors in loan decisions', *Journal of International Law and Economics*, Vol. 13. No. 1 (1978), pp. 113–136.

## 1 *Some Remarks on Sources and Perspective*

An exploration of the original meaning of Article 4(10) of the Articles of Agreement of the IBRD raises two preliminary and related questions. Which sources are available to interpret this article? Is it adequate to interpret these sources through the lens of the U.S. government – as this paper does?

The Articles of Agreement of the IBRD were drawn up and adopted during the conference at Bretton Woods, New Hampshire, which lasted from 1 to 22 July 1944.[10] 44 states attended the conference.[11] A significant number came from Central and Latin America; 19 in total, only Argentina was absent. Ever since the plan for an Inter-American Bank in the late 1930s, which was submitted to Congress in 1940 by the Roosevelt administration but had not passed, it was understood that the Americas favoured and would take part in the creation of international bodies to deal with monetary, development and trade issues.[12] Other attendees included the delegates of 5 Asian countries, including China and India, 4 African countries, including Liberia and South Africa, and many European countries, including 4 from Eastern Europe. The U.S.S.R, particularly important for the topic of this paper, was present as well.

Countries had been invited to Bretton Woods for the purpose of formulating definite proposals for an International Monetary Fund and 'possibly' a Bank for Reconstruction and Development (the adjective international was added at Bretton Woods). Indeed, it had only become clear in June 1944, at the end of a smaller, preparatory conference in Atlantic City, New Jersey, that agree-

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10 Except when indicated otherwise, this section is based on Mason and Asher, *The World Bank since Bretton Woods*, pp. 11–35; Devish Kapur, John P. Lewis and Richard Webb, *The World Bank; Its first Half Century* (*2 vols*), *Vol 1: History*, (Washington, DC: The Brookings Institution, 1997), pp. 1–84; Raymond F. Mikesell, 'Bretton Woods; Original Intentions and Current Problems', *Contemporary Economic Policy*. Vol. 18, No. 4 (2000), pp. 404–414; idem, 'The Bretton Woods Debates: A Memoir', Essays in International Finance, (Princeton NJ: Princeton University Department of Economics), March 1994; World Bank Group Historical Chronology, available at www.worldbank.org.

11 The list with countries represented and the chairmen of the delegations is in the *Articles of Agreement International Monetary Fund and International Bank for Reconstruction and Development*, United Nations Monetary and Financial Conference, (Washington, DC: U.S. Treasury, 1944), at pp. 86–87.

12 Charles G. Fenwick, 'The Third Meeting of Ministers of Foreign Affairs at Rio de Janeiro', *The American Journal of International Law*, Vol. 36, No. 2 (April 1942), pp. 169–203; Eduardo Villaseñor, 'The Inter-American Bank: Prospects and Dangers', *Foreign Affairs*, Vol. 20, No. 1 (Oct. 1941), pp. 165–74; Michael J. Francis, 'The United States at Rio, 1942: The Strains of Pan-Americanism', *Journal of Latin American Studies*, Vol. 6, No. 1 (May 1974), pp. 77–95.

ment on an international bank was within reach and that the proposal for the Bank could be added to the agenda of Bretton Woods. Yet the IMF always remained the primary focus of the delegates at Bretton Woods. Commission II, which dealt with the Bank and was chaired by Lord J.M. Keynes, met briefly on July 3, only to reconvene on July 11, when the conference was half way and the Articles of Agreement of the IMF were mostly finished.[13] Indeed, such was the stature of the bank that the conference-secretariat sent stenographers to Commission I, on the IMF, whenever there were not enough to cover both commissions. No stenographers were available to record the meetings of the small committees of Commission II. As a result, the verbatim records of the Bretton Woods proceedings, which were discovered by Kurt Schuler in 2010 and recently published as *The Bretton Woods Transcripts*, shed some but not much light on discussions on the Bank.[14] They only cover the second meeting of Commission II of 11 July, where Keynes leads a first run-through of the draft agreement on the Bank and assigns clauses which cause major difficulties to one of the committees, reserves clauses which give intermediate difficulties to Commission II itself, and assigns uncontroversial clauses to the Drafting Committee to polish the language before final approval. Interestingly, Article IV Section 10 was sent to the Drafting Committee straightaway, so it is unlikely that important exchanges on the political prohibition clause were lost. Even so, the verbatim records of 11 July show some exchanges which are relevant to the interpretation of the Bank's mandate, as will be shown later.

Some commentators have concluded from these facts that the Bank was merely an afterthought.[15] Yet the main reason why efforts at Bretton Woods focused on the IMF was that this proposal was of greater complexity.[16] The Bank, like the IMF, was important to many delegations. It had also been 3 years in the making and was the result of extensive and careful deliberations.

13 Kurt Schuler and Andrew Rosenberg, 'Introduction', in: idem (eds.) *The Bretton Woods Transcripts*, (New York: Center for Financial Stability, 2012). NB This e-book publication does not have page-numbers.

14 Schuler and Rosenberg, *The Bretton Woods Transcripts*.

15 Richard Peet, *Unholy Trinity; The IMF, World Bank and the WTO*, (London: Zed Books: 2009, 2nd edition), at p. 127; Richard N. Gardner, *Stirling-Dollar Diplomacy in Current Perspective; The Origins and the Prospects of Our International Economic Order*, (New York: Columbia University Press, 1980, New, expanded edition with revised introduction), at p. xxii; Kapur et al., *The World Bank; Its First Half Century*, Vol. 1, at p. 59.

16 This is clearly established on the basis of primary sources in Eric Helleiner*, Forgotten Foundations of Bretton Woods, International Development and the Making of the Postwar Order* (Ithaca and London: Cornell University Press, 2014), pp. 99–132.

Shortly after the outbreak of the war in Europe, the U.S. government started to plan for the postwar world. The Treasury became responsible for the planning of a postwar international economic order. Harry Dexter White (1892–1948) became the key person in this effort. An economist who had joined the Treasury in 1934, shortly after Roosevelt had become president, White was head of the Division of Monetary Research. In December 1941, after Pearl Harbor, Treasury Secretary Henry J. Morgenthau asked him to prepare a memo on an international stabilization fund and an inter-allied bank. At that time, White already appears to have been working in private for some months on a plan for a bank for reconstruction and development, inspired by the proposal for an Inter-American Bank in 1939–40, in which he had been closely involved.[17] Hence, White could submit a lengthy scheme for an international bank only 15 days after Morgenthau's request. One of the versions of the White-plan,[18] as it came to be called, was sent to interested colleagues within the Treasury and in other departments early in 1942 in mimeographed form.[19] The April-version, which was sent to Roosevelt in mid-May, was called *Suggested Plan for a United and Associated Nations Stabilization Fund and a Bank for Reconstruction and Development of the United and Associated Nations*.[20] It is the first draft proposal for the Bank available in print.

In May 1942, following a meeting between Morgenthau and Roosevelt, the Treasury established the American Technical Committee (ATC), which organized and oversaw informal discussions and negotiations of the plan within the government and with some foreign governments prior to Bretton Woods.[21]

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17 Mikesell, *The Bretton Woods Debates: A Memoir*, at p. 2.

18 For various versions of the White Plan in early 1942 and 1943, see Helleiner, *Forgotten Foundations*, ch. 4 and Robert. W. Oliver, *International Economic Co-Operation and the World Bank* (London: MacMillan, 1975), pp. 110–144.

19 Two detailed accounts of the U.S. origins of the proposal for bank have been written by former colleagues of White in the Division of Monetary Affairs: Henry J. Bittermann, 'Negotation of the Articles of Agreement of the International Bank for Reconstruction and Development', *International Lawyer*, Vol. 5, No. 1 (1971), pp. 59–88; Mikesell, *The Bretton Woods Debates: A Memoir*. Also valuable are the histories of the origins and early development of the Bank, based in part on interviews he conducted with key persons in the context of the Bank's oral history project, in Oliver, *International Economic Cooperation and the World Bank* and Robert W. Oliver, *Early Plans for a World Bank*, Princeton Studies in International Finance no. 29, (International Finance Section, Dept. of Economics, Princeton University 1971).

20 Reprinted in: Oliver, *International Economic Cooperation and the World Bank*, pp. 279–322.

21 Mikesell, *The Bretton Woods Debates: A Memoir*, pp. 6–7; Oliver, *International Economic Co-Operation and the World Bank*, pp. 135–136.

It was chaired by White and consisted of representatives of the Treasury, State Department, Commerce Department, Federal Reserve Bank and other government agencies. By October 1943 and after many serious revisions, the plan was in sufficiently good shape for discussion during a joint session of Senate and House Committees on foreign relations.[22] It was well-received, and in November 1943 the Treasury published the plan and formally sent it to foreign governments to open international negotiations. To emphasize that it regarded the plan as tentative and that it welcomed constructive critical responses, the Treasury gave it the exceptionally cautious title *Preliminary Draft Outline of a Proposal for a Bank for Reconstruction and Development of the United and Associated Nations*.[23]

The *White Plan* and the subsequent *Preliminary Draft Outline* are thus important sources for the interpretation of the original meaning of the Bank's mandate. Also relevant are some U.S. documents, particularly a booklet which was simply called *Questions and Answers* and went through various editions in the run-up to Bretton Woods after its first release in January 1944. Written in response to questions and concerns from foreign governments as well as domestic audiences,[24] the booklet offers an elaborate explanation of the underlying rationale of many draft provisions, including Article 4(10).[25]

The Articles of Agreement of the IBRD and the sources just mentioned have traditionally been interpreted from the perspective of the United States government and, to a much lesser extent, the British government.[26] Despite their extensive presence at Bretton Woods, the views of undeveloped countries have hardly played a role in accounts of the origins of the Bank. In his recent book *Forgotten Foundations of Bretton Woods*, Eric Helleiner persuasively argues that historians have thereby distorted the early history of the Bank.[27] From the late 1930s onwards, international support for development had been discussed

22 Bittermann, 'Negotiating of the Articles of Agreement', p. 63.

23 The *Preliminary Draft Outline* (as it will be called in the remainder of this article) was printed in *Proceedings and Documents of the United Nations Monetary and Financial Conference, Bretton Woods, New Hampshire, 1–22 July 1944*, Volume 2, (Washington, DC: United States Department of State, U.S. Government Printing Office, 1948), pp. 1616–1628.

24 Mikesell, *The Bretton Woods Debates: A Memoir*, p. 32.

25 I will quote from the June 1944-version, which was distributed to delegates and journalists at Bretton Woods: United States Department of the Treasury, *Questions and Answers on the Bank for Reconstruction and Development*, June 10, 1944, ed. and transcribed by Kurt Schuler and Dylan Schuler (New York: Center for Financial Stability Paper in Financial History, 2012), available at www.centerforfinancialstability.org

26 The UK exercised significantly more influence on the plan for the IMF than for the Bank.

27 Helleiner, *Forgotten Foundations.*

between the U.S. government and representatives of undeveloped countries, particularly from Latin and Central America as part of the so-called 'Good Neighbor Policy' of the Roosevelt administrations. Moreover, this dialogue influenced some of the outcomes of the Bretton Woods agreements, including the Articles of Agreement of the Bank.

Helleiner's account is an important and rich addition to the literature on Bretton Woods. But it does not fundamentally alter the perspective from which the sources of the Articles of Agreement of the IBRD should be interpreted, at least with respect to the mandate. It is true that delegates of undeveloped countries had some influence on the wording of the Bank's mandate, as we shall see. It is also true, as was noted before, that the plan for the Bank was influenced by the failed initiative of an Inter-American Bank in the late 1930s. Even so, the U.S. was clearly in the driver's seat.[28] The U.S. government initiated and drafted the first plan, organized discussion within the U.S. as well as with foreign governments, revised subsequent versions of the plan, and drafted the Articles of Agreement. Moreover, the U.S. was the world's largest economy and creditor and it was abundantly clear that the Bank would largely depend on U.S. financial support; there was very little room for other governments to impose their views on the U.S.

## 2 The Origin of the Political Prohibition Clause

Was the World Bank always supposed to be a nonpolitical organization? In his recent analysis and critique of the history and current practice of development aid, William Easterly has argued that the prohibition on political interference was a part of the very first draft plan for a World Bank.[29] According to Easterly, White was the 'principle author of Article IV, Section 10'.[30] Since the White Plan 'embodies the technocratic approval of state power and disregard for human rights',[31] it can therefore be regarded as the 'moment of original

28 Helleiner also notes that 'US officials had tight control of the proceedings and sought to avoid votes on issues where its goals might not be served'. He adds that the '. . . influence of delegates from Latin America and other parts of the South should not be overstated'. Helleiner, *Forgotten Foundations*, p. 15.

29 William Easterly, *The Tyranny of Experts; Economists, Dictators and the Rights of the Poor* (New York: Basic Books, 2013).

30 Easterly, *The Tyranny of Experts*, p. 164.

31 Easterly, *The Tyranny of Experts*, p. 166.

sin' of the World Bank in particular and the development industry in general.[32] According the Easterly, White's motivation for introducing the nonpolitical mandate was to cement the 'US-Soviet alliance both during and after the war'.[33] When the World Bank started to extend loans in the late 1940s, the nonpolitical mandate would serve to justify support for authoritarian regimes which violate human rights but were useful in the struggle to contain the Soviet empire; the Colombian Gómez-regime was one of the first notorious examples.[34]

There is some truth in this assessment of the origins and later use of the political prohibition clause. The Soviet Union was indeed an important motivation behind Article IV, Section 10, although it was not the only one, as will be shown later. Moreover, White chaired the ATC, which oversaw and steered the discussions and the development of the plan for the Bank from 1942 to Bretton Woods, so he must have been one of the architects of the political prohibition clause. Yet it is inaccurate that White's 1941 Draft contained a political prohibition clause and that his draft is insensitive to human rights (though it did indeed betray belief in technocratic experts).

White's Draft was not a legal document with careful and guarded legalistic articles and sections covering all aspects of the Bank. It was succinct summary of some of the main functions and characteristics of the Bank, accompanied by an essay which explored (too) many ambitious ideas for the postwar international economic order. White gave the bank an extraordinary range of purposes, powers and functions. He argued, for example, that the bank would provide for 'the financing and distribution of foodstuffs and other essential commodities needed for the relief of populations devastated by war conditions',[35] a function that would be performed by the United Nations Relief and Rehabilitation Administration (UNRRA), established in 1943. The Bank would finance an International Essential Raw Materials Development Corporation and an International Commodity Stabilization Corporation.[36] He also proposed the establishment of a new international currency.[37] As Mikesell, his former colleague in the Treasury, later noted, the White Plan had a 'somewhat rambling nature' and at times appeared to be a 'rather personal

32 Easterly, *The Tyranny of Experts*, at p. 149, 163–167.
33 Easterly, *The Tyranny of Experts*, at p. 165.
34 Easterly, *The Tyranny of Experts*, p. 167.
35 *White Plan*, at. p. 291.
36 *White Plan*, at. p. 313.
37 *White Plan*, at pp. 305–311.

expression of experimental ideas'.[38] There is nothing which resembles a legal clause on political interference in White's Draft Plan.[39]

More importantly, the White Plan was not nonpolitical and insensitive to human rights. White stated that one of the Bank's purposes was 'to enhance the opportunity throughout the world for a healthy development of democratic institutions'.[40] He also suggested to make eligibility for membership of the Bank conditional upon adherence to a bill of rights of the peoples of the United Nations; 'there might be a requirement that the participants subscribe publicly to a 'Magna Charta of the United Nations' … The Magna Charta constitutes a bill of rights of the peoples of the United Nations'.[41] White believed that this adherence would be opposed by none 'since the document sets forth the ideal of freedom for which most of the peoples are fighting the aggressor nations'.[42] However, he also realized that public endorsement was likely to be shallow in some cases; 'there are a number of countries which in their practices do not now give, and have not given, evidence that they subscribe to the principles contained therein'.[43] Nonetheless, it was important to make membership conditional upon acceptance of a bill of rights, since the mere public announcement would be 'a great step forward in the struggle to obtain those rights for all the peoples' and indicate the 'beginning of a truly new order in the realm where it has hitherto been most lacking – international finance'.[44] If anything, the *White Plan* was progressive in advocating both democracy and human rights as integral components of the international financial order.

White's suggestions regarding human rights and democracy never made it to Bretton Woods. All references to these ideals quickly disappeared from the plan for a Bank. The *Preliminary Draft Outline* of November 1943, which was a proper legal draft, made no mentioning whatsoever of democracy and human rights. Indeed, it included a categorical prohibition on political interference: 'The Bank and its officers shall scrupulously avoid interference in the political

38 Mikesell, *The Bretton Woods Debates; A Memoir*, pp. 9–10.

39 Easterly does not refer to the parts of the White Plan which deal with the Bank, but with the part which deals with the IMF. In particular, he rests his case on the statement in the White Plan on the IMF that 'No restrictions as to membership [of the fund] should be imposed on grounds of the particular economic structure adopted by any country', a statement which, according to Easterly, '… later seem[s] to have drifted into the World Bank part'. See Easterly, *The Tyranny of Experts*, at pp. 165 and 505 (note 27).

40 *White Plan*, p. 297.

41 *White Plan*, p. 319.

42 *White Plan*, p. 319.

43 *White Plan*, p. 319.

44 *White Plan*, p. 320.

affairs of any member country. This provision shall not limit the right of an officer of the Bank to participate in the political life of his own country. The Bank shall not be influenced in its decisions with respect to applications for loans by the political character of the government of the country requesting the loan'.[45] At Bretton Woods, very little changes were made to this draft article, and these amendments did not affect its meaning.[46] Thus, the political prohibition clause was introduced somewhere between April 1942 and November 1943.[47] In this period, the Draft was primarily discussed by various U.S. agencies, and also, informally, with some foreign governments, under the auspices of the ATC, which White chaired.[48] In other words, the U.S. government had quickly become convinced that the Bank had to avoid promoting democracy and human rights and operate nonpolitically. Why?

## 3 Reconstruction and Development

Article 4(10) prohibits the Bank from letting political considerations play a role when it decides or acts to achieve its purposes, reconstruction and development. What did the founding members of the Bank mean by reconstruction and development? What would the Bank do to achieve these purposes? How and why were the Bank's decisions and actions supposed to be nonpolitical?

Given today's stature of the Bank as the world's premier development organization, it is natural, when looking for its roots, to expect admirable foresight and profound thinking on the nature of development and reconstruction among the founding members. In fact, their views were rather inarticulate, especially with respect to development. They clearly regarded reconstruction and development as distinct from postwar relief and aid[49] – the core business of the United Nations Relief and Rehabilitation Administration (UNRRA), which was established in 1943 and would play an important role in the immediate

45 Article 4 (19) *Preliminary Draft Outline*, p. 1626.

46 At Bretton Woods a positive formulation was added: 'only economic considerations shall be relevant to their decisions, and these considerations shall be weighed impartially in order to achieve the purposes stated in Article 1'.

47 In fact, the political prohibition clause appears to have been introduced in the August 1943-version of the White Plan. See Oliver, *International Co-Operation and the World Bank*, p. 142.

48 Bittermann, *The Bretton Woods Debates; A Memoir*, p. 63; Mikesell, *The Bretton Woods Debates: A Memoir*, pp. 10–12.

49 *Questions and Answers*, p. 10.

aftermath of the war, particularly in the care for displaced persons in Europe.[50] Reconstruction and development were long-term efforts and aimed at production and economic growth, not immediate consumption. They did not, however, regard reconstruction and development as fundamentally different enterprises.[51] Less developed countries did not have special economic problems; their problems were just much larger and would take more time to address. Reconstruction meant replacing bridges, port facilities, electric power production and distribution facilities, railroads, industrial enterprises, flood control and irrigation systems, farm mechanization, and other capital which had been destroyed in the war. Development meant bringing such infrastructural, agricultural and industrial capital to places where it had never been.[52] In other words, development 'was a project of industrialization and modernization designed to catch up to the leading economies'.[53] Both reconstruction and development were generally defined as 'raising living standards', 'increasing production' and 'creating employment'. Whether it is the *Preliminary First Draft Outline* or the many official documents explaining Bretton Woods or the Conference Proceedings itself, reconstruction and development were almost invariably mentioned in a single breath. *Questions and Answers*, the most elaborate official explanation of the Bretton Woods proposals, nowhere raised the issue of whether reconstruction and development were different enterprises and did not discuss the meaning of the terms.

One of the reasons why founding members did not spend more time on discussing the nature and differences between reconstruction and development was that they expected the Bank to be primarily involved in the reconstruction of Europe and the Far East in the first decade or so after the war. Development would have to wait 'until the reconstruction of Europe is much further advanced', as Keynes said.[54] A Mexican proposal, on behalf of Latin American delegations, to provide in Article 3(1) of the Articles of Agreement that 'the Bank shall give equal consideration to projects for development

50 William I. Hitchcock, *The Bitter Road to Freedom: A New History of the Liberation of Europe* (New York: Free Press, 2008), pp 215–48; George Woodbridge, *UNRRA: the History of the United Nations Relief and Rehabilitation Administration* (New York: Columbia University Press, 1950).

51 Oliver, *Early Plans for a World Bank*, pp. 36–39.

52 See for instance Morgenthau's 'Closing Address by the Secretary of the Treasury Henry Morgenthau, July 22, 1944', Army Information School, *Pillars of Justice; Documents pertaining to American Interest in Establishing a Lasting World Peace, January 1941- February 1946* (Pennsylvania: Book Department Army Information School, May 1946), pp. 32–35, p. 34.

53 Helleiner, *Forgotten Foundations*, p. 20.

54 Kapur et al. *The World Bank; Its First Half Century, Volume 1: History*, p. 60.

and to projects for reconstruction, and [that] its resources and facilities shall always be made available to the same extent for either kind of project', was rejected at Bretton Woods.[55] Although delegates agreed with the spirit of the proposal, they felt its formulation was too strict to allow for a disproportionate use of Bank resources for reconstruction in the immediate postwar years, and therefore opted for a more flexible formulation.[56] As expected, the first Bank loans, in 1947, were for reconstruction and went to France, The Netherlands, Denmark and Luxemburg.[57] However, in June that year the U.S. announced the European Recovery Program, better known as the Marshall Plan.[58] It then became clear that the Bank's role in the postwar reconstruction of Europe would be significantly more modest than anticipated at Bretton Woods. Suddenly, the Bank realized it had to focus on development; on 5 November 1947, Bank President John J. McCloy told the Board: 'I think we are going to be driven into a very different field sooner than I thought, into the development field'.[59]

Moreover, there was little experience with development as an aim of international policy. Many books on the subject have taken President Truman's famous inaugural address on 20 January 1949, as the beginning of the era of development aid.[60] In this address, Truman called for 'a bold new program for making the benefits of our scientific advances and industrial progress available for the improvement and growth of underdeveloped areas'.[61] In fact, development had slowly become an aspiration of international politics since the First World War. Moreover, the Roosevelt administration had made a cautious start

55 Schuler and Rosenberg, *The Bretton Woods Transcripts*, 2012, Part III: Commissions II and III: World Bank, chapter 37.

56 Article 3, section 1 (a) of the Articles of Agreement reads: 'The resources and the facilities of the Bank shall be used exclusively for the benefit of members with equitable consideration to projects for development and projects for reconstruction alike'.

57 World Bank Group Historical Chronology; Mason and Asher, *The World Bank Since Bretton Woods*, p. 813

58 William I. Hitchcock, 'The Marshall Plan and the creation of the West', in: Melvyn P. Leffler and Odd Arne Westad (eds.), *The Cambridge History of the Cold War, Vol 1: Origins*, (Cambridge University Press, 2013), pp. 154–174, at p. 156–157; Gaddis, *The Cold War; A New History* (New York: Penguin Press, 2005), pp. 30–32.

59 Kapur et al., *The World Bank; Its First Half Century, Volume 1: History*, p. 83.

60 See for example Gilbert Rist, *The History of Development; From Western Origins to Global Faith*, (London: Zed Books, 3rd edition, 2008), pp. 69–79; Arturo Escobar, *Encountering Development; The Making and Unmaking of the Third World* (Princeton, New Jersey, 1995), pp. 3–4.

61 Quoted in Rist, *The History of Development*, p. 71.

with plans for economic and financial cooperation with Latin and Central America as part of its Good Neighbor Policy.[62] By the early 1940s, development was an accepted ideal of international policy.[63] In January 1941, Roosevelt declared the freedom from want as one of the Allies' peace objectives. On 14 December 1941, Churchill and Roosevelt signed the Atlantic Charter, which included among its eight principles the 'assurance that all men in all the lands might live out their lives in freedom from fear and want'.[64] In 1943, Roosevelt called the Hot Springs Conference on Food and Agriculture, which led to the establishment of the Food and Agriculture Organization (FAO). The Charter of the United Nations adopted in San Francisco included among its aims 'higher standards of living, full employment, and conditions of economic and social progress and development'.[65] Development was an ideal of international policy before 20 January 1949, but it had little concrete content – which, incidentally, it still had not in Truman's speech.

It should be noted that there was very little academic work which could have inspired a more concrete vision. Development economics as a field of study did not yet exist, except in the form of one or two papers which, with the benefit of hindsight, are regarded as marking the birth of the sub-discipline.[66] Only in the 1950s did development economics become an autonomous subdiscipline with the publication of such classics as Ragnar Nurkse's *Problems of Capital Formation in Underdeveloped Regions* (1953), Tibor Scitovsky's 'Two Concepts or External Economies' (1954), Richard R. Nelson's 'A Theory of the Low-Level Equilibrium Trap in Underdeveloped Economies' (1956), Harvey Leibenstein's *Economic Backwardness and Economic Growth: Studies in the Theory of Economic Development* (1957) and of course Gunnar Myrdal's *Economic Theory and Under-developed Regions* (1957).[67]

62 Helleiner, *Forgotten Foundations*, pp. 29–51.

63 Amy L.S. Staples, *The Birth of Development; How the World Bank, Food and Agriculture Organization, and World Health Organization Changed the World, 1945–1965* (Kent, Ohio: Kent State University Press, 2006), especially pp. 1–21.

64 Principles 5 and 6.

65 Ch. 9, Article 55(a).

66 Heinz W. Arndt, *Economic Development; The History of an Idea* (Chicago: Chicago University Press, 1987), pp 43–88. The papers are by Paul Rosenstein-Rodan: 'Problems of Industrialization of Eastern and South- Eastern Europe', *Economic Journal*, Vol. 53, No. 210/211, (1943), pp. 202–11; 'The International Development of Economically Backward Areas', *International Affairs*, Vol. 20, No. 2, (1944), pp. 157–165. Incidentally, Rosenstein-Rodan would join the World Bank as an economist in 1947.

67 Christopher B. Barrett, 'Development Economics: An Overview', in :C.B. Barrett (ed.), *Development Economics: Critical Concepts in Development Studies* (4 volumes) (London:

The founding members' views on the nature of reconstruction and development may have been hazy, their idea on what it would take to achieve these aims was crystal clear: a postwar revival of world trade. To replace their former wealth or uncover and develop their resources, war-torn and undeveloped countries needed large quantities of capital equipment. Since they could no longer produce such equipment, or had never been able to, they would need to import a large volume of productive machinery and equipment from countries with heavy industries which could produce capital for export. As Article 1(1) of the Articles of Agreement states, the purpose of the Bank is:

> . . . to assist in the reconstruction and development of territories of members by facilitating the investment of capital for productive purposes, including the restoration of economies destroyed or disrupted by war, the reconversion of productive facilities and the encouragement of productive facilities and resources in less developed countries.

## 4 Why a New International Bank?

Reconstruction and development required the import of large volumes of capital equipment from the U.S and a few other countries, but where would war-torn and undeveloped countries find the money to place orders with American and Canadian firms? Clearly, they needed to borrow at least a part of the purchase money. Traditionally, two mechanisms had existed for such international financing: inter-governmental loans and international private investment. Postwar planners did not believe that these mechanisms, by themselves, would suffice to restore world trade. That is why they established the Bank.

Inter-governmental loans would of course continue to exist after the war, but they were a shaky foundation for a postwar revival of foreign investment. Governments extend loans to other governments to advance their own political interests, so many countries in need of reconstruction or development would not be able to obtain loans, because they were not strategically important. Also, bilateral loans would be extended, withheld or terminated to extract political concessions, irrespective of imminent or continuing needs for reconstruction or development. Another shortcoming of dollar diplomacy was that creditor governments usually did not care about how borrowers would spend the money. In the 1930s, many governments had spent loans on military

Routledge, 2007), pp. 1–48; Arndt, *Economic Development; The History of an Idea*, especially pp. 43–88.

equipment, the payment of old debts, corruption, and other unproductive purposes. Such expenditures would be unsuitable to strengthen and stabilize the economies of war-torn and undeveloped countries and increase the volume of world trade.[68]

Postwar planners were also concerned about the other mechanism of international financing, international private investment. Private investors were expected to be exceedingly reluctant to trust their money to foreign governments and enterprises. In the 1930s, the confidence of private investors had received a serious blow as they had been caught by a sharp decline in international trade, an epidemic of defaults, and international economic aggression through such devices as exchange controls, competitive currency depreciation, and multiple currency practices.[69] Had the past done much to bring foreign loans into disrepute, the future did not look particularly bright either. Uncertain business conditions were likely to prevail for some time after the war in many countries. Furthermore, private investors, because of a lack of knowledge or interest or both, had proved to be poor judges of whether projects for which loans were sought contributed to the long-term productivity of the country concerned– not to mention their inability to adequately assess whether the borrower would be able to repay principal and interest.[70] Money had been wasted on corruption, arms, and bad investments. Another shortcoming was that private investors were characteristically motivated by a desire for profit and interested to invest in enterprises which promise relatively quick and attractive financial returns, such as mines and factories. They were less likely to be enthusiastic about investments in the (re)establishment of a badly needed framework of public utilities and key industries such as roads, port facilities, hydroelectric power stations, telephone lines, and irrigation.

Postwar planners believed that reconstruction and development would have to be financed primarily by a large and steady volume of private international investment through the usual channels. If that was to happen, however, trust needed to be restored.[71] Moreover, safeguards needed to be established to ensure that investment would contribute to long-term productivity and growth. This was the role of the World Bank: to encourage and facilitate international lending by private investors for productive purposes.

68 *Questions and Answers*, p. 22.
69 *Questions and Answers*, p. 9.
70 *Questions and Answers*, p. 18.
71 *Questions and Answers*, p. 17–8, 20–21.

Postwar planners and delegates at Bretton Woods believed that the Bank would restore trust primarily by acting as a guarantor.[72] Whenever an investment was considered, the Bank could be asked to guarantee the partial or full repayment of the interest or the principal of the loan, or both, depending on the nature of the project and the circumstances. When the loan was made to a private entity or decentralized political entity, the Bank would secure the guarantee of the government of the member country in which the project was to be located; it would then add its own guarantee. In this manner, private investors would have the assurance that the risk of defaults would not fall on them, but upon the Bank, i.e. all 44 member countries. The Articles of Agreement left open the option that the Bank would participate in loans made by private investors or extend loans itself, but postwar planners and delegates at Bretton Woods considered these alternatives of participation and direct lending as secondary; the Bank would mainly act as a guarantor to restore trust in international lending.[73]

To ensure the payment of loans and prevent the misdirection of investment into unproductive projects, the Bank would only act as guarantor if various precautionary conditions were met. Firstly, the Bank needed to be satisfied that the project for which the loan was sought was in the interest of the member national government.[74] This was assured by the member government's guarantee of payment in the event of default by the private or municipal debtor. The Bank also needed to be convinced that the project would increase the productivity of the country concerned.[75] To this end, a technical committee of the Bank would make an extensive technical analysis of the proposed project. The Bank would also develop procedures to ensure that funds would not be diverted from their intended use, such as audits, inspections and reporting, with due attention to considerations of economy and efficiency.[76] The Bank would open an account in the name of the borrower and ensure that the borrower could only draw on this account to meet expenses that were actually incurred in connection with the project.[77] Finally, the Bank would determine whether the loan could be serviced by ascertaining that the prospective balance of payments of the borrower was such that transfer of payments to

72 *Questions and Answers*, p. 6; Art. 1(ii) Articles of Agreement.
73 *Questions and Answers*, pp. 6, 16.
74 *Questions and Answers*, p. 22.
75 Articles of Agreement, Article 1(i, ii).
76 Articles of Agreement, Article 3, Section 5(b).
77 Articles of Agreement, Article 3, Section 5(c).

foreign creditors seemed assured.[78] In short, the Bank determined the soundness of the loan from the point of view of the investor as well as the borrower on the basis of economic criteria.

## 5 The Original Meaning and Rationale of the Political Prohibition Clause

The Bank was established to encourage and facilitate a large and steady flow of private international investment. In carrying out this task, the Bank was not allowed to interfere in the political affairs of any member or to be influenced in its decisions by the political character of the member concerned. What did this mean? What was the rationale behind Article 4(10)?

The original meaning of the political prohibition clause was straightforward. When deciding whether or not to guarantee a loan or participate in loans or lend directly, the Bank was not supposed to take into consideration the nature of the political system or the form of government or the composition of the incumbent regime of the country concerned. The Bank could do business with capitalist as well communist states, with democracies as well as autocracies, and with regimes which were popular as well as unpopular in the eyes of their own citizens or foreign governments. The only caveat was that the Bank had to assess whether a country was politically stable. But that was an economic consideration in decision-making, not a political one: the productivity of the project for which the credit was asked and the prospect of servicing the loan might be jeopardized by serious political instability.

The rationale of this prohibition of political interference was threefold: the need for war-time collaboration; a vision of long-term post-war peace and prosperity; and the core business of the Bank as a guarantor and facilitator of international private investment. All of these reasons, particularly the first two, were heavily influenced by the perceived importance of securing participation of the U.S.S.R, but it is mistaken to regard the desire to ensure that this communist autocratic state would join the Bank as the only significant rationale for the introduction of the political prohibition clause in the Articles of Agreement of the IBRD, as has thus far been suggested.[79]

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78 Articles of Agreement, Article 3, Section 4(v).

79 Cissé, 'Should the Political Prohibition Clause Be Revisited?', Hassane Cissé, Daniel D. Bradlow and Benedict Kingsbury (eds.), *The World Bank Legal Review, Volume 3, International Financial Institutions and Global Legal; Governance* (Washington, DC: The World Bank, 2012), pp. 59–92, p. 60; Mason and Asher, *The World Bank Since Bretton Woods*, p. 27. Cissé suggests that the political prohibition clause was also introduced to

The war was far from over in 1943 and early 1944 and victory over the Axis depended importantly on the U.S.S.R. In Europe, the U.S.S.R always fought 80% of the German *Wehrmacht* before the invasion in Normandy in 1944. Even after January 1943, when the Soviets had won the battle of Stalingrad, the turning point in the war, it remained important that Germany's hands were tied on the Eastern front if the U.S. and its Western allies were to successfully open the second front with relatively few casualties – an important consideration for Churchill and Roosevelt. Moreover, the U.S. needed the U.S.S.R to join the war effort in the Far East, where Japan proved to be a tough enemy. The 'Manhattan Project' had not yet produced results; only on 16 July 1945, would the first atomic bomb be detonated in the desert in northern New Mexico. Before that day, the entry of the U.S.S.R into the war was eagerly anticipated; indeed, Roosevelt went to great lengths, at Yalta, to ensure the promise that the U.S.S.R would join the fight in Asia three months after the European war had ended. It was clear in 1943 that the U.S.S.R. was suffering tremendous destruction in physical and human capital and would need vast amounts of capital for post-war reconstruction. At war's end, it had lost a staggering 25 million people, 1700 cities and towns, 31000 factories and over 70000 villages and hamlets. One of the means to secure continued fighting by the U.S.S.R. was the promise of money. In addition to vast Lend-Lease shipments and other assistance during the war worth 11 billion USD, the U.S. therefore offered the U.S.S.R a multibillion reconstruction loan – which, in the end, was never extended.[80] The World Bank could provide an additional source of capital for the U.S.S.R.

Roosevelt not only wanted to win the war, he also wanted to win the peace that would follow.[81] This meant the establishment of a new collective security organization, which would avoid the shortcomings in the design and membership of the League of Nations.[82] But it also meant the establishment of an international economic order based on collaboration between the major economic

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ensure the confidence of capital markets. In my view, however, this rationale only became important in the course of 1946, when it became clear that the Bank would not act as a guarantor but had to lend directly, as will be explained extensively in the next section. Although *Questions and Answers* discussed the option that the Bank would participate in loans or engage in direct lending, this was clearly of secondary importance and it was not connected with the rationale of the political prohibition clause (see pp. 15–17).

80 John Lewis Gaddis, *The United States and the Origins of the Cold War*, 1941–47 (New York: Columbia University Press, 1972), pp. 174–197.

81 Franklin D. Roosevelt, Fireside Chat December 9, 1941 quoted and commented on in Gaddis, *The United States and the Origins of the Cold War*, p. 1.

82 Paul Kennedy, *The Parliament of Man; The Past, Present and Future of the United Nations* (New York: Vintage Books, 2006), pp. 24–47; Gaddis, *The United States and the Origins of the Cold War*, pp. 27–30.

and military powers, as the administration believed that military-strategic dimensions of peace could not be separated from economic dimensions. The Roosevelt administration, like many, believed that the economic warfare of the 1930s, with its autarky, closed trading blocks and nationalistic barriers to foreign investment and currency convertibility, had contributed importantly to the outbreak of the war. Moreover, the administration subscribed to the idea that free trade and foreign investment contribute significantly to peace – the capitalist peace thesis, the sister of the democratic peace thesis.[83] Furthermore, membership of the IMF and the Bank of the major powers, alongside participation in the United Nations, would help to strengthen the ties between them and ensure that the grand alliance would not disintegrate after the common enemy had been defeated. For all these reasons, Morgenthau, White and others in the Roosevelt administration worked tirelessly for a multilateral regime of liberalized trade, equal investment opportunities for all countries, stable exchange rates and full currency convertibility. In their view, it was crucially important that the U.S.S.R would join the two organizations which were key to the postwar international economic order.[84]

The rationale of Article 4(10) lay, finally, in the nature of the Bank's envisioned role as guarantor of international lending by private investors. As Jacob Vines, the famous economist and advisor to the Roosevelt administration, noted at the time, private enterprise is 'normally nonpatriotic': owners will not use their privately-owned resources, at financial cost to themselves, to serve national ends of power, prestige, or prosperity.[85] Nor are they interested in the political character of the country in which they invest, except when political instability threatens the prospect that loans are serviced. They are not motivated by a desire to realize political change. Private investment decisions are made primarily on the basis of calculations of private profit and the degree of assurance that promises are kept. Hence, if the Bank were to introduce political considerations in its decision-making it would alienate, not encourage, private investors. The U.S. Treasury explained part of the rationale of prohibition on political interference by noting that 'It is reasonable to assume that private

83 Gerald Schneider and Nils Petter Gleditsch, 'The Capitalist Peace: The Origins and Prospects of a Liberal Idea', *International Interactions*, Vol. 36. No. 2 (2010), pp. 107–114; Erik Gartzke, 'The Capitalist Peace', *American Journal of Political Science*, Vol 51, No. 1, 2007, pp. 166–91; Katherine Barbieri, *The Liberal Illusion; Does Trade Promote Peace?* (Ann Arbor, MI: Michigan University Press, 2002).

84 Gaddis, *The United States and the Origins of the Cold War*, pp. 22.

85 Jacob Viner, 'International Relations Between State-Controlled Economies', *The American Economic Review*, Vol 34, No. 1, (1944), pp. 315–329, at p. 316.

investment institutions would not give weight to political factors, except as the stability of the government affects the risk element in all foreign loans'.[86] Indeed, during the later war years, there was great optimism among American investors, banks, businessmen and federal agencies about business-opportunities in the U.S.S.R, with predictions of postwar export to the country ranging from 500 million to 5 billion USD per year, despite their concerns about communism.[87]

It is worth stressing that the long-term rationales behind the political prohibition clause were inextricably interwoven with U.S. economic interests. The U.S. was by far the largest economic power and the world largest creditor. During the war, the country had built up a massive industrial plant to produce war materials – from canned food to tanks, trucks and bombers- for itself and its allies. By 1944 the U.S. supplied a third of Great Britain's material needs and a quarter of those of the Soviet Union. In Willow Run, Michigan, Ford Motors had built the largest factory in the world, which produced no less than three hundred B-24 bombers per month.[88] The war industry had brought full employment, an aim which the New Deal, despite its success in creating new jobs, had never realized. There was widespread concern, however, that these impressive results would not last. At war's end, heavy industries would have to undergo a reconversion to produce consumer goods, but the home market was far too small to absorb the output of the U.S. industry. Many feared a sharp decline in employment and, as a result, another depression. Foreign demand was the solution. It could replace the artificial stimulus of military expenditure, solve the problem of a surplus of consumer goods and industrial equipment, and maintain full or at least a high level of employment. A short booklet on the Bretton Woods proposals, published in 1945 by the U.S. Treasury to garner support among the American people, made the U.S. interest in a revival of postwar trade abundantly clear:

> While the United States is concerned with the reconstruction and development of other countries for their own sake, our principal interest in bringing about an expanded volume of American investment abroad arises out of concern for our own welfare. After the war, our economic policy will be aimed at full employment and full utilization of a greatly enlarged industrial plant. These objectives, however, cannot be realized

86 *Questions and Answers*, p. 31.

87 Gaddis, *The United States and the Origins of the Cold War*, pp. 182–189.

88 Joyce Appelby, *The Relentless Revolution; A History of Capitalism* (New York & London: Norton and Company, 2010), p. 284.

> unless we find new outlets for products of farm and factory – outlets that will be steady and profitable after war demands have dropped off.[89]

Incidentally, developing countries were not shocked by this self-interested defense of development cooperation; at Bretton Woods, the Mexican delegation argued that as a result of development assistance '… we will undoubtedly benefit not only ourselves, but the world as a whole, and particularly the industrial nations, in that we shall provide better markets and better goods'.[90] The notion that rich countries have a duty to give aid to undeveloped countries, regardless or even at the cost of their own economic interests, had not yet arrived.

## 6 After Bretton Woods

The atmosphere of cooperation and internationalism which had pervaded the negotiations at Bretton Woods soon evaporated. The harsh realities of securing ratification of the agreements, turning the agreement into a functioning organization and, last but not least, the rapid deterioration of the marriage of convenience between the U.S.S.R and the U.S. put great pressure on the political prohibition clause. Article 4(10) would survive ratification. Its meaning would stay the same during the second half of the 1940s. However, an element was added to its rationale, because it soon became crucially important for the Bank to become accepted by Wall Street. Moreover, the political prohibition clause only survived because it became a myth.

## 7 Gaining Wall Street Credibility

Postwar planners had believed that the Bank would encourage private international investment primarily by acting as a guarantor. That was a miscalculation. It soon became clear that private investors were unenthusiastic to buy the bonds of borrowers in member countries, even when guaranteed by the Bank. Indeed, the Bank would never guarantee either a foreign loan of a private investor or a public offering of a foreign government. Consequently, the

89 U.S. Treasury, *The Bretton Woods Proposals*, Washington, D.C., 15 February 1945, p. 9.

90 Schuler and Rosenberg, *The Bretton Woods Transcripts*, 2012, Part III: Commissions II and III: World Bank, other, chapters 37.

Bank had to focus on direct lending. The problem, however, was that its immediate available resources were extremely limited.[91]

The size of the capital stock of the Bank was one of the points on which states disagreed prior to Bretton Woods. They also held different views on whether the Bank could act as guarantor for its subscribed capital or in excess – two, perhaps three times- of that amount. The compromise at Bretton Woods was that the Bank would have an authorized capital stock of 10 billion USD, divided into 100.000 shares of the par value of 100.000 USD each.[92] The Bank could not act as guarantor in excess of that amount.[93] The U.S. was by far the largest subscriber (3.175 million USD), followed by the UK (1.300 million), the U.S.S.R (1.200 million, but this country eventually did not ratify the Bretton Woods Agreement), China (600 million), France (525 million), all the way down to Ethiopia (3 million), Iceland (1 million) and Panama (0.2 million).[94]

Ten billion USD may seem a considerable amount of money, but member countries paid very little directly into the Bank. 80% of the subscriptions of each member were subject to call only if and when required to meet the obligations of the bank.[95] This part of the subscriptions was a guarantee fund, unavailable for use in the Bank's lending operations. Another 18%, which was payable in the own currencies of members, could only be used for loans with the consent of the country concerned.[96] The U.S. was expected to give its consent, and it did; other countries were not in a position to permit the export of capital. Only 2% of the subscriptions, which had to be paid in gold or U.S. dollars, were freely available for use in the bank operations.[97] At the end of the day, the Bank's immediate available loanable resources amounted to 730.000.000 USD.[98]

The consequence of this arrangement was that the bank would have to rely on the private money market for the major portion of its loanable funds.[99] It could only lend if it could borrow. Backed by the guarantees of subscriptions that could be called up on demand, the Bank had to sell securities to large

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91 Mason and Asher, *The World Bank Since Bretton Woods*, pp. 43–44, 105–149; Kapur et al., *The World Bank; Its First Half Century, Vol. 1: History*, pp. 905–925.

92 Articles of Agreement, Article 2, Section 2 (a).

93 Articles of Agreement, Article 3, Section 3.

94 Articles of Agreement, Schedule A (Subscriptions).

95 Articles of Agreement, Article 2, Section 5 (ii).

96 Articles of Agreement, Article 2, Section 7 (i).

97 Articles of Agreement, Article 2, Section 7 (i).

98 Mason and Asher, *The World Bank Since Bretton Woods*, p. 53.

99 Mason and Asher, *The World Bank Since Bretton Woods*, pp. 125–138; Kapur et al., *The World Bank; Its First Half Century, Vol 1: History*, pp. 915–925.

institutional investors, such as banks, insurance companies, trust funds and others who customarily invest in prime securities. Its capital structure tied the Bank to the private investment community, and in the foreseeable future that meant the American investment community. Given the fact that the Bank's unexpectedly had to take the route of direct lending instead of investment guarantees, an approach to the U.S. market became a matter of urgency.

The Bank's first President, Eugene Meyer, therefore soon urged leading insurance companies and other institutional investors to invest in the Bank's obligations once these were issued.[100] His appeal fell on deaf ears. The private investment community was 'thoroughly unenthusiastic about giving any financial support for the Bank'.[101] In theory, the Bank had a guarantee fund of close to 10 billion USD, but private investors only had faith in the American subscription; the nature of the guarantee, not its size, mattered.[102] Moreover, the experience of the 1920s and 1930s had made investors weary of foreign portfolio investment. Furthermore, the Bank was an unknown *sui generis* entity and investors were concerned that it would be run as a political organization rather than on the basis of sound investment principles. They became particularly concerned when relations between President Meyer and the U.S. executive director, Emilio G. Collado, deteriorated rapidly and a stalemate between the two men ensued, for reasons to be discussed shortly. The Bank was perceived to be struggling, its future looked nebulous.[103] It seemed as if the Bank would never be able to play a role in reconstruction and development.

In the early spring of 1947, however, a completely new management took over.[104] They were able within a short period of time to inspire confidence of capital markets. On15 July 1947, the Bank entered the bond market for the first time with an offering of 250 million USD. Dealers across the U.S. were eager to handle the sale and the issue was heavily oversubscribed. In 1949, Morgan Stanley and First Boston Corporation were chosen to manage the syndicates of dealers. In 1951, the bank would start selling bonds in Europe.

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100 'Meyer Urges Aid for World Bank', *The New York Times*, December 14, 1946.

101 See Transcript of Interview with Richard H. Demuth, The World Bank/IFC Archives Oral History Program, 10 August 1961, at p 10; Kapur et al., *The World Bank; Its First Half Century*, p. 914.

102 Transcript of interview with Mr Eugene R. Black, President, The World Bank/IFC Archives Oral History Program, 6 August 1961, at p. 8.

103 Mason and Asher, *The World Bank Since Bretton Woods*, p. 43–45.

104 Mason and Asher, *The World Bank Since Bretton Woods*, pp. 48–52; Kapur et al., *The World Bank; Its First Half Century*, pp. 76–84, 916..

The composition of the new management was a key to this success. The new President was John J. McCloy, a former Assistant Secretary of War and a former legal counsel of the Chase National Bank. The terms on which he agreed to accept the position included the installation of two Wall Street bankers in key positions.[105] The new American director was Eugene Black Jr, a vice president of the Chase National Bank and former associate and friend of McCoy. The new vice president was Robert L. Garner, vice president of the General Foods Corporation and a former banking executive.[106] The *New York Times* reported that financial circles in the U.S. and the U.K. were 'jubilant' after learning that 'Wall Street has moved into the bank in Washington'.[107] The new management soon appointed other bankers in temporary and permanent positions and opened a New York office located in the Federal Reserve Bank.[108]

The new management was also unusually energetic.[109] They invited investment bankers to D.C. to learn about the bank, went into the country and 'made speeches all the time, everywhere',[110] published booklets, pushed for the passing of pending legislation in states to make Bank-bonds legal investments, and successfully persuaded Moody's, Fitch and Standards & Poor to give the bank a good rating. In the first months of the Bank's existence, under Meyer, financial circles had felt that they were left in the dark about the bank's plans and operations;[111] the new management, by contrast, initiated 'a phenomenal

105 'McCloy is Elected World Bank Head', *The New York Times*, March 1, 1947

106 Kapur et al., *The World Bank; Its First Half Century*, p. 915. Kapur et al note that the new triumvirate in the top of the Bank had close business and personal networks with the 'self-selected aristocracy of lawyers, bankers, corporate chiefs, and government officials' which formed 'the old American establishment'. These networks of the Bank's management, Kapur et al note, are detailed in Philip Burch, *Elites in American History, vol 3: The New Deal to the Carter Administration* (New York: Holmes and Meier, 1980), pp. 93–5, 118–119.

107 'World Bank Set-Up Pleases the British', *The New York Times*, March 4, 1947.

108 For influx of Wall Street bankers, see for example *The New York Time*s, June 3, 1947 (H. Warren Wilson, vice president Union Securities Corporation, joins Bank), *The New York Times*, June 11, 1947 (Francis T. Ward, partner at Morgan Stanley & Co and former governor of the Bond Club of the New York and a governor of the New York Stock Exchange, assists bank with marketing of initial bond issue). See also Mason and Asher, *The World Bank Since Bretton Woods*, p. 130.

109 Mason and Asher, *The World Bank Since Bretton Woods*, pp. 52–54; Kapur et al., *The World Bank; Its First Half Century*, pp. 916–925.

110 The World Bank/IFC Archives, Oral History Program, Transcript of interview with Eugene R. Black, August 6, 1961, p. 14..

111 'Wall St Awaiting World Bank Issues. Investment Groups Reported Bewildered by the Lack of Information', *The New York Times*, October 27, 1946.

growth of public relations activity'; indeed, 'more promotion went into the issuance of 250 million USD of securities than into any comparable fundraising in the history of American finance'.[112]

It is hard to overstate the extent to which the Bank wanted to convince Wall Street of its business acumen and sound banking credentials in those early years. The details of the Bank's retirement plan, annual leave and salary scales, for example, were all deliberately similar to what was normal in the banking industry, not in regular international organizations such as the United Nations.[113] More consequential was the Bank's handling of the first loan applications from countries which had defaulted on their loans in the 1930s and had not fully repaid or made a settlement on their debts. The Bank insisted it would not consider a loan as long as the issue was unresolved, because it would otherwise been unable to sell its securities to the American private investment community. In a meeting with Chile, where this problem first came up, management made the connection between defaults and the Bank's own standing abundantly clear:

> the most difficult policy problem facing the Bank is where borrowers are in default on previous debt... The present management does not see how the Bank can make loans in the face of widespread dissatisfaction in financial and investment circles to whom the Bank must sell its own bonds. The principle applies, of course, not only to Chile but equally to all potential borrowers.[114]

Unsurprisingly, the Bank was sometimes called Wall Street's debt collector.

The political prohibition clause, too, was a crucial selling point in the strategy to gain and maintain Wall Street credibility. The new management wanted to assure the banking community that it full well realized that the Bank would have to be run on sound investment principles.[115] The Bank could and would never accept any pressure to make loans for political purposes, Garner explained, '... for it is generally understood that if the Bank should ever embark on such a course, its ability to borrow, and therefore to lend, would

112 Charles P. Kindleberger, 'Bretton Woods Reappraised', *International Organization*, Vol. 5, No. 1 (February 1951), pp. 32–47, at p. 43.

113 Mason and Asher, *The World Bank Since Bretton Woods*, pp. 44–45.

114 Notes of a meeting between Bank management and Chilean government officials on 21 May, 1947, quoted in Mason and Asher, *The World Bank Since Bretton Woods*, pp. 156–157.

115 Mason and Asher, *The World Bank Since Bretton Woods*, pp. 125–138.

be at an end'.[116] He continued: 'The objective, non-political character of the Bank's activities is important from the standpoint of assuring investors in the Bank's bonds that its resources will not be dissipated in uneconomic loans'.[117] Black concurred:

> It is obvious ... that if the Bank is to succeed in stimulating the flow of private capital, the integrity of our lending operations must be preserved. This ... means that we cannot and will not lend more than borrowing countries can afford to repay. Nor can the Bank tailor its lending to political purposes of any kind.[118]

The idea that Bank needs to insulate itself from political considerations to maintain the confidence of capital markets would remain a powerful and lasting rationale for Article 4 (10) ever since the late 1940s. For example, Hassane Cissé, the current Deputy General Counsel, recently wrote: 'A financial intermediary, the Bank borrows funds from capital markets to finance its lending operations. If political considerations were to drive decisions, the smooth operation of the Bank's business model might be affected, because the Bank might have difficulty maintain the confidence of the capital markets where it sources its funds as well as the member countries to which it lends the borrowed funds'.[119] The idea also rested, from the very start, on a myth.

## 8 Or Else We'll Go Back to New York This Afternoon

In March 1946, a year before the Wall Street triumvirate entered the Bank, the Board of Directors had held its inaugural meeting in Savannah, Georgia. The agenda-items seemed unspectacular, but they were variations of an existential question. Was the Bank an independent international financial institution, directed by an international group of expert civil servants who owed their loyalty to the organization and no one else? Or was it an instrument to advance

116 Robert L. Garner, 'The International Bank for Reconstruction and Development – A New Departure in International Finance', *Vanderbilt Law Review*, Vol. 1, No. 4, (1948), pp. 501–511, at 503.

117 *Ibid.*, p. 504.

118 Eugene R. Black, 'The World Bank at Work', *Foreign Affairs* Vol. 30, No. 3, (1952), pp. 402–11, at p. 411.

119 Cissé, 'Should the Political Prohibition Clause Be Revisited?', p. 60. See also Shihata, *World Bank Legal Papers*, p. 226

the interests of its members, especially the one which provided a third of its subscribed capital and nearly all of its initial working capital? Would the Bank be a new instrument of U.S. dollar diplomacy? Who ran the Bank?[120]

It would seem that member states already answered this question in Bretton Woods. Had they not issued a categorical prohibition on political interference and instructed the Bank to decide on the basis of economic considerations only? They had, but general principles do not automatically trickle down in the more detailed provisions on the organization of decision-making and daily operations. Indeed, organizational lines of demarcation and procedures can contribute to the realization of abstract principles as much as they can undermine them. At Bretton Woods, delegates had been unable to reach agreement on this Achilles heel of the prohibition on political interference. Savannah was supposed to bring clarity.

There was, first of all, the location of the Bank. Should it be based in the world's financial centre in New York City or close to the representatives of national governments, especially the U.S. government, in Washington D.C.? The U.K. and India strongly opposed Washington as a site of the Bank, but said they would accept if the U.S. insisted, and insist they did – which Wall Street saw as an expression of the desire to take political control over international finance.[121] The more important issue was the management of the Bank. At Bretton Woods, it was agreed that, for daily operations, the two important organs of the Bank were the Executive Directors and the President and his international staff. The Executive Directors were appointed by member states. Five of them came from the five largest stockholders (the U.S, the U.K., France, China and, as long as the U.S.S.R failed to ratify the agreement, India). The other seven were elected by the remaining members.[122] The Executive Directors were 'responsible for the conduct of general operations of the Bank' and exercised powers delegated to them by the Board of Governors, which, ultimately, held all the powers of the Bank.[123] The President, who was selected by the Executive Directors, would be 'chief of the operating staff' and conduct 'the ordinary business of the Bank'.[124] President and staff would 'owe their duty entirely to the Bank and to no other authority' – language which was strikingly

120 John W. Pehle, 'The Bretton Woods Institutions', 55 *The Yale Law Journal* Vol. 55, No. 5 (1946), pp. 1126–1139, at pp. 1137–1138,

121 'Washington Urged as Bank Site: Committee Turns Down This City', *The New York Times*, 14 March 1946.

122 Article V, section 4 (a) and (b).

123 Article V, section 1.

124 Article V, section 5(a) and (b).

absent in the provisions on the Executive Directors, who, clearly, were accountable to the governments of their countries.[125]

So what, exactly, was the role of the Executive Directors vis-à-vis the President and his staff? One view, defended by the U.S. government, was that the Executive Directors would be continuously involved in operations and decision-making and exercise close control over the Bank.[126] The Bank's president and staff would merely execute these decisions. Since the U.S. held 37 % of the votes and since, under the Articles of Agreement, the Bank cannot raise capital in a country without the consent of its government[127] – and the Bank could borrow nowhere else but in the U.S. for the foreseeable future- this meant, in effect, that the U.S. controlled the Bank through its Executive Director.[128] 'Ours is a position of tremendous power', U.S. Treasury Secretary Fred M. Vinson, Morgenthau's successor, correctly observed.[129] Moreover, the business of the Bank, as Vinson continued, was a matter of 'high economic policy' and neither the Bank nor the IMF could therefore be run as 'just two more financial institutions'. The other position, passionately defended by Keynes in particular, was that the Executive Directors would only meet occasionally and exercise general oversight. Indeed, the Executive Directors would hold posts in their own countries, for instance in the Treasury or Central Bank, and come to a meeting at head office from time to time to do their Bank-work. The President and the international staff would run the Bank as a technocratic, autonomous financial institution. This meant, in effect, that 'the Executive Directors become little more than an advisory body', as Vinson wrote dismissively.[130] At Bretton Woods, delegates had agreed to disagree. The Articles of Agreement stated that 'the Executive Directors shall function in continuous session at the principal office of the Bank and shall meet as often as the business of the Bank shall

125 Article V, section 5(c).

126 Mason and Asher, *The World Bank Since Bretton Woods*, pp. 34–40;

127 Article IV, section 1(b).

128 Nathaniel Weyl and Max J. Wasserman, 'The International Bank: An Instrument of World Economic Reconstruction, *The American Economic Review*, Vol. 37, No. 1 (March 1947), pp. 92–106, at p. 105 give an overview of all the elements of American power in the Bank under the Articles of Agreement, noting, in addition to the points mentioned above, that the U.S. can veto any Amendment to increase the capitalization of the Bank and that it can form a majority with the U.K. or the Chinese and French votes, under some conditions.

129 Fred M. Vinson, 'After the Savannah Conference', *Foreign Affairs*, Vol. 24, No. 4 (July 1946), pp. 622–32, at p. 631.

130 Fred M. Vinson, 'After the Savannah Conference', p. 627.

require'.[131] Whether that meant that Bank business required the Executive Directors to meet daily, monthly or annually was anybody's guess.

In Savannah, U.S. delegates were not in the mood for giving in. Nor could they had they wanted to. In January 1945, President Roosevelt had sent the Articles of Agreement of the Bank and the Fund to Congress for approval. Six months later, on 31 July 1945 Congress had passed the Bretton Woods Agreements Act. Obtaining congressional approval, however, had not been a walk in the park. Some Republicans, including Senator Fulbright and particularly Senator Robert A. Taft, objected to hand over the power to determine the destination, terms and use of American money to an international organization which was not controlled by the U.S. Taft regarded the Bank as a convenient device for foreigners to give away American taxpayers money to other foreigners. He felt the arrangement came down to '… pouring down money down a rat hole'.[132] Fullbright added, while pointing out that the U.S. had, before the war, invested in the economies of its later enemies, that Bank-decisions should not just be based on economic considerations, but also on a political assessment. 'It occurred to me that before the war we did business with such countries as Japan and Spain without any regard to political considerations. It does not seem to me that in future we can isolate the economic from the political'.[133] Opponents also pointed out that the U.S. would be giving away their economic bargaining power without receiving anything in return. In response to these criticisms, Morgenthau and White had firmly defended the cause of multilateralism. Morgenthau replied to Fulbright: 'I am sorry … but I would not be honest if I did not stick by my guns … These are financial institutions run by financial people, financial experts, and the needs in a financial way of a country are to be taken care of wholly independent of the political connection'.[134] White was less polite. The Bretton Woods agreement, he said to Taft, was not meant 'to ram down the throats of every other country, whatever the opinion

131 Article V, section 4(c).

132 Bretton Woods Agreement Act. Hearings Before The Committee on Banking and Currency United States Senate, Seventy-Ninth Congress, First Session on H.R. 3314, 1945, p.126 (Tuesday, June 12, 1945).

133 Bretton Woods Agreement Act. Hearings Before The Committee on Banking and Currency United States Senate, Seventy-Ninth Congress, First Session on H.R. 3314, 1945, p.14 (Tuesday, June 12, 1945).

134 Bretton Woods Agreement Act. Hearings Before The Committee on Banking and Currency United States Senate, Seventy-Ninth Congress, First Session on H.R. 3314, 1945, p.14 (Tuesday, June 12, 1945),

of the United States should happen to be'.[135] Bretton Woods provided for 'an international institution, not machinery to impose our views on others'.[136]

In the end, the administration had to ensure Congress that American interests would be served and protected. The result was the establishment, in the Bretton Woods Agreements Act, of the National Advisory Council on International Monetary and Financial Problems. This was a Cabinet-level committee, consisting of the Secretary of the Treasury, as Chairman, the Secretary of State, the Secretary of Commerce, the Chairman of the Board of Trustees of the Export-Import Bank and the Chairman of the Board of Governors of the Federal Reserve System.[137] The Council would give 'general policy directions for the guidance of the representatives of the United States'; 'advice and consult . . . on major problems arising in the administration of the . . . Bank'; and:

> coordinate . . . the policies and operations of the representatives of the United States on the Fund and the Bank . . . and all other agencies of the Government to the extent that they make of participate in the making of foreign loans or engage in foreign financial, exchange or monetary transactions.[138]

In short, the American Executive Director in the Bank was made subordinate to the Council, which gave him instructions and to which he was accountable. Against this background, it is not surprising that U.S. delegates stuck to their positions on the location and management of the Bank in Savannah. And given the fact that the U.S. provided by far the largest chunk of the Bank's capital, there was not much that other countries could do about it.

Was the U.S. in a position to steamroll all opposition to Washington as the Bank's domicile, resistance to operational control over the Bank by the U.S. executive director, or rather the National Advisory Council, proved harder to overcome. The U.K. and other countries persisted in their objections in Savannah, so a compromise was again sought and found.[139] Needless to say,

135 Bretton Woods Agreement Act. Hearings Before The Committee on Banking and Currency United States Senate, Seventy-Ninth Congress, First Session on H.R. 3314, 1945, p. 125.

136 Bretton Woods Agreement Act. Hearings Before The Committee on Banking and Currency United States Senate, Seventy-Ninth Congress, First Session on H.R. 3314, 1945, p.125

137 Bretton Woods Agreements Act, Section 4(a).

138 Bretton Woods Agreements Act, Section 4(b) nrs 1–3,

139 The bylaws provided that 'it shall be the duty of an Executive Director and his Alternate to devote all the time and attention to the business of the Bank that its interests require, and between them to be continuously available at the seat of the Bank'. Quoted in Mason and Asher, *The World Bank Since Bretton Woods*, p. 38.

that was not the end of the story. President Meyer and his newly appointed staff as well as observers from financial circles in Wall Street and London firmly rejected the notion that the president and his staff had no control over the bank's operations and decision-making. A battle in the Bank ensued over the jurisdictional lines between staff and board. True to his belief that the executive directors should run the Bank, Collado attempted to exercise detailed control over operations, insisting, for example, that directors should be present during all staff meetings and be involved in negotiating loans (which they also had to approve or disapprove).[140] As a result, working relations between Meyer and Collado soon became untenable. Meyer resigned, only six months after he had started as president.[141]

The early resignation was as surprising as it was embarrassing for the U.S. government. Worse yet, the search for a new president with sufficient clout in financial circles took painfully long; no candidate, and a handful were approached, was willing to accept what was in effect merely a nominal position, despite the prestige and a 30.000 USD salary, tax free. Suggestions were made for amending the bylaws and even for amending the Articles of Agreement in order to create a more balanced division of powers between staff and executive directors. In the end, a solution was found in an informal and unwritten agreement. McCloy accepted the presidency on the condition that he could fill the top positions with bankers, including the U.S. executive director.[142] He also demanded that president and staff would form the Bank's 'management' – a term which became part of the jargon since then-[143] while the executive directors would provide general oversight and make ultimate decisions on loan applications. The U.S. government agreed, and so, after a bit of pressure, did the executive directors. From March 1947, it was clear that the Bank's day-to-day operations were going to be run by the Bank's management and international staff.

140 Transcript of Interview with Morton M. Mendels, The World Bank/IFC Archives Oral History Program, July 17, 1961, pp. 28–30.

141 The official reason for Meyer's resignation was that he had completed the task of steering the bank through its initial phase, but different sources indicate that the struggle over the board-staff relationship was the main real reason. See Transcript of Interview with Richard H. Demuth, The World Bank/IFC Archives Oral History Program, August 10, 1961, at p. 3–4; Mason and Asher, *The World Bank Since Bretton Woods*, p. 42, 46–7, 95–6.

142 Kapur et al., *The World Bank; Its First Half Century*, pp. 1162–65; Mason and Asher, *The World Bank Since Bretton Woods*, pp. 48–53, 87–88.

143 See Transcript of Interview with Richard H. Demuth, The World Bank/IFC Archives Oral History Program, August 10, 1961, at p. 9; Transcript of Interview with Morton M. Mendels, The World Bank/IFC Archives Oral History Program, July 17, 1961, p. 19–20, 22.

Garner's recollection of the episode is delightful:

> There'd been a difference of opinion from the beginning in the Bank as to the role of management and the role of the directors. At Bretton Woods most of the important countries had felt that the directors should not attempt to actually operate the institution. The United States representatives had rather argued in favor of a very active role for the directors. This question was not resolved during Mr. Meyer's tenure and I believe that it was one of the causes of his resignation … It was generally understood at the time in conversations carried on with McCloy that it would be agreed that the management would actually manage the institution and the directors would play the usual role of general supervision without interference in the conduct of business. When we got down here, there was still some hesitation on the part of some of the directors to make that position perfectly clear. So we listened to the discussions, and then McCloy finally said that the only condition under which he felt it was possible to handle the situation would be a clear declaration as to the power of the management to manage, that if the directors were not fully in agreement with that, we would go back to New York that afternoon. Then the directors went into executive session and after lunch they said they were fully agreeable. So the deal was made … There was no formal signed agreement. So with that basis, we took over'.[144]

In the years that followed the new line of demarcation between the jurisdiction of management vis-à-vis directors gradually crystallized in the organization of decision-making. Whenever the bank received a formal loan application or a policy-question presented itself, the staff would make an initial analysis of available facts, economic position and policies of the country concerned, alternative courses of action and in most cases engage in extensive discussions with the country concerned. Staff would then produce a specific recommendation which integrated detailed analysis of aims, terms, amount, and other relevant factors of a loan. This recommendation would then be submitted to the Board of Executive Directors, which would decide whether or not to extend the loan. Executive directors could never attend meetings of the staff loan committee, let alone be involved in negotiations. Moreover, the directors would only meet at the call of the President. Furthermore, management was responsible for hiring and firing staff, and they rejected the idea, entertained by some directors,

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144 Transcript of Interview with Robert L. Garner, July 19, 1961, The World Bank/IFC Archives Oral History Program, pp. 3–4.

that qualifications should be subordinate to geographical distribution.[145] All of these policies and procedures served to bring the management of the Bank closer in line with the political prohibition clause and remove it from direct control of member governments. Indeed, in 1949, after two years of forthright management by McCloy and Garner, the Bank was 'entering a period where some resentment was growing … among the directors, who felt that perhaps they were needless but it was not necessary to make quite so clear that they could be needless'.[146]

## 9 The Victory That Wasn't

The entry of Wall Street bankers in the bank was hailed as a victory in financial circles in Wall Street and London. They saw it as a vindication of their view that the bank should be an independent international financial organization, far above the forces of national rivalries and dollar diplomacy. The feeling was justified, from the bankers' perspective. After some struggles, the general principle of the prohibition on political interference in the Articles of Agreement had been brought in line with the manner in which the bank operated and was managed. Yet it was also a hollow victory. In fact, it was not a victory at all.

The Roosevelt administration had conceived the Bank as an organization which was truly universal in its membership and in its operations. It would include countries from across the globe, including the U.S.S.R. Indeed, the political prohibition clause was partly introduced to ensure that a communist state could be member and enjoy the benefits of the Bank. The U.S.S.R, however, or what was left of it, did not join the Bank until after the fall of the Berlin Wall. In Savannah, they had been given an extension to 31 December 1946, to ratify the Bretton Woods Agreement they had signed in 1944.[147] By late 1946, it became clear that they would not.[148] Indeed, the U.S.S.R soon became a vocal critic of the Bank. At a conference on the United Nations in Lake Success,

145 At Bretton Woods, delegates had reached a compromise on this matter in Article V, section 5 (d), which says that staff appointments are 'subject to the paramount importance of securing the highest standards of efficiency and of technical competence' but also 'pay due regard to the importance of recruiting personnel on as wide a geographical basis as possible'.

146 Transcript of Interview with Morton M. Mendels, The World Bank/IFC Archives Oral History Program, 17 July 1961, pp. 44–45.

147 'Washington Urged as bank Site. Committee Turns Down This City', *The New York Times*, 14 March 1946; Vinson, 'After the Savannah Conference', p. 625..

148 'World Bank is Ready for Lending Program', *The New York Times*, 13 October 1946.

in October 1947, the Soviets accused the Bretton Woods institutions of being 'merely branches of Wall Street' and stated that the Bank was 'subordinated to political purposes which make it the instrument of one great power'.[149]

The U.S.S.R. had always had mixed feelings about Bretton Woods. On the one hand, the country needed a tremendous amount of capital for reconstruction. Moreover, good relations with the U.S. and Britain were important for the Soviet Union's survival and lasting security. During the war, the Soviet Union needed its allies to open the second front, for which it had to wait until June 1944. After the war, Stalin needed his allies to acquiesce in his plan to achieve security for his regime and his country by cautiously building a sphere of influence in Eastern Europe and the Balkans as well as to gain territories in the Far East and Southwest 'underbelly'. On the other hand, it had difficulties with many aspects of the Bretton Woods agreements. Under the Bank's Articles of Agreement, the Soviet Union would occupy the third place in the number of votes, well below the United States. No country had a veto power. Membership required the disclosure of information which the Soviet Union regarded as state secret, such as gold production and gold and foreign exchange holdings. Borrowers would be subject to close scrutiny and investigations to obtain approval for loan applications. They would also have to account in detail for the manner in which loans were spent. Apart from these issues, most of which were equally troublesome for other proud sovereign states, for instance France,[150] the Soviets had principled objections against the Bretton Woods institutions; the IMF and the Bank were designed to promote private foreign investment and advance multilateral free trade – the capitalist system. On balance, however, the benefits of membership had long seemed sufficiently important to Moscow to collaborate, albeit unenergetically, in founding the Bretton Woods institutions.[151]

Despite their mutual interest in avoiding confrontation and keeping good relations, the Grand Alliance unravelled with breath-taking speed after the death of Roosevelt in April 1945.[152] From the Soviet perspective, it looked as if

149 'Russia attacks U.S. over World Bank; Charges in U.N. that we use it in our foreign policy – Thorp emphatic in denial', *The New York Times*, 14 October 1947.

150 Transcript of interview with Robert Garner, The World Bank/IFC Archives, 19 July 1961, at p. 9.

151 Pechatnov, 'The Soviet Union and the World, 1944–53', Melvyn P. Leffner and Odd Arne Westad (eds.), *The Cambridge History of the Cold War: Volume I: Origins* (Cambridge University Press 2013), pp. 90–111, at p. 93–94.

152 Gaddis, *The United States and the Cold War*, at pp. 95–352; Gaddis, *The Cold War; A New History*, pp. 5–32; Leffler, 'The emergence of an American grand strategy, 1944–52', Melvyn P. Leffner and Odd Arne Westad (eds.), *The Cambridge History of the Cold War: Volume I:*

the U.S. and Britain had embarked on a concerted ideological, political, economic and strategic offensive. The sudden termination of vast land-lease shipments; the withholding and ultimately the cancellation of a 6 to 10 billion USD loan to the Soviet Union for postwar reconstruction, which had originally been proposed to Moscow by the U.S. government;[153] the refusal at Potsdam to grant requests for German reparations payments as well as for internationalization of the Ruhr, for a trusteeship in the Mediterranean, and for bases in the Turkish straits; the decision in August 1945 to throw atomic bombs on Hiroshima and Nagasaki; the subsequent refusal to allow the Soviet Union a role in the postwar occupation of Japan; the refusal to officially recognize the puppet regimes installed in Bulgaria and Romania; Churchill's speech in March 1946 in Fulton, Missouri, about an iron curtain which had descended across Europe from Stettin to Trieste- it all contributed to the perception in Moscow of a strategy to undermine the security of the Soviet Union and its regime. By the summer of 1946, Stalin had concluded that the U.S. had become the Soviet Union's main adversary, pursuing hegemony. A massive reconstruction and rearmament program was planned, including an accelerated atomic program. As long as negotiations with the U.S. over Germany and other geopolitical and economic issues were ongoing, Moscow tried to avoid an all-out confrontation, especially over Eastern Europe. Partly intended to accommodate the Yalta agreement and the long-standing U.S. desire that all countries should choose their own form of government after the war, Moscow pursued the strategy of supporting 'People's democracies', governments composed of Soviet-backed communist parties and traditional parties, which would gradually chose and follow the path to socialism – in strategically important countries with strong anti-communist and anti-Soviet traditions, notably Poland and Romania, Soviet involvement was of course direct and overwhelming. In early 1947, however, as 'People's democracies' proved less popular than anticipated in most countries along its Western border, and returns of cooperation with the U.S. diminished, Moscow decided to impose the Soviet model by force; by the end of 1947, the Kremlin exercised full control over Eastern Europe and the Balkans.[154]

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*Origins* (Cambridge University Press 2013), pp. 67–89; Pechatnov, 'The Soviet Union and the world, 1944–53'.

153 For both the termination of Lend-Lease and the origins and fate of the Russian loan, see Gaddis, *The United States and the Origins of the Cold War*, pp. 174–197.

154 Norman Naimark, 'The Sovietization of Eastern Europe, 1944–1953', Melvyn P. Leffner and Odd Arne Westad (eds.), *The Cambridge History of the Cold War: Volume I: Origins* (Cambridge University Press 2013), pp. 175–97 and Svetozar Rajak, 'The Cold War in the Balkans, 1945–56', in: idem, pp. 198–220.

The U.S., for its part, was dismayed by Moscow's policy of installing and supporting provisional governments throughout Eastern Europe, especially its treatment of Poland. Not only did the U.S. consider self-determination and national sovereignty as pillars of the postwar order and Moscow's policy as violations of the Yalta agreement. It also viewed Moscow's policies in Eastern Europe, its refusal to withdraw from Iran and its attempt to acquire territorial rights in Turkey as signs of an expansionist strategy which went well beyond what the countries' security required. No less alarming was news brought by John J. McCloy, at that time the U.S. Assistant Secretary of War, after a visit to Western Europe, where economic devastation was causing widespread despair, hunger and disease. Communist parties, already popular because of their prominent role in the underground resistance during the German occupation, were gaining massive popular support, including in elections, in many West European countries, which raised the spectre of a Soviet-dominated continent. Following the advice of the famous long telegram sent by George F. Kennan from the U.S. embassy in Moscow in February 1946, Truman therefore decided on a strategy of containment of the Soviet threat, which he announced during a speech to Congress on 12 March 1947.[155]

Just a few days after the Truman doctrine was promulgated, Black, McCloy and Garner were appointed in the top of the Bank. It is unlikely that this was a coincidence. Once it had become clear that the Soviet Union did not ratify the Bretton Woods agreement and would not be able to use Bank loans to reconstruct and revive its economy, the United States government could relinquish close control over the operations of the Bank to financial experts. With the Wall Street credibility of the new top management, the Bank would be able to raise capital from private money markets and support reconstruction and development everywhere except in the Soviet Union and its satellites. When needed, the U.S. could use its votes to block assistance which might help its new enemy and support assistance which could undermine it.

The fate of early loan applications by Poland and Yugoslavia supports this interpretation of the take-over of the Bank by the Wall Street bankers. In late 1946, Poland was among the first countries to express an interest in a loan. The country wanted to modernize its coal industry, and since many Western countries badly needed the fuel, the prospect of repayment of principal and interest was bright. In the spring of 1947, Poland submitted a memorandum requesting a 128.5 million USD loan. Bank staff was satisfied that the project met the usual conditions and requirements, but negotiations were difficult and slow, especially after Poland, despite its profound interest in the scheme, failed to

155 Leffler, 'The emergence of an American grand strategy, 1945–1952'.

participate in the Marshall Plan, because Moscow did not allow it. Even so, the Bank's top management, including President McCloy and U.S. director Black, were eager to make the loan. By mid-1948, however, it became clear that the U.S. government would not allow the export of mining machinery to Poland and that it would vote against the loan if it were presented to the board for approval.[156] 'I got instructions, as the American director', Black would later recall, 'that if a loan came up to the board to vote against it. It never got to the board because I conveyed this information to the President of the Bank, Mr. McCloy, and the loan was never put up to the board'.[157] Poland subsequently withdrew its membership from the Bank in March 1950, arguing that the Bank had 'adapted its policy entirely to the needs and directions of the United States Government to the detriment of other countries'.[158] Four years later, in 1954, Czechoslovakia, which had a similar experience with a much smaller loan application, also ceased to be a member. The Bank no longer counted countries from the Soviet Bloc among its members.

Yugoslavia received a rather different treatment. Regarded as Moscow's most trusted ally in the immediate aftermath of the war, Tito embarked on an independent foreign policy and his 'own road to socialism' in early 1948. He was expelled from the Cominform, the organization which Moscow had established in 1947 to monitor compliance with its directives. The split was welcomed by the U.S. Not only did it undermine cohesion in the Soviet bloc, it was also a valuable asset in the global propaganda war against the Soviet Union. From 1949 to 1955, Yugoslavia would receive 1.5 billion USD in economic and military aid from the West, without which the country would not have been able to withstand Stalin.[159] Tito was a 'son-of-a-bitch', but at least he is 'our son-of-a-bitch', as Secretary of State Dean Acheton put it.[160] Yugoslavia also made successful loan applications with the World Bank. On 29 July 1949, the Bank announced its first mission to study the country's economy; just two months later, in October, two multimillion loans were approved – when needed the Bank's assessments of the soundness of loan applications could be extremely fast indeed.[161]

156 Asher and Mason, *The World Bank Since Bretton Woods*, at pp. 170–171.

157 The World Bank/IFC Archives, Oral History Program, Transcript of interview with Eugene R. Black, August 6, 1961, p. 27

158 *World Bank Group Historical Chronology*, p. 31–32.

159 Naimark, 'The Sovietization of Eastern Europe, 1944–1953', pp. 178, 191–2; Rajak, 'The Cold War in the Balkans, 1945–56', pp. 200–203, 208–215.

160 John Lewis Gaddis, *The Cold War; A New History*, p. 33.

161 *World Bank Group Chronological History*, pp. 28–29.

It is again worth quoting Black, who by that time had become the Bank's president:

> Q: How did the people in the US investment community feel about the Polish loan?
> Mr. Black: It never got that far. One of the loans we made that I was worried about the reaction of the New York market was the Yugoslav loan. Yugoslavia is the only case we've ever made a loan to a Communist country, and I had to do some spadework in getting acceptance of that loan . . .
> Q: Why do you suppose the U.S. government didn't react against the Yugoslav loan as they had with the Polish loan?
> Mr. Black: Because the Yugoslavs had broken with the Russians.[162]

In this light, the fight between Wall Street and the U.S. government over control of the Bank does not seem to have ended with a victory of Wall Street after all. It rather seems as if the U.S. government concluded somewhere in late 1946 or early 1947 that there was no more point in fighting. The U.S. government did not need close control over the Bank to ensure that the Bank would serve American interests. The Bank would support reconstruction and development in countries which adhered to capitalism and free trade and thereby serve as an instrument of the U.S. containment strategy.

Why did Bank staff not object? After all, their internationalism, technical competence and independence from politics had become an essential part of their self-awareness and self-esteem since the Wall Street triumvirate took over management of the Bank. One explanation may be that the U.S. flexed its muscles only occasionally and invisibly to the public eye – as in the case of the Polish loan. Another explanation is that many Bank staff were equally unsupportive of communism. Indeed, Garner, when he looked back at his time as the Bank's vice-president, suggested that the World Bank was established to advance the cause of capitalism and free enterprise. Although the Bank could support some state-owned enterprises, for example electricity or telephone companies, it was the 'conviction' of Bank staff that the private sector must take responsibility for most economic activities. 'At an early date', he recalled, Bank management

> took a decision that it would not finance government-owned industries which it felt should be in the field of private enterprise . . . I guess it was

162 The World Bank/IFC Archives, Oral History Program, Transcript of interview with Eugene R. Black, August 6, 1961, p. 29

> just the conviction ... one, that we believed in private enterprise in those fields in which it could operate, and two, we felt that governments had so many things to do that were purely in their sphere that they shouldn't divert resources to other things, and third, that most governments are incapable of running industrial enterprises effectively .... The view of management too was that if any of these countries are really going to develop, they could own transport, they could own power, they could have other infrastructural projects, but the only way they were going to really increase the production of goods and have people have more and get more jobs and raise then standard of living and build up the country was through the development of private enterprise industry, and agriculture.[163]

It does not seem as if it was a cause of great professional frustration that the Bank could not do business with communist countries.

## 10 Conclusions

The original meaning of the Bank's nonpolitical mandate was uncomplicated. The Bank was established to assist with reconstruction and development – in that order. Postwar planners expected that private investors would be extremely reluctant to invest in other countries, given the traumatic experiences of massive defaults of the 1930s. They established the Bank to act as guarantor of foreign direct investments and thereby encourage a massive flow of capital to war-torn and undeveloped countries after the war. The prohibition on political interference meant that the Bank would decide on whether to act as guarantor on the basis of sound economic criteria, particularly the prospect that the loan would be serviced and that the project for which the loan was sought would contribute to the productivity of the country concerned. The Bank would not be influenced by the form of government or the regime or the ideology of the country concerned.

Originally, the rationale for this nonpolitical mandate was threefold: to help keep the grand alliance during the war together, to ensure peace and prosperity after the war, and to serve international private investment. The U.S.S.R. was the dominant concern behind the first two rationales and it also played some role in the third. Not much of this rationale survived the war. Contrary to

163 Transcript of Interview with Robert L. Garner, July 19, 1961, The World Bank/IFC Archives Oral History Program, pp. 44–45.

the expectations of the postwar planners, private investors were not interested in the Bank as a guarantor of loans. If the Bank was to play a role in reconstruction and development, it had to lend directly, which meant that it had to borrow at U.S. capital markets. This, in turn, meant that it had to be credible in the eyes of Wall Street, and Wall Street did not trust an organization where political considerations played a role in decision-making. The trust of capital markets became a new rationale of the political prohibition clause, and it would remain that to this day. The Bank's self-image as a dedicated, internationalist, professional and technocratic international financial institution, which operates far above the rivalries of national politics, also emerged in those days.

But the nonpolitical character of the Bank was a myth. After the war had ended, the ideal of postwar collaboration between the two major political powers collapsed as the Cold War became an undisputable fact. Initially, the U.S. government responded by trying to obtain close political control over the Bank, against the letter and the spirit of Article 4 (10). However, once it became clear that the U.S.S.R. would not join the Bank, the U.S. government was prepared to relinquish control over the Bank to Wall Street bankers, at least most of the time. No longer did the U.S. have to fear that the Bank would support its new enemy. When the Bank considered supporting Soviet satellites, which it occasionally did, the U.S. director intervened and blocked assistance. So the Bank was nonpolitical, but only when the capitalist West and its friends were concerned. By the end of the 1940s, the Bank would shift its attention from reconstruction to development. It was soon confronted with the question whether the nonpolitical mandate meant that it should turn a blind eye to regimes which seriously repress its citizens or pose threats to neighbouring countries. How the Bank dealt with that issue, however, is another story.