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The World Bank's Early Reflections on Development:

A Development Institution or a Bank?

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Abstract

Until the late 1960s, the World Bank presented itself as an institution devoted to making sound and directly productive project loans. Yet, during its very early years, some discussions developed inside the Bank regarding the possibility of issuing different types of loans, namely (i) loans aimed at tackling social issues ("social loans"), and (ii) loans aimed at providing foreign currency to address disequilibria in the balance of payments ("impact loans"). This paper brings together historical analysis and theories of organization development to study the housing issue as a case in point. The analysis reveals that the Bank was unwilling to lend for housing programs not because these were not sound—in fact, they were—but because they were geared toward achieving social welfare objectives and were not directly linked to productive investment projects, such as dams, power stations, and railroads. This early decision had a significant impact on the subsequent development of the Bank's view of policy-making: it locked the institution into a particular lending pattern, and deprived it of important intellectual resources. It was not until the late 1960s that the Bank began to take social issues into consideration, rather late compared with other multilateral institutions.

This paper—a product of the World Bank Archives and the Development Economics Vice Presidency—is part of a larger effort to use the Bank's Archives to investigate the links between development economics and operational policy. Policy Research Working Papers are also posted on the Web at http://econ.worldbank.org. The author may be contacted at Michele.Alacevich@unimi.it

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A Development Institution or a Bank?

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1. Introduction

The International Bank for Reconstruction and Development (IBRD) – since its beginnings known as the World Bank – was instituted at the 1944 Bretton Woods Conference with the principal purpose of aiding European reconstruction after World War II. The onset of the Cold War and the concomitant direct intervention by the U.S. in European reconstruction with the Marshall Plan, made the World Bank loans to European countries redundant – in fact useless – principally because of the much greater magnitude of the U.S. commitment: while the Bank's loans in 1947 totaled less than half a million dollars, the Marshall Plan brought to Europe around four billion dollars per year (Kapur, Lewis and Webb, 1997).

The World Bank thus switched – much earlier than expected – to its second mission: promoting the development of poorer member countries. At a November 1947 meeting of the Bank's Executive Directors, the Bank's President John McCloy predicted that "we are going to be driven into a very different field sooner than I thought, into the development field" (quoted in Kapur, Lewis and Webb, 1997, p. 83). The problem was that there were no experts on development issues in the U.S. or in Europe at that time, let alone in the less developed countries. The lack of interest in such matters on the part of academia, and the virtual non-existence of most underdeveloped countries in the late 1940s – they were still dominions or colonies and had been studied only in respect to the developed economies (Meier and Seers, 1984) – meant that development issues were unknown terrain.

Throughout 1948 and part of 1949 the Bank almost entirely ceased issuing loans, and its personnel and officials undertook an intense program of study and missions to underdeveloped member countries in order to collect data and information.

Recollections of those years, including accounts by Bank officials who took part in those events (Knapp, 1975; Sommers, 1989), give rather cursory treatment to this transitional period, concentrating on the outcome of the transition itself. The Bank became an institution devoted to financing projects with infrastructural and productive purposes (e.g. power stations, dams, roads, and agricultural machinery). Yet the transitional period is worth analyzing as a crucial moment for the shaping and evolution of the Bank's policies. Within the organization, different views about the role of the Bank as a development actor emerged. These views belonged to different individuals or groups; each of them had a different vision for the future of the Bank, or gave prominence to different aspects (e.g. project lending vs. financial creditworthiness, vs. economic research). Leonard Rist, at that time the head of the Economic Department, pointed out many years later that the Bank's policy "was not *formulated*. It was formed. It evolved. It resulted from events. And it changed with different loans. […] Policy formulations have been extremely rare" (Rist, 1961, p. 47). It is thus interesting to examine the internal debate whereby these policies were formed, and to determine whether there were alternative policies which in fact lost out in the confrontation. As will become evident, alternative policies were explicitly discussed at the Bank, but they were set aside for a variety of reasons.

Identifying the terms of the debate and understanding the reasons why certain views won over others can offer meaningful insights on the processes that shaped the political economy of the World Bank. Specifically, this is interesting because the vision that eventually emerged from the transition conditioned the subsequent

practices of the Bank, and gave it the traits of a conservative financial institution. From then, the Bank experienced long and sustained growth until the end of the 1960s, which marked a decisive change of direction as a consequence of Robert S. McNamara's appointment. To use Robert Asher's metaphor (Asher, 1973), the leopard had changed its spots: no longer a simple bank, it had evolved into a development institution.

Analyzing such a complex issue in its entirety would be beyond the scope of this paper. The paper focuses on the Bank's activities related to housing because the issue was of primary importance in the internal debates between the 1940s and the 1950s, and it became again a priority in McNamara's agenda. I analyze such activities through the lens of historical analysis and organization theory. It should be noted that archival holdings cover other topics in a very uneven way; for example, there are only a few useful documents on education, water and sanitation for those years.

The paper is organized as follows. The next section discusses the Bank's first encounter with housing and urban development issues. Section 3 reviews the Bank's internal debates on these issues and their eventual practical outcomes. Section 4 considers the usefulness of focusing on the early years of an institution's life for understanding its subsequent path of development. Section 5 offers some concluding remarks.

2. The ILO and the Housing Issue at the World Bank

The idea that the World Bank would offer loans for urban development and housing had arisen within the Bank itself – more precisely, as will be shown below, within its early missions to less developed member countries. But as a matter of fact, the institution which first sponsored the issue was not the World Bank, but the International Labour Organization.

ILO's Building, Civil Engineering and Public Works Committee had met for its Second Session in Rome from 16 to 25 March 1949. On that occasion, the Italian employers' delegate, with the support of the delegates of the French and the Italian governments, suggested that the ILO investigate the possibility of establishing a completely new institution – the International Institute for Building Loans – under the control of the two Bretton Woods institutions, the IBRD and the IMF. According to a subcommittee's minutes, "the function of the proposed institute would be to collect private savings by the issue of bonds in countries where such savings exist, with a view to making mortgage loans for housing construction, especially for the lower-income groups" (ILO, 1949a, p. 9). The main purpose of this proposal was to sustain and stabilize employment, firstly by stimulating an important labor-using activity, and secondly by promoting a better distribution of labor among countries. As regards this latter point, it was stressed that the project would favor migration from countries with surpluses of population to those with deficits (ibid., p. 10). [1]

[1] Government delegates from Eastern European countries opposed the proposal, thus provoking a split among trade unions delegates: those representing Communist trade unions opposed the

The Resolution was adopted on 25 March, and the ILO Governing Body was invited to contact the IBRD (ILO, 1949c). This it did one month after Eugene Black took over the presidency of the IBRD.[2] The matter was thus immediately passed to the Bank's Economic Department for preliminary examination. The Economic Department, under the direction of Leonard Rist, discussed two separate matters: first, whether housing could be considered a sufficiently "productive" project, as required by Article I(i) of the Bank's Articles of Agreement; and, second, whether there was any rationale for the Bank to contribute with loans in U.S. currency to projects whose outlays would principally be in local currency.[3]

As for the first issue, the answer was quite clear: the Bank's "productivity" requirement would certainly not be met in every country, "but no doubt, there were areas where the housing shortage seriously hampered the development of new resources and industries, so that financing of new houses would in those areas be directly productive even within a narrow understanding of that term."

As for the second point, the analysis was more complicated, not least because it was impossible to understand, at that very preliminary stage, what possibilities were being considered by the ILO. The Bank focused on three.

The possibility considered most likely by the Economic Department was that a new Institute for Building Loans would sell bonds in the private markets of capital-exporting countries, under guarantees by the IBRD. In this case, the problem would arise that the proceeds were mostly in U.S. currency, while the housing projects would mostly require local currency. The Economic Department assumed that this extra U.S. currency would be added to the general foreign currency resources of the borrowing country as a supplement "necessary to absorb the inflationary pressure created by increased construction activity."

A second possibility was that the Bank would guarantee not the bonds themselves, but the monetary policy of the government hosting the building investment. The Bank would intervene to persuade potential *local* investors to buy the proposed Institute's bonds in the local market, offering a guarantee by the IBRD against losses due to devaluations of the local currency. The underlying idea was that the Bank's direct involvement—that is, its authority and control—would "keep the local government in line."

A less likely third possibility was that the Bank would participate merely by lending its prestige and experience, without any formal guarantees on the Institute's bonds.

Although these three scenarios—and principally the first of them—were at odds with the Bank's previous loan policy (which had principally consisted of directly providing foreign currency for reconstruction programs), the Articles of Agreement envisaged the possibility that, "if the project gives rise indirectly to an increased need for foreign exchange by the member in whose territory the project is located," the

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proposal or abstained, while those representing Catholic or otherwise "Atlantic seaboard" trade unions—as the Belgian Workers' delegate put it (ILO, 1949a, p. 6)—were in favor (ILO, 1949b).

[2] David A. Morse to Eugene R. Black, 12 August 1949, Housing and Urban Development, Vol. 1, Central Files, Fonds 2, World Bank Group Archives (henceforth *Housing 1*).

[3] These remarks, and those of the next several paragraphs, draw on an internal Economic Department memorandum: Svend Andersen, Economic Department, General Studies, "An International Institute for Building Loans," 26 August 1949, *Housing 1*.

Bank might provide that additional foreign currency (Article IV, Section 3 (c)). In such cases, unlike its usual project loans, the Bank was allowed to disburse loans that would help countries in trouble with their own balance of payments due to the financing of a local project in local currency. The Economic Department therefore advised that the matter should be investigated further, asking the ILO to specify the nature of the involvement required from the Bank.[4]

3. The World Bank's Internal Deliberations on the Housing Issue

3.1. The Bank's Disengagement

Contacts between the ILO and the Bank continued for a while, but the Institute for Building Loans never came into being. This was partly due to conflicts within the ILO itself, principally among country representatives on the one side, and the internal technical staff on the other.[5] The ILO staff, in fact, was highly skeptical that such a huge new institution was feasible, or that it could find resources to finance housing projects, or that the Bank could sponsor it on the basis of the ILO Committee's resolution. The country representatives, by contrast, expressed the need of many governments to cope with reconstruction or social problems, or both, and saw a new institution headed by the IBRD as a means to channel resources into the housing sector. The "housing shortage" was a widely discussed problem, and many proposals for programs or institutions to finance housing were put forward at least until the mid-1950s.[6]

The World Bank, for its part, managed to avoid any commitment to housing projects.[7] As the Bank's president Eugene Black explained to his ILO counterpart, David Morse, it was a strict rule of the Bank that loans in foreign currency should be used only to finance the cost of imported goods and services, and they could not be diverted to the financing of local expenditures.[8] Moreover, a more general rule was that the Bank's loans should be for directly productive purposes. As Richard Demuth, then head of the Technical Assistance and Liaison Staff Office, put it: "the first test of any project to be financed by the Bank is its productivity," and housing's relation to productivity seemed too remote.[9] The Bank's Vice President Robert

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[4] Svend Andersen to Leonard B. Rist, "ILO – Proposal for an International Institute for Building Loans," 25 August 1949, *Housing 1*.
[5] Walter Hill to Robert L. Garner, Report H 105, "Conversation with ILO Staff in Geneva Relating to the Suggested Creation, under the Control of IBRD, of an International Institute for Building Loans," Paris, 17 October 17 1949, *Housing 1*.
[6] For example an International Loan Bank for Building, by the International Federation of Building Trade Employers and Civil Engineering Contractors in October 1951; a European Credit Institute for Housing, by the Council of Europe's Consultative Assembly in December 1951; a report by the United Nations Economic Commission for Europe on methods and techniques of financing housing in various European countries, which aroused interest in the other two UN regional Economic Commissions, namely ECLA and ECAFE; see Ernest Weissmann to Davidson Sommers, 9 January 1952, *Housing 1*.
[7] See, for example, Walter Hill to Leonard B. Rist, January 17, 1951, *Housing 1*.
[8] Eugene R. Black to David A. Morse, December 13, 1949, *Housing 1*.
[9] Richard H. Demuth, "Financing of Housing," May 22, 1952, *Housing 1*.

Garner, a few months later, emphasized the same concept: "The Bank should concentrate its efforts on projects which will yield the greatest and quickest increase in output and productivity. As a rule, projects for municipal improvement do not meet this test."[10] Projects that most contributed to increased output and productivity were thus deemed – as many Bank documents reported – bankable or sound, and no further elaboration was made on the criteria at the basis of the distinction between sound and unsound projects. In the words of Mason and Asher: "the early literature of the Bank is full of references to 'sound' economic policies, 'sound' fiscal and monetary policies, and 'sound' policies of various other kinds, with the clear implication that the distinction between sound and unsound policies is as obvious as the distinction between day and night. The distinction is not always perfectly clear, however, and, in such cases, those to whom it *is* crystal clear seem irritatingly doctrinaire" (Mason and Asher, 1973, p. 186, italics in the original).

This blurred distinction between sound and unsound, and the perception that it was doctrinaire, was also due to the blurred view of economists observing the Bank's policies and directions. For example, Paul Rosenstein-Rodan criticized the Bank because – in his opinion – it did not sufficiently emphasize the importance of the so-called Social Overhead Capital, which would have made indivisibilities affordable, and would have permitted externalities, balanced growth, and a planning approach; on the opposite side of the spectrum, Albert Hirschman criticized the Bank because it concentrated its investments in fields (transportation and power) which Hirschman considered the core of Social Overhead Capital.[11]

The Bank was somewhat detached from these debates: it privileged loans for single and well-defined specific projects – even though its publications used to pay tribute to the rhetoric of plan – regardless of whether they would fit in the category of Social Overhead Capital. What mattered for the Bank was that its loans should yield a fast and high increase in output and productivity to repay the debt. The implicit assumption of the Bank's top management was that a causal link existed between economic growth and modernization of a country. In fact, by lending for projects that met the so-called productivity test,

> we believe we can most effectively assist our member countries to develop new sources of wealth and income which would enable them to provide out of their own resources better municipal services, better housing, better health and education – in fact, all of the fruits of greater economic productivity.[12]

Hence, the Bank granted no loans to finance activities in the fields of housing, town planning and building materials.[13] Only two loans concerned, among other

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[10] Robert L. Garner to Emilio Toro, April 21, 1953, in Lauchlin Bernard Currie Papers, Rare Book, Manuscripts, and Special Collections Library, Duke University, Durham, NC (henceforth *LBCP*).

[11] For Rosenstein-Rodan's and Hirschman's elaboration on the related concepts of "Social Overhead Capital" and "directly productive investments" or "Directly Productive Activities" see Rosenstein-Rodan, 1950, 1961a, 1984, and Hirschman, 1958. For their criticism of the Bank lending preferences, see Rosenstein-Rodan, 1961b and Hirschman, 1958, p. 83.

[12] Robert L. Garner to Emilio Toro, April 21, 1953, *LBCP*.

[13] Housing was eventually considered in 1960 when the Bank established its so-called "soft window", that is the International Development Association, which would make loans for "low-yielding and

things, building activities. In the case of a reconstruction loan made to the Netherlands in 1947, some resources were used to finance the importing of materials used for housing. In the Netherlands, in fact, replacement of workmen's houses destroyed during the war "was a step necessary for the rehabilitation of Dutch industries essential to the national economy."[14] In the case of a loan made in 1952 to improve Iceland's agricultural production, some resources were used for the construction of farm buildings (IBRD, 1952a). However, since Iceland had to import almost all its building materials, this loan was considered consistent with the rule that only the foreign exchange requirements of a project could be financed. With the exception of these two loans, building activities were in practice ruled out of consideration by the Bank, except residually, as for example in the case of the settling of a construction camp at the site of a dam project.

3.2. Internal Discussions at the Bank: Impact Loans and Social Loans

Nevertheless, discussion on the issue had not ceased at the Bank. In fact, it concentrated on two different proposals: for so-called impact loans and for social loans.

The first internal discussion focused on what the Economic Department had already argued regarding the ILO proposal: that even in the case of mainly local currency needs, a hard currency loan (i.e. in dollars) could prove useful in tackling balance of payments pressures deriving from local expenditures. This was what came to be called an impact loan, that is, a loan made not to sustain a specific project, but to counteract the subsequent inflationary impact of this project on the entire country's economy.

This effect had been fully acknowledged by the Bank's Fifth Annual Report. This document discussed at length the possibility that local expenditure on labor or on domestically produced equipment could give rise to increased demand for imported consumer goods or raw materials, or, in the Report's terms, to "foreign exchange requirements indirectly resulting from expenditures in local currency" (IBRD, 1950, p. 10). In this case, a loan from the Bank would be perfectly legitimate if was intended to tide a country over a period of expansion without inflation.

This analysis was based on ideas arising from the work of Paul Rosenstein-Rodan, then a member of the Bank's Economic Department, on the loan application submitted by the Italian government to the Bank at the end of 1948 for the development of Southern Italy. The Italian government, in fact, had the means to undertake an investment program whose capital equipment would be provided from domestic sources, but it lacked large reserves of foreign currency. In that situation, Rosenstein-Rodan predicted, the increased income resulting from the investment program would generate increased demand that would either create additional demand for imports or a reduced supply of exports. In both cases, the country would be subject to inflationary pressure and would need a greater amount of foreign currency. Making this additional foreign currency available should be the

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slow-yielding projects in such fields as health, education, and housing" (Mason and Asher, 1973, p. 381).

[14] A. S. G. Hoar to Jacob L. Crane, April 21, 1952, *Housing 1*.

Bank's task. The loans would thus "finance the *impact* of an investment program which the Italian government undertakes" (Rosenstein-Rodan, 1961b, p. 14). The loan to Italy proved successful, but it was not repeated: "it was contrary to many people's thinking, notably to […] the most conservative business thinking in the Bank" (ibid., p. 13).

The second discussion, complementary to the first, developed from the experience of the first comprehensive survey missions undertaken in less developed member countries. These missions recognized from first-hand observation of the social and economic conditions of the countries visited that not only directly *productive*, but even directly *social*, interventions were indispensable for a sustained process of development. This process would change sectoral growth rates, the structures of demand and supply, and the growth rates of urban and rural populations, thus placing the social structure of countries already facing profound social hardship under great strain.

The Cuba mission of 1950, for example, recommended that urgent action be taken to greatly increase the supply of drinking water to the city of Santiago, which was at risk of humanitarian disaster (IBRD, 1951). The Jamaica mission urged the replacement of almost 30 percent of the houses on the island (IBRD, 1952b), while the Nicaragua mission opened its final report by declaring that "expenditures to improve sanitation, education and public health should, without question, be given first priority [for] the development of the Nicaraguan economy" (IBRD, 1953, p. 22).

Particularly relevant to the present discussion is the rehabilitation program for the slums of the city of Barranquilla, Colombia, proposed to IBRD in 1952 by Lauchlin B. Currie, who had headed the Bank's 1949 comprehensive survey mission to that country, and in 1952 was an economic advisor to the Colombian government. The bulk of the program consisted of a housing program with two purposes: to upgrade living conditions in the Barranquilla area called the Zona Negra, "probably the worst slum in Colombia,"[15] and to stimulate economic growth through an investment program in a sector—building—which could expand largely without depressive effects.[16]

Lauchlin Currie would propose his Leading Sector model only in the 1970s—significantly, the model identifies building as one such leading sector—yet the mechanism, if not the label, was already operative in the Barranquilla housing program. His 1974 reflections on the building sector are therefore pertinent to the discussion:

> The import component is low. The unskilled labor component is relatively high. The need it serves is so compelling that in the United States and Canada, despite the high level of incomes, 'home operations' still capture about 30% of disposable income. The stock of houses is so large that a relatively small addition should have little effect on prices […]. It is true that the stock is not so great in a developing country but this is more than offset by the high growth rate of urban population and the desirability of replacing extensive slum areas. (Currie, 1974, p. 7)

[15] Emilio Toro to Robert L. Garner, April 7, 1953, *LBCP*.

[16] For more thorough discussion of the Barranquilla case, see Alacevich (2005).

Currie was not satisfied by explanations of poverty and the vicious circle of poverty in less developed countries couched in terms of a general scarcity of capital, or by solutions that relied on a general process of growth to move the entire economy upward. Rather, he proposed removing obstacles to sectors whose demand was potentially large but latent and which could achieve sustained growth "independently of the overall rate of growth of the economy" (ibid., p. 6). These two conditions identified a sector that could transmit its own independent upward movement to other sectors, thus leading the economy through a process of sustained growth.

Moreover, this process could be triggered and driven by addressing social items on the development agenda, for example dwelling renewal. In his advice on Colombia, Lauchlin Currie was reviving his pre-war endeavor to reconcile "the humanitarian and social aims of the New Deal [with] sound economics."[17]

3.3. The Bank's Rejection of Impact Loans and Social Loans

However, neither the concept of impact loans nor the possibility of matching social aims with sound economics changed the Bank's position. The social prescriptions advanced by the missions to Cuba, Jamaica, and Nicaragua were ignored by the Bank, and it did not participate in the Barranquilla program.

This was for three main reasons. The first was that it was necessary to convince U.S. investors that the Bank was creditworthy, and that its bonds—its main source of funds—were sound (Oliver, 1995). This was an exogenous and compelling reason that goes some way toward explaining the propensity to manage the institution cautiously. Yet, it is not sufficient to explain why possibly sound investments were avoided (housing, for example), and in general why no consideration was made of solutions that, within the frame of a general soundness principle, could tackle both economic *and* social issues.

Therefore, one must also consider a second reason, namely that the top management of the Bank—the Presidents and their closest staff— came from Wall Street (Kraske, 1996), and it was in the culture and in the interests of their social milieu to conceive the Bank as strictly a bank: that is, a sound, conservative institution whose investments should "yield the greatest and quickest increase in output and productivity."[18] John McCloy, the second President of the World Bank, was a New York lawyer well acquainted with Wall Street conservative circles. According to Kraske, McCloy was determined to transform the Bank into a "financially sound lending institution […] The criteria that were to determine the conduct of its business were to be acceptable to Wall Street" (Kraske, 1996, p. 53). Several contemporaries of McCloy were of the same mind: in discussing Bank loans

[17] Lauchlin B. Currie to Franklin D. Roosevelt, "Memorandum on Full Employment," 18 March 1940, quoted in Barber (1996, p. 130). This is the principal reason why Currie was been considered a pioneer by many economists who, in the 1960s and '70s, advocated a shift from the idea of development as maximization of economic growth to a broader definition that encompassed social issues, such as basic needs or redistribution policies. In "The Objectives of Development," written at the invitation of Paul Streeten, Currie (1978) provides an overview of his pioneering ideas.

[18] Robert L. Garner to Emilio Toro, April 21, 1953, *LBCP*. The broader scenario for this point, which merits much closer attention than is possible here, is the resumption of direct political responsibilities (because of the needs of the war economy) by the US business community, which had been relegated to peripheral positions during the years of the New Deal (Maier, 1977).

to Chile, the U.S. Ambassador in Chile wrote to President Truman that "our enemies are […] charging that the International Bank is under the domination of Wall Street and that we are back to Dollar Diplomacy with the Good Neighbor Policy scrapped."[19] Robert Garner was recommended for the position of Bank's Vice President by Harold Stanley, one of the two associates of Morgan Stanley (Garner, 1972, p. 206), and Eugene Black, who ruled the Bank until the early 1960s, had been a Vice President at Chase National Bank. Black wanted either Douglas Dillon or David Rockefeller, both exponents of the élite of the American financial establishment, as his successors. This did not happen, but George Woods, who took his place in 1963, had until then been chairman of First Boston Corporation.

The third reason was that the first development loans proved very successful in that they were almost completely repaid. Although Bank disbursements to member countries increased from 250 million in 1947 to 708.8 in 1963, at the end of Black's presidency, net transfers (i.e. disbursements minus repayment of capital and interest) followed an opposite trend, and at the end of the 1960s they were even negative.[20] When Woods became the Bank's fourth President, the Bank's profits were growing "at an almost indecent rate" (Mason and Asher, 1973, p. 407). Hence there was no reason, from the point of view of conservative bankers at least, to change policy.

4. Persistence and Change in the History of an Institution

4.1. The Establishment and Consequences of Strategic Visions in Formative Periods

This brief historical reconstruction has shown that the World Bank was involved with the housing problem from very early on in its history. It was involved in analysis of the issue conducted externally by the ILO Committee, and internally both by the Economic Department, which devised a loan pattern that would include housing loans, and by the missions to less developed countries, which proposed that traditionally bankable loans should be linked with social loans.

However, the Bank did not take up those proposals, and decided to grant loans only for directly productive purposes. Since this policy yielded high returns, it seems coherent to propose a functionalist explanation for what happened: there was a well-defined situation with certain constraints (funding, for example), and the institution developed a perfectly efficient solution for it.

The paper has provided evidence that this kind of explanation misrepresents the historical record. In actual fact, there were more than one option, and none of them was intrinsically in conflict with the others. For reasons that were not exclusively economic, the institution opted for one particular solution to the exclusion of the others, thus establishing a pattern that would be pursued long afterward.

The sociology of organizations has a well-established tradition of studies that analyze the mechanisms underlying the dynamics described above. Among these mechanisms, the most relevant here are the relations among different subjects and

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[19] Quoted in Kraske (1996, p. 60).

[20] Data are from Table 7-1. *World Bank Loans and IDA Credits by Fiscal Years through June 30, 1971*, in Mason and Asher 1973, p. 192, and Table 7-8. *Flow of World Bank Funds, by Type of Flow and Country Group, Fiscal Years 1947-70*, in Mason and Asher (1973, p. 219).

groups within institutions, the definition and reproduction of the character and mission of institutions, the shaping of specific configurations through these interrelations, and their consequences on the future development of an institution.[21]

In his classic study of the Tennessee Valley Authority (TVA), for example, Philip Selznick showed how the TVA leadership was unable to preserve the idea of democratic planning that inspired the TVA's foundation, and how the leadership's legitimacy was called into question by an internal group that progressively acquired control over the organization and eventually managed to impose its own ideology and its commitments to a distinct political constituency (Selznick, [1949] 1966). Beyond the specific case under examination, Selznick underlined the importance of internal interactions and behavior of groups and individuals to understand how an institution changes over time. Tensions arise between the management, which defines a strategic vision and tries to impose it, and "the individuals within the system [who] tend to resist being treated as means. They interact as wholes, bringing to bear their own special problems and purposes" (Selznick, [1949] 1966, p. 251).

Likewise, Herbert Simon stressed the need for the leadership to define and enforce a clear mission that functions as a catalyst for the whole organization. Simon's elaborations well complement Selznick's. Analyzing the establishment of the Economic Cooperation Administration (ECA),[22] Simon noted how the most urgent problem for the ECA top management was to create a homogeneous environment that would enable the organization to function and would make the decision-making process sufficiently smooth. Simon described "a power struggle in which ideas – in particular the conception of the program – played a major role" (Simon, [1953] 1976, p. 323). This struggle ended only when the top management eventually shaped the organization's basic principles and had them accepted internally. It was, in Simon's words, a "representation-seeking process;" only when "a consensus [was] reached on a suitable representation, did the organization of the Economic Cooperation Administration take definite form" (Simon, [1947] 1976, p. xxxix). Only those units and individuals who adhered to these principles and this representation flourished; opponents were marginalized and even ousted.

These considerations are in line with Mark Granovetter's thesis that organizations acquire a particular shape for reasons that have to do with social dynamics—Granovetter stresses networks—and that their further evolution depends on that particular shape (Granovetter, 1990). It is for this reason that the formative periods of institutions, and by extension the turning points in their history, are so important: from uncertain conditions, a shape progressively acquires solidity and becomes less subject to mutations. This shape influences the subsequent institutional development and determines a sort of institutional path dependence—in the words of Paul David (1994, p. 208), the "persisting consequences of some aleatory and transient conditions that prevailed early in the history of the process." In his study of ECA, Simon assigned a central role to individual ideas: "in its formative stages the organization consisted largely of a series of pictures in the minds of different people. These several pictures were far from congruent with each other, and the

[21] The terms "organization" and "institution" are contiguous in meaning, but the latter implies "that we are going to pay some attention to [an organization's] history and to the way it has been influenced by the social environment" (Selznick, [1957] 1984, p. 6).

[22] ECA was the US Federal agency in charge of administering the Marshall Plan.

process of organizing consisted in considerable measure in arriving at a single picture that was held more or less in common" (Simon, [1953] 1976, p. 315). From that point on, the institution entered a phase of growth and stability.

This historical reconstruction of the housing issue at the Bank proves many mechanisms highlighted by the literature on organizations. The housing issue triggered a remarkable amount of reflections within the Bank, which eventually focused on the rationale for Bank loans, and on the concepts of impact and social loans. The Economic Department had a very open approach to different scenarios for lending. More specifically, within the Economic Department Paul Rosenstein-Rodan emphasized the need to strengthen long-term overall plans; he also encouraged impact loans to counteract disequilibria in the balance of payments. At the same time, the Bank's overseas missions emphasized the need to enlarge the scope of Bank lending to include housing and other social issues. However, the Bank's top management moved along different lines, emphasizing soundness and a focus on projects, and rejecting – or at least not endorsing – different approaches.

In this phase, the Bank consisted of different pictures in the minds of different people. As the various approaches, or pictures, took shape, the top management made sure they would not inform the overall conduct of the Bank, and dissenting opinions were silenced. Lauchlin Currie left to advise the Colombian government in the early 1950s. In 1953 Paul Rosenstein-Rodan went to MIT, "to the academic world, where," in the words of the Bank's vice-president Robert Garner (1961, p. 98), "[…] his talents lie." Even more significantly, the Economic Department headed by Leonard Rist was disbanded in 1952 (Oliver, 1975). In the senior management's opinion, "the Bank was not the place for the development of broad economic policies or studies" (Garner, 1961, p. 98). Most importantly, the 1952 reorganization excluded the Economics Department from the decision-making process on loans. Before the 1952 reorganization, the Economic Department had had a veto power over the decision of granting a loan to a country; after the reorganization, it maintained only consultative functions, and became a service to other operational departments.[23] Using Simon's metaphor, it could be said that the Bank's top managers had in their mind the picture of a bank, not of a development agency; they worked accordingly – and successfully – to preserve that picture.

The early exclusion of impact loans and social loans from the range of the Bank's possible interventions, and strict adherence to the features typical of a bank with no concession made to more flexible patterns of lending, affected the institution's subsequent development and characteristics, eventually preventing it from taking further steps in comprehension of the mechanisms and of the many facets of the modernization process in developing countries. When, during the 1960s, the entire community of development scholars and practitioners began to criticize the development creed hitherto followed, the World Bank was lagging behind. While, at the beginning of the 1970s, David Morse—still head of ILO—spoke of "dethronement of the GNP" (1971, p. 7), referring to what was by then the widespread belief that reliance on economic growth alone was not sufficient to achieve real and effective development, and on various occasions had even led to

[23] For a historical analysis of the 1952 reorganization, see Alacevich, 2009 forthcoming; for a functionalist analysis, à la Chandler, see Galambos and Milobsky, 1995.

unexpected negative results (see for example Singer, 1965; Seers, 1969; ul Haq, 1971), a World Bank official had to admit that "we [at the Bank] know more about the cost effectiveness of alternate production techniques of motor boats than we do of teaching reading or delivering prenatal care" (Simmons, 1974, p. 50). Somewhat paradoxically, the World Bank was paying for having found an internal equilibrium that was no longer under discussion.

4.2. Path Dependence and Change

So far I have described a pattern whose main engine is institutional path dependence. When the formative phase has ended and an institution has acquired a shared picture of its own mission, subsequent developments are consistent with the prevailing vision, and they reinforce it. It is now worth considering institutional change. Path dependence of course does not exclude change, but perhaps it influences the nature of change: the more path dependence inhibits initial change, the more change erupts suddenly and abruptly when it has accumulated sufficient energy to break the constraints of path dependence.

In the past 35 years, evolutionary theories have explained change as discontinuous development, where one can see at work both mechanisms of path dependence and sudden and unexpected changes. Old evolutionary biology theory was dominated by phyletic gradualism. It held that evolution occurs as a slow and steady transformation, which, in the long run, would produce new species. Instead, the theory of punctuated equilibrium proposed by Eldredge and Gould in 1972 holds that evolution occurs through rapid and concentrated changes dotted along long static phases. As Eldredge and Gould put it: " the history of evolution is not one of stately unfolding, but a story of homeostatic equilibria, disturbed only 'rarely' […] by rapid and episodic events of speciation" (1972, p. 84).

This pattern, of course, is not new to social sciences, but punctuated equilibrium has become a prominent model to investigate organizational change (Gersick 1991). Tushman and Romanelli, for example, state that "organizations evolve through convergent periods punctuated by strategic reorientations (or recreations) which demark and set bearings for the next convergent period" (1985, p. 171). This model helps in visualizing why the emphasis on the formative period for the subsequent path dependent development of an institution is not at odds with sudden changes that have no apparent relation with any path predictability. In the case of the World Bank, the strong stability experienced under Black's presidency was suddenly disrupted by the strategic reorientation operated by McNamara. Far from invalidating path dependence mechanisms, sudden change appears as a consequence of them.

The early exclusion of approaches to lending policies other than those favored by Black and his top managers caused the Bank to be lacking the expertise needed to take the lead in the broad discussions and renewal processes that were boiling in the development field. It was no accident that Robert McNamara's attempt to give the

institution a new direction involved criticism of the previous creed[24] and the recruitment of a new generation of development scholars: *in primis* Hollis Chenery, and then Mahbub ul Haq, Frances Stewart, Paul Streeten, Shahid Burki, Norman Hicks, and others.

Chenery revived the Bank's Economic Department, and established collaboration between the Bank and the Institute for Development Studies of Sussex University, whose analyses were collected in the volume *Redistribution with Growth* (Chenery *et al.*, 1974). The group that gathered around Paul Streeten began to work with the ILO, importing from it the stimulus to study the basic needs approach[25] and proposing its own original contributions (see Streeten *et al.*, 1981; Hicks, 1979, 1982; Hicks and Streeten, 1979; Burki and ul Haq, 1981; Stewart, 1985). Communication between the ILO and the World Bank on basic needs resulted in a number of joint missions (ul Haq, 1981; Kapur, Lewis and Webb, 1997, p. 255). The question of whether McNamara actually achieved positive results in poverty reduction is beyond the scope of the present discussion, but the change in perspective of the McNamara years is undeniable.

Interestingly for the case analyzed in this paper, McNamara further widened the Bank's agenda by providing it with an Urban Development Department and an Urban Poverty Task Group, both headed by Edward Jaycox. This initiative was perceived as a novelty within the institution. As a Bank's programmatic sector working paper stated in 1972, "the proliferation of squatter settlements and slums, and the rising backlog in urban services, have been accompanied by growing recognition that 'development' implies much more than just expansion of output. […]. In recognition of the importance of these issues, the World Bank recently decided to supplement its activities in individual sectors with a more direct focus on problems of urbanization. […] This is a new field for the Bank" (World Bank, 1972, p. 3). The focus was heavily on housing, because of its importance to development "in both economic and welfare terms" (World Bank, 1975, p. 10). From 1972 to 1981, 58 percent of the urban projects, representing 46 percent of the urban lending, were for housing (Kapur, Lewis and Webb, 1997, p. 317).[26] Since the early 1970s, urban development, and more specifically housing, have become an integral part of the Bank's research and lending activities (for a far-reaching analysis over time, one can follow Michael Cohen's work through several publications over the decades, for example Cohen, 1973; World Bank, 1983; Serageldin and Cohen, 1995).

5. Concluding Remarks

Through the analysis of patterns of path dependence and change in the history of institutions, this paper has shown how the political economy of the World Bank

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[24] "[I]t would be comforting to continue to believe that there is no conflict between rapid overall growth and comparable improvement in the incomes of the poor. But, unfortunately, in the real world in which we live, the evidence suggests that there is" (McNamara, 1972, p. 219).

[25] The proposal for a new approach based on "basic human needs" came from an ILO conference held in Geneva in 1976 (ILO, 1976, 1977).

[26] Kapur, Lewis and Webb, however, note that the overall urban development lending over the same period amounted to only 4 percent of total Bank lending (p. 317).

took shape in its formative years, and how it affected the institution's subsequent developments, its strengths and weaknesses. The paper focused on housing as a particularly interesting case in point, representative of a broader scenario.

In the 1970s, the Bank was eventually able to join the frontiers of the development debate, at least with some outstanding scholars recruited by McNamara. But it must not be forgotten that at the outbreak of the debate, during the 1960s, the Bank was bringing up the rear.

Referring to housing, Bank publication recognized that "the World Bank Group entered this field, in the 1970s, as a latecomer" (World Bank, 1975, p. 6). What is worth analyzing thoroughly, and I have tried to do it in this paper, is why the Bank found itself as a latecomer, through what processes and decisions. Discussions that had taken place inside the institution between the 1940s and the 1950s, starting with the debate over the housing issue, show that from the very beginning of its development commitment the Bank could have cultivated a broader view on development issues than it actually did during the 1950s and most of the 1960s. Instead, the Bank consciously refused to adopt different perspectives on development, or, in the words of its vice-president, to consider broad economic policies or studies. While, on the one hand, this decision gave the institution strong stability, on the other hand, it stripped it of the ability to understand the changes that had come about in the development field during the 1960s. What McNamara tried to do was recover suggestions made very early in the life of the Bank, but which had neither been taken up nor, perhaps most importantly, incorporated into the institution's cultural heritage.

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