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A CONVERSATION WITH IRVING S. FRIEDMAN, III

WASHINGTON, D.C.

July 15, 1985

CONVERSATIONS ABOUT GEORGE WOODS
AND THE WORLD BANK

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Robert W. Oliver

OLIVER: Irving, we have talked a lot about your experience in the Fund and the reasons you came to the Bank to be The Economic Advisor to the President, but maybe you would briefly repeat that story and then deal with the general questions: What was it that you understood you were being asked to do at the Bank? and How were you going to go about doing it?

FRIEDMAN: Well Bob, if I may repeat myself, because I am sure some of this has been said to you a number of times before, the initiative of my going to the Bank came entirely from George Woods. It isn't as if I had any preconceived ideas of what I would like to do. I had no idea that I would ever be in the World Bank. Despite very early interest back in Treasury days in the World Bank, I had remained a person whose interest in the Bank really was largely formed by the responsibilities and the work I was doing in the International Monetary Fund.

I wasn't really all that familiar in detail with what the World Bank was doing. So when I went to the World Bank, although I had lived just a few feet away, I wasn't all that much more knowledgeable about the World Bank than someone might have been who lived a few hundred miles away. I think that is kind of important. Secondly, when Woods

approached me and asked me to come and have lunch with him, the way he put it was -- the first that I can recall, and I think it was very early in the game, if not at the very beginning: Would I come and do for the Bank what I had done for the International Monetary Fund? That's the way he defined it, not the way I defined it. We talked about that: what he had been impressed with was that the Fund seemed to have a program of assessment and consultation with all countries, on a periodic basis; the Fund seemed to have a view about countries, about their monetary and fiscal management, their balance of payments management and exchange rates.

He told me that he didn't feel that the Bank had this. They didn't have a periodic program for assessing member countries. I remember at that time his citing, quite early, the experience with Brazil: the Bank had not had anything new in Brazil for years, because there had been joint U. S. - Brazilian commission which Burke Knapp had been on which had gotten into some difficulties, and the Bank and Brazil had broken off speaking to one another. He cited this as an example of what shouldn't happen.

OLIVER: Would there have been in the Fund actual annual reviews?

FRIEDMAN: Oh yes. The system, which I may say I invented as well as administered, provided for an annual review with all countries under Article Fourteen. By this time, it had also been applied to Article Eight countries, which meant all member countries. We didn't always succeed in having a review of all countries. Sometimes there would be a technical difficulty, like a ministry not prepared to talk because it was a budget period, or something had happened to central bank personnel. The large majority of countries were done every year, and, in principle, the countries agreed to have consultations every year in the field.

The Fund consultations were the first of their kind; it had never been done before. The idea of having missions in the field with an independent civil service staff, an international civil service staff, doing its own assessment periodically on behalf of an international group, in this case the International Monetary Fund, was novel.

Where Woods had gotten such a high regard for this process, I don't know. I wouldn't have thought that bankers in New York knew we had annual consultations with members of the Fund. I don't really know where he got my name. We had a number of mutual friends, people like Martin and Andy Overby. The chances are there is someone I haven't even thought of who gave him the idea of asking me to come and do in the Bank what I had done in the Fund.

The other point that he made very early in the game -- I don't dare say, Bob, that I can remember the chronology of these events; I know it was very early, before I decided to come, and I was very interested in what I was going to do and why he wanted it done. He made the point that he had been pulled into his job by President Kennedy, whom he obviously greatly admired, although I believe Woods was a Republican. Kennedy had spoken to him about the fact that United States foreign policy had one great weakness and that was its relations with developing countries. If anything, there was a widening (I think

that was the word he used) chasm between the developing countries and the United States. The logical bridge institution was the Bank, and he, Jack Kennedy, wanted George Woods to build a bridge between the United States and the developing countries. That was why he was asking Woods to be President of the World Bank. And Woods turned to me and said, "And you're going to help me build that bridge." That was the decisive comment that he made. There was nothing technical, it wasn't anything very precise, but there was the idea the major institution to bridge the developing world and the United States was going to be the World Bank. Mr. Woods was going to build the bridge, and I was going to help him build that bridge.

OLIVER: May I interrupt? This luncheon where you were talking to Woods about these issues -- was this the luncheon when he was asking you to come? Was this the first time that you had met him face to face?

FRIEDMAN: When he first asked me to consider coming was the first time I had met him, I would say, face to face. We might have said, "Hello," at a Governor's Conference. I surely had not had more than a few words with him before. It was my first conversation with the man. Then we had a series of luncheons at which we discussed my coming, all of which occurred within about two weeks. That's why I say, I don't remember the chronology of it.

OLIVER: All, I guess, in the late spring or early summer of 1964?

FRIEDMAN: It was in the early summer; I would have guessed the spring or early summertime. We were visiting Edna's mother in Ridgefield, Connecticut, which we usually visited in the late spring or early summer, and it was decided over the phone what my title would be. I was visiting there over the weekend. I did not try to record our meetings, but I'm sure it's recorded somewhere.

Then we talked about what I would do. We talked in terms of the fact that there were two candidates in his mind -- two people -- one was Alec Cairncross and the other myself. Indeed, he asked me what I thought about Cairncross. I told him I thought Alec Cairncross was great, that the World Bank would be lucky to have someone like Alec Cairncross come to the World Bank. Mind you, at this point, were not talking about departments, titles, or anything. We were just talking about my coming to the Bank. At some point during this early week, I reported to him the view of Pierre Paul Schweitzer that if I came to the Bank, it had to be as something that was equivalent to a promotion from the Monetary Fund. Woods said, "Sure because you're going to be equivalent to Burke Knapp and Geoffrey Wilson who are my two vice presidents."

Then, in the course of two weeks, he brought out the point that he had committed himself also to make Sim Alderwereld a vice president, and that I would come in at a rank equivalent to that. It was at that time that he also made the point that if I came to the Bank I would never suffer financially or career wise; I would have as a minimum the same tenure, the same assurances that I would have had staying in the Fund. I told him what Schweitzer had said about being the Third Man in the Fund, and I never could be less for the rest of my career; and Woods said, "Oh well, just tell Pierre Paul that it's going to be the

same thing here; you're going to be -- you're going to have the same assurances." (Woods was a very practical person about salary and tenure. It was a sensible thing to consider. He never was embarrassed about talking about things like tenure and salary. He thought it was perfectly reasonable that someone should be concerned about it, and I found it very easy to talk about it.) He said, "You will never suffer from having come over to the World Bank." That had a lot to do with my decision.

Again, at this point, we hadn't even talked title. We had not talked departments or anything except why he wanted me to come. He made the comment which I found very significant in light of my later relations with Woods. . . . Mind you at this time I don't know him; I'm meeting him for the first time. I can't remember how the point was provoked to be made. He said that the reason I want you to come and develop this program is that I think that IDA has to become more important than the World Bank. I really don't think that most of these countries that we're dealing with are the kind of countries that ought to get a lot of loans from the World bank; they ought to get IDA. While I'm here, we're going to try to make IDA bigger than the World Bank. He went on to say, "I think I know about banks. I know about how to decide to make a loan or not, but I don't know how to make a decision about IDA-- how to decide whether Pakistan and India and these other countries should have more or less."

When he talks about creditworthiness in the Bank, which he emphasized -- "I want you to work on creditworthiness" -- it's not the creditworthiness of a commercial bank. He was not concerned that countries wouldn't repay the Bank. The Bank already had a well-established policy of being a preferred creditor. That was already the cornerstone of creditworthiness to the World Bank: borrowing countries paid back the World Bank or else they didn't get any more loans. The Bank insisted on being paid. Already in the 1950s and 1960s, important borrowers from the Bank, like Brazil and Chile, had had debt problems. The practice had been well established that countries might restructure their debts with other public entities -- like the Export-Import Bank, but they didn't restructure their debt with the World Bank. Woods was concerned, it seemed, more with the question of the allocation of IDA funds.

There was much to do. At first much of our economic work revolved around IDA, rather than around the World Bank. How do we argue for a bigger IDA? How do we allocate IDA funds? What is the role of consultative groups or consortia? What kind of a world can economists make? Woods said, "I think economists are better than bankers in making judgements about things like IDA, so that is why I want you to be here." Again we were not talking departments; we were just talking about what to do and the reasons for my coming to the bank. What really intrigued me about coming to the Bank was not a title nor a department. I was in charge of what probably was considered at the time the most influential department in the Monetary Fund. I had the title of being a Department Director of the Monetary Fund and knowing that I had been proposed as Deputy Managing Director by the previous

Managing Director of the Fund. There was no title in the World Bank that was better than the title I had, and no department or function in the World Bank that was more attractive for me to head than the one I headed in the Fund.

There was one thing -- just a personal thing -- which helps to explain my attitude. In the Treasury I was in a research division. I began in the Fund as head of the research on the United States and Canada. As an economist, I was very proud of those positions. This was a time when the things I was writing were being read by the Council of Economic Advisors. I was in touch with leading economists like Smithies, Salant, Kuznets, Haberler and Samuelson. I was innovating the integration of monetary and national income analysis. I was revelling in being an economist. I then became a Department Director in the Fund.

My new position was still that of an economist, but it was very applied. I was eager to be less applied. That's why when Woods asked for a title, and it couldn't be vice president, _I_ was the one who said I'd be _The_ Economic Advisor. It was important that now I would have a chance to be an economist with a Capital E. I was going to be labeled an economist. I was going to be the Chief Economist of the World Bank, and that was much more important to me than the rank or the money.

My income was already quite satisfactory. I also had a nice income tenure and security in the Monetary Fund, which I was bringing to the World Bank with the assurance of no risk of going backwards compared to my colleagues staying in the Fund. This idea of being the

Chief Economist of the World Bank was a pretty heady idea.

I offer this as a digression because it has a lot to do with my decision to go to the Bank and how I approached my new job. I wasn't called in to change anything that was going on in the World Bank. I wasn't called in because Woods was unhappy about how the other work was being done. I was supposed to do an additional thing, to fill a gap seen by Woods. I was supposed to add to the Bank something it was not doing. I wasn't there to abolish anything. That's why it was quite possible for things of the past, like the Economic Development Institute, for example, which was nominally put under me, to remain only loosely administered by me. I never interfered with it; I never changed the Economic Development Institute except to support it with the President. I found economic units on Debt and on Statistics and on Commodities. I tried to give them support. I tried to give them more people. I tried to put them into some more acceptable organizational structure. I never changed what Leonard Rist did. I was not interested in that. I was interested in adding on something which would meet a need I felt I knew that Woods wanted to do for the Bank, and this became my definition of what I wanted to do.

My view of the Bank then is that of an expert on what I did rather than on what others did. I didn't really make it my business to have a detailed view of what the projects or other people did. For example, I believe I could have gone to Loan Committee if I had strongly insisted. I deliberately, Bob, for years never attended a meeting of the Loan Committee, because I did not want Burke Knapp and my colleagues to see

me as trying to interfere. As an experienced international civil servant, I knew what it meant to have an outsider come in at the top rank and interfere with work. It had happened to us in the Fund. I never did it. I didn't ever try to find out what individuals like Sim Aldererweld did or how they managed their departments. I never asked Woods what they were doing. I never asked Woods what he thought about what they were doing. Whatever he told me about them was because he volunteered it. I'm not an expert on what these people were doing in the Bank, even though I was a member of the President's Council, which met daily. Within the economics complex, I tried my best to give credit for its achievements to others. My own role was to build the role of economists. I did not feel the need to build my own career.

OLIVER: May I interrupt to ask about the Senior Staff meetings? You were a member of the Senior Staff as well as the Presidential Council. I've seen some of the minutes of the Senior Staff meetings. They go into some detail on some occasions about things that were being done in various sections of the bank. How did you participate?

FRIEDMAN: I tried very hard to be a positive voice rather than meddling. For example, there was some discussion as to whether we ought to expand in education. I supported it, because I thought it was a good thing. At that time, there were discussions as to whether we ought to expand our consultative group work of which Dick Demuth was largely in charge. I was a strong supporter at these meetings as well as in the President's Council. I strongly supported the work of our relations with the UNDP and UNCTAD which primarily was the responsibility of Dick Demuth again. I was a strong supporter when I could support something.

I didn't get involved when the projects people reported that they had done a study. I remember they did a study on whether they could become more efficient and cut down the time necessary for project evaluation. They had originally came out with the conclusion that they couldn't make any appreciable reduction in the time spent. I didn't become part of that controversy. I deferred to someone like Burke Knapp, who knew much more about project work than I did. I guess I must have commented one way or the other, but I didn't try to play an active role because I didn't feel I knew enough about it. But when it came to subjects like relations with the Monetary Fund, I played a very active role because I knew the subject.

OLIVER: In the case of education or agriculture, did you ever suggest that economic analysis per se might contribute to a better understanding of the importance of education or agriculture per se?

FRIEDMAN: Yes, often. When we had a general problem of economic analysis in evaluating a project, one guessed that it would be discussed by our Economic Committee. For example, on one occasion we had a discussion of palm oil in West Africa and the financial return on the project (I think it was in the Ivory Coast, if I remember correctly), and that the internal rate of return was not good enough to meet the Bank's standards. This led to an extensive discussion of shadow pricing. This exemplifies what I thought was the proper role that I could play to inform some of these -- like in education: we had a

discussion of the contributions to economic development of education and how one would go about analytically looking at education from the economic point of view. I remember proposed educational loans coming before the Economic Committee. I had informal evening seminars with participants in our Economic Development Institute and for those who cared to discuss new areas like health and education.

We discussed all the loans at the Economic Committee before they went to the Loan Committee, but our discussions were on the economics of the projects. I would try to use it as the occasion not merely for a discussion of a project per se but also more broadly. I would like to comment, at some point, about my view about the role of economics which was quite different from the views of other people.

OLIVER: Before we get onto that, I think it would be a good idea if you would say a bit about how the Economic Committee got started, because it got started after you became The Economic Advisor.

FRIEDMAN: The Economic Committee got started because I felt that if economics was to play a role in the Bank, it had to be operational. It couldn't be primarily background for decisions or long-term research studies. This was the lesson I learned from my experience in the Monetary Fund. I'll be glad to elaborate that separately: How to build a mechanism into the Bank so that the economic analysis of the country becomes a major element in the decision-making of the World Bank?

Economic Judgement as such was not the focal point of attention in the Bank. I believed it should be, and my proposed mechanism was an

Economic Committee composed of all departments which would review all loan proposals before they went to the Loan Committee, as well as other economic matters. I mentioned this proposal to Woods. I don't think it took more than one or two conversations and we had it going. I told him, as far as I was concerned, I wanted all the departments on it, including the Projects Department as well as the Area Departments.

I got splendid cooperation from most members of the Committee, from people, for example, like Takahashi, who, at this point, was the chief economist in agriculture. Takahashi was very good in bringing to the Economic Committee some questions of the economic analysis of agriculture projects. Obviously, like anything else, the degree of cooperation and enthusiasm varied from one group to another. I remember very vividly those people who accepted and cooperated. We had some people in the Bank who never accepted this special work, who always thought that there was enough economic work done in connection with a loan for the Loan Committee. They could not see why it was necessary or desirable to have a separate discussion in the Economic Committee, or, for that matter, separate economic analysis apart from the loan analysis.

The other point that I made that was innovative, if I may use that word, was that I wanted the Monetary Fund to sit in on our deliberations. That was really very, very different, and I knew at that time the Monetary Fund would not welcome this in a formal way. They were not ready for close and formal relations between the Fund and the Bank. This is a point in time when the Fund was still trying to

establish itself vis-a-vis the Bank. The Bank was the more senior institution of the two, and the Fund was pretty self conscious. This came out in all sorts of things, including who gave luncheons at the Governor's Conferences, who spoke first and who was the spokesman for the two of them. Whenever that came up, it was usually the World Bank. Veterans of the Fund like myself smarted under this for years. We felt that we were as good as the Bank, but the world didn't seem to agree with this.

The other side of the coin was that the Fund was pretty sensitive about formal relations with the Bank. I canvassed the area department directors of the Fund at that time and asked them whether or not they would be prepared to come <u>informally</u> to our meetings whenever their countries were being discussed. Everyone of them cooperated -- like Jorge del Canto in Latin America or John Gunther in the Middle East. We never (never maybe is too strong), nearly never, perhaps never, had a meeting on country in the Economic Committee where the head of the department of the Fund did not come unless he was out of the country, in which case he would send his deputy. I always made it a point in the Economic Committee that we never had a view of a country without my calling on a Fund person to give his view as seen by the Fund -- to make sure we didn't have silent representation.

OLIVER: Can you illustrate what kind of issues the Economic Committee dealt with? Was it defined in the discussion of the rate of growth? or the measurement of Gross National Product? or the amount of saving that could be generated by one program or another? All of these?

FRIEDMAN: Not quite. The way I distinguished between the Fund and the Bank economically was that the Bank was essentially concerned with the strategy of economic development, with long-run planning and with the implementation of that strategy, the assessment of whether or not countries had the right kind of strategy and had the right kind of policies for the implementation of that strategy and whether they had the right kind of institutions and institutional practices. That's how I distinguished the Bank from the Fund. I knew from my own experience that the Fund did not cover these aspects. We came up to that gate, but we didn't walk through that gate. This guided me in the work of the Economic Committee. In the Economic Committee, questions were directed toward what members thought of the economic strategy in the country under consideration? Did they have the right kind of implementation? Some times questions of fiscal policy were raised, or questions about pricing policy. If questions about exchange rates arose, I would turn to the person from the Monetary Fund: "What do you think about this?" Sometimes, it was commodity pricing or the treatment of foreign investments.

OLIVER: Is it fair to say that the discussions were more concerned with questions of growth and growth strategy than with simple creditworthiness?

FRIEDMAN: Oh yes, definitely. We didn't spend much time on creditworthiness. I now realize, after going to Citibank, that to be concerned with creditworthiness really means you're worried about being repaid.

In the World Bank, we were much more concerned with the use of borrowed funds and with the appropriateness of its use. We had a lot of discussion about whether or not a country like Thailand should continue to receive funds from the World Bank. Those were the days of the military build-up, and Thailand was being flooded with U. S. dollar income. Should Thailand continue to be eligible for Bank loans? We had discussions on whether or not Japan was still eligible for the World Bank or should Japan be cut off? We also had discussions on industries and sectors: Should we make loans in industries like Tourism or Steel or Oil? Woods' point of view got discussed: we really should not be in those industries where the private sector was quite willing to provide the investment. If the countries didn't want to have them, that was their own decision. There was no reason why the World Bank should step in and be a substitute. Those are the kind of issues that we discussed.

OLIVER: Did the issue of absorptive capacity get talked about?

FRIEDMAN: Yes, a number of times.

OLIVER: Talking generally, of course, and income distribution?

FRIEDMAN: I think so. I'm not sure that the categorization would be the same then as now or the way these things came up for consideration. One of the new things I was asked to do was in connection with the issues that had been raised in the UNCTAD world. UNCTAD reflected more of the general debate about economic development than most any other place, because it had just come into existence in 1960 and had had only one or maybe two meetings -- maybe in '60 and '64, I forget.

It still had Prebisch as the head of it and was the institution that was intellectually inspiring people. The idea of the first development decade came out of UNCTAD, I believe.

The Supplementary Finance Proposal originated in an UNCTAD resolution. Another question was the external debt question. Capital requirements was another subject in which we worked. People who were doing quantitative analysis in economic development were making estimates of capital requirements. They differed, and this became very important because one of the early questions Woods gave to me was: How big should IDA be? What do we go for? In Wood's mind, that was a question for an economist to answer which he particularly addressed to me. I was the one who came up with the idea of a four-fold increase in IDA from $250 million to $1 billion.

I found myself involved in this discussion of capital requirements. I evolved a new technique which was circulated to the Economic Committee and others. It was discussed by the Economic Committee. We discussed both the methodology I used and the results. I don't know if you want me to summarize how we did it, but. . . .

OLIVER: I think at the very least you should identify the article so I can go read it.

FRIEDMAN: I'll find it. One version came out in Finance and Development. You have access to the archives. There are much better things in there.

I had little confidence in the way others were doing projections of capital requirements. The export world did not know what the

capital-output ratios were in different countries. We had an early study on Turkey, and a four-to-one ratio had been deduced from the available evidence at the time. Experts kept on using capital- output ratios of four to one. We made estimates of foreign-exchange earnings that were equally arbitrary. Thus I had no confidence whatever in the projections being made, including those which were being advocated by Prebisch at the time.

Part of my job was to explain to Woods this intellectual controversy that was going on and the significance of it for those of us in the business of development finance. It was a very important practical question. I took the point: What kind of inhibition is being placed on social-economic development by the lack of foreign exchange? What productive investments could be made if foreign exchange were available? At this time, remember, absorptive capacity was very much in the forefront of economic developing thinking. John Adler, for example, in the World Bank, had written on this subject with great authority. I did not pretend to do an academic exercise in absorptive capacity.

I told Woods that I would try to approach the subject from the viewpoint of the World Bank. We did something that was really quite original. I asked all of the people in the World Bank who worked on countries to give me their judgement based on their knowledge and experience as to what amount of capital -- external capital -- could be used in the immediate and short run for productive purposes in that country. If the capital restraint could be eliminated -- the foreign-exchange constraint -- how much did they think could be used on what terms, and why? In effect it was asking about what these officers saw could be done that was not being done because of the external capital constraint. I asked some people to collate the replies. I think it included Bob de Vries and Ravi Gulhati, but I'm not quite sure that I am remembering the right people.

OLIVER: I don't know that second one. Would you say that name again?

FRIEDMAN: Ravi Gulhati. He was one of the whiz kids in the World Bank at this point. He is still there. We surveyed the countries and came out with a total of $4 billion. This was the collective opinion of the World Bank economic staff.

OLIVER: Could be used over what period of time?

FRIEDMAN: Per year in the foreseeable future, I think it was. (I want to check that back. I haven't looked at it since then.) We then looked at the countries to judge which were IDA worthy and which were World Bank worthy. If I remember correctly (this is the methodology even if the numbers are wrong), we came out with something like $2 billion of the $4 billion ought to be on IDA terms. We then made a purely political judgement that we at the World Bank ought to go for half of it; we ought to aim to provide half of the grant funds from official sources. It was by that kind of arithmetic that we got the $1 billion figure for IDA (plus $1 billion for the World Bank).

OLIVER: This was done in '65 was it?

FRIEDMAN: This was the prelude to the $1 billion dollar figure. It might have been in '64, but it was surely done by the middle of '65. Having come out with the figure of a billion dollars, part of my job was to tell Mr. Woods to explain our view -- about what I felt were the issues involved and what I thought was a reasonable policy position for the World Bank. This was when I tried to explain to Woods my understanding of the Two Gaps Theory and other theories of the way one did projections, models, and so forth.

One of the persons who became an admirer and my great support at this time was Barbara Ward. Mr. Woods had a great respect for Barbara Ward. I had the feeling that after I told him something, he would go and talk to Barbara about it, to see whether it struck her as being sensible. I don't think he had as many friends in the academic world as someone like McNamara. He may also have been talking to Ed Mason, who was often in the Bank. "Ed Mason," he said, "He's over the hill; any guy who's 71 is over the hill." He never took Ed Mason seriously. He never took John De Wilde seriously, and John was a very bright person. I don't know why, but it was already so before I came. Otherwise, why wasn't John a candidate for my job?

The senior economists in the Bank -- John Adler, John de Wilde, and Andy Kamarck -- were not Wood's idea of someone that he wanted to be his top economist. I think partly it was because, in Wood's mind, I was his Economic Advisor as well as administrator of the economic staff and programs. Woods, I believe, wanted someone he felt comfortable in talking to, that he could have confidence in --

confidence in his ability and confidence in the way he dealt with George Woods. I managed to explain things to Woods in such a way that he did not feel that he was a nicompoop because he didn't know the Two-Gaps Theory.

I suspect there were other people in the Bank who had that facility, but I had it. I would have thought that Jerry Alter could have done the job. I would have of thought that Andy Kamarck could have done the job. He was not that interested in how I managed the economic work and staff. This became a primary interest of McNamara, but not for Woods. He was interested in the Economic Committee and what it did. He was a stalwart supporter of it, but I don't think he ever asked detailed questions about its organization.

He usually supported me very strongly. Occasionally he didn't support me vigorously enough. For example, one of the earlier thoughts I had was that, in order to make the economists in the Bank more important, each area department head ought to have a deputy for economics. The director of the area department would be its chief loan operations officer. That was the primary role of the director but there was no such a thing as economic work in the Bank divorced from loan work. The major integration of economic and loan activities took place when a loan decision was made.

I think it should be in the Archives that I proposed, after speaking to Woods about it, that the department directors have a deputy director for economics. Woods didn't take the proposal very strongly one way or the other. He supported it, but it never

happened. The loan officers, the people heading the area departments, wanted to have economists as advisors, not as deputies, so economists per se never did become anything more than advisors. It just didn't seem important enough to Woods. As long as my own position was strong and he consented to support my personal position when an issue came to his attention, it did not seem to matter much.

He and I agreed to the principal that all the economists were under my general monitoring. I was responsible for the proféssional standards of economics everywhere in the Bank including in project evaluation. I tried to build the Economic Committee to the place where this would be implemented. He agreed and it was so written up, but, as a matter of fact, the economists in the Projects Department and in the Area Departments looked to their own department directors primarily rather than to me. Whenever anything came up and I would find that I hadn't even been consulted and Andy Kamarck hadn't been consulted, the answer would be, they were told by their Director, Sim Alderwereld, "Forget it, Just go ahead and do it the way we tell you to." I never remember going to Woods about this. I would not have bothered Woods. When he heard rumors and asked, my usual reply was that I killed my own snakes. That was my job. I had to worry about things like how to get the economics people to be more influential.

When I tried to have a population economist appointed, knowing Woods and his interest in population, I got turned down by Administration on the grounds that it was improper for the Bank to have a population economist. Woods didn't fight for it. He said, "Well Mike LeJeune or Hugh Ripman, feel strongly about this. Come on Irving. Why care about such things?" Otherwise when it came to the organization of the economics work, he just left it to me. If I said I was in dire straights, he would help me out.

I really had a tremendous amount of freedom of action and a tremendous feeling of support which everyone in the bank recognized. They always knew, if they were dealing with me, they were dealing with someone who in the end the president was going to support if I made an issue of it. The organizational techniques, the structures, the management methodology seemed to be something he didn't care much about. He was much more interested in my views on substance. For example, he would have long discussions with me about inflation, though I never succeeded in getting him to put some paragraphs in his annual speeches on inflation -- this was in the '60s -- how inflation was going to become a great menace to economic and social development. I believe he chatted with others who assured him that inflation was not worrisome. Others probably told him that my views were silly. "Irving, you know, he comes from the Monetary Fund; they focus on things like inflation." And he wouldn't put it in his speeches, but loved to talk about it. He loved to chat about absorptive capacity and development strategy pricing. He thought this was fascinating stuff. Whether we organized the economics work with three departments or one department, or what you called it, just didn't seem to be something he cared about much.

OLIVER: May we talk a bit about this question that you referred to

earlier, that is, your own personal views about the economics of development? What I want to get at, if I can, is the apparent contradiction, a little bit of a contradiction, between your saying that you thought of the economics work as being operationally oriented, on the one hand, but at the same time your being concerned with the economics of development as a subject, per se, on the other hand. I'm also trying to get at the issue of how you have seen the economics work while you were heading it up in the Bank as being different in any sense from the economics work which preceeded your being in the Bank and the economics work that is more associated with a later period.

FRIEDMAN: Well, I'll tried to describe it; then maybe we can go back and draw the contrasts. I will try to describe it as accurately as I can recall. I think first, perhaps, I should say that, having come from the Monetary Fund, I had become convinced that the Fund could not have the same policy for developing countries as for developed countries. I had been the leader of the view that the Fund rules on restrictions on exchange rates and exchange restrictions should not be applied to developing countries the same way as to developed countries. They could not be expected to live in a regime of unitary and stable freedom of convertibility and from exchange restrictions on current payments.

That had been a great issue in the Fund. (This is not irrelevant to your question. Remember I'm the same person.) The Fund Articles of Agreements had envisaged that the transitional arrangements under Article 14 would only last five years -- within five years after 1946 all countries were supposed to establish regimes which were free from restrictions on current payments or at least a regime in which the case of restrictions required Fund approval. If applied, this exchange regime would mean the convertibility of the country's currency and non-discriminatory foreign trade. I had fought that rule as unrealistic for most lending countries. By the time I left the Fund, eighteen years after 1946, the great majority of the developing countries were still under Article 14, which is a much more flexible regime. After I left, the Fund began to move countries to Article 8 status. All the so-called Article 8 lending countries became countries with large-scale use of restrictions, discrimination, multiple exchange rates, unable to live up to convertibility rules. All the countries we agreed to in the 1950s -- like France, England, Germany and Japan -- that moved to Article 8, stayed as countries with relative freedom from restrictions as payment lessons were very fresh in my mind when I joined the Bank.

I had written memoranda to Jacobbson about how we in the Fund should pay much more attention to the special problems of developing countries, and he had agreed. That was one of the reasons I became the trouble shooter on the Philippines, Brazil and Argentina. As a monetary economist, he thoroughly accepted the idea, thinking less of these countries because they couldn't live up to the Fund principles, but nevertheless understanding that they couldn't in practice. Emphasis in the Fund was, he agreed, on working with such countries to

help achieve eventually the pre-conditions for sustained growth. There were important consequences for economic policy and financial policy management in this approach which the lending countries thoroughly appreciated.

I guess maybe one other view I had is at least worth mentioning. I shared the conviction of the Fund staff that good monetary and fiscal policy was really a pre-condition to sound development, even though it was difficult to achieve and maintain. The best environment for economic development was sound monetary and fiscal policy. With such policies, it could be possible to avoid significant inflation, multiple currency practices, and intensive use of trade and payments restrictions. I had the conviction when I came to the Bank that, on the one hand, developing countries were different from industrial countries and, on the other hand, that the philosophy we had in the Fund was sound. I propagated the view within the Bank that whenever we had a conflict on fiscal or monetary questions, we should ask the Fund people what they thought. We should go along with what they thought was good fiscal and monetary policy. At least that's where we should start. We shouldn't be trying to second guess the Monetary Fund in their areas of expert knowledge and responsibility. This was not particularly welcomed by some of my colleagues in the Bank, who felt they knew as much about these matters, and maybe did, as the staff in the Monetary Fund.

When I came to the Bank, therefore, I was very much concerned with the fact that in the Bank economics was a secondary profession, that in the Bank if a staff person wanted to be important he no longer carried the label of economist. I had been very impressed as an outsider by how many of my friends who were economists in the World Bank had left their roles as economists. If you asked them what they did, they would tell you they were loan officers, a metamorphosis we never had to go through in the Monetary Fund. I never stopped being an economist because I left the Research Department and went into other activities in the Fund. No one ever stopped calling me an economist. I was still expected to give scholarly papers. I fostered Staff Papers. We got people to finish their Ph.D. degrees. I got the Fund to finance people going to the American Economic Association no matter in what department they were. They never ceased to be professional economists.

When I got to the Bank, I found that the economics profession was highly regarded. Indeed, it was one of the ways in which you became a loan officer. But the profession of economics as such was practiced by people who wanted to be called economists. There were some outstanding examples, like John Adler or Drag Avramovic, but they were put on special subjects like debt or the Economic Development Institute or something like that. If a staff member wanted to be in the main stream, he or she ceased being an economist and became a loan officer.

My own conviction was that the Fund and the Bank were institutions of applied economics. In these institutions, the staff applied their skills, professional training, and experience as

economists. They were applying them to a set of problems which had been given to these institutions as their international responsibilities. They were no less economists in the Fund or in the Bank than they were in the academic world. In the World Bank or the Monetary Fund, the professionalism of economics had to be on the same caliber as academic.

This does not mean that everybody had to have a formal degree in economics. There were a lot of people in England who didn't have formal degrees, but the work done had to meet high professional standards. Low standards could not be excused on the grounds that, well after all, in this place economics was not all that important because what was important was being a loan officer. I did everything I could to build the position of the economists and the economics profession within the Bank. The resistance I got was not that the economists weren't good, or not useful; but that economists could remain economists and be operationally important was something that seemed to be strange to a number of people there. If you were an economist, you were an advisor -- you commented on things, you improved things, but the decision-making and decision-taking responsibility was for people who had left the economics profession.

I was trying hard to get across this idea that the decisions of the World Bank had to be taken by people who felt they were taking them as professional economists and were willing to justify their work as professional economists, not on diplomatic, legal or political grounds (political in the best sense of the word), but on grounds which, from a professional economist's point of view, could be justified. In that process I got much more concerned with the integration of the economics profession into the Bank than with the concern as to whether an economist was continuing to do independent research. We were adding to economic knowledge and methodology. We had meetings in the Economic Committee on this. We knew what the academic people were doing and sought to support them. I had numerous conversations with Andy Kamarck about how we might use the World Bank to help such people. But my concern was primarily with whether we were using effectively what was known in the economic profession. The skills and methodology we were developing in the Bank were making economists a vital part of the decision making process in the Bank.

OLIVER: May I interrupt to ask: Did you think of it as being a function of the Economics Department to do research per se that in some sense might be comparable to the academic research being done on the outside? or Did you think of the Department as a collection of people who were economists by training and whose major function in the Bank was to use the knowledge they already had (and were acquiring by reading articles being written by academic economists) in the operations of the bank per se?

FRIEDMAN: For me, issues like Absorptive Capacity, Capital Requirements, Development Strategy, Investment Priorities, Encouragement of Savings, Allocation of Savings among different usages, were operational issues. They weren't in the Bank before my time, I believe. The view I had of it was that these were not

separate questions, they were part of each loan decision.

In the Fund, I had always been in favor of independent, long-term research and it had never become important. Eddie Bernstein, who was the luminary of the Monetary Fund for many of the years that I was there, never succeeded in having an independent research program. The people who did major independent research in the Fund were those who were not able to do the work of the Fund. They were individuals, and some of them were very distinguished individuals, but they were always regarded as peripheral people whom the Fund could do without at any time, and nothing would happen to the Fund. They were people who had tenure, who had been given positions, who were tolerated, but they were never integrated into the work of the Fund. They were people like Bill White, mostly really fine intellectuals. In fact, they used to come and cry on my shoulder that they felt left outside the main concerns and dreams of the Fund. Some left and got academic jobs; they left in despair that nobody in the Fund seemed to be using them, and nobody seemed particularly interested in what they were doing. They were the ones that were publishing in The American Economic Review.

OLIVER: Or the Staff Papers of the International Monetary Fund?

FRIEDMAN Well, Staff Papers were for the more usual people. Our staff felt they were competing intellectually with the best in the profession. Many became distinguished professors. But the Fund, where there was great respect for economists, could not use them in academic pursuits. I remember talking at great length with Oscar Altman, who was a very fine economist and was Director of

Administration and had other special assignments. Oscar and I were close personal friends for many years. He was Director of Administration for years, but we never could get the Fund to agree to have a proper long-term research program. It was only after Oscar was no longer Director of Administration that he worked as an individual or such matters as the rising Euro-Dollar Market and gold. Very few paid any attention to his work.

When I came to the Bank, I decided, by God, now I'm The Economic Advisor to the President; now I have a chance to promote long-term economic research. So I called in Guy Orcutt to help. I had a great personal regard for him and knew that Guy's great interest in life, at least at that time, was in long-term research. He had worked with most of the Fund.

OLIVER: And was a professor at Yale.

FRIEDMAN He was a professor at Yale. He had been a professor at Harvard and had gone to Wisconsin and, at this time, I think he was already at Yale. I gave Guy the mandate to develop a long-term research program, which he did, but I never could get strong support for it. I probably had by that time nearly a hundred economists plus support staff. The most I could get as a budget for Guy was seven economists for long-term research. He quit on me on the grounds that the World Bank really didn't believe in long term research, didn't want such research. Woods was not supportive of long-term research. He was a very warm supporter of what we were describing before, of economics as part of decision making. He supported long-term research

because I favored it but not to the extent of insisting with the administrative people who thought of long term research as a waste of time and money, a drain on the budget. It strained my relations with Administration which were never friendly.

We started a long term research program. Some of the work that was picked up by Hollis Chenery later was already well started before he came. For example, one of the problems the Economic Committee had discussed at my suggestion was: How did the signals on the macro level ever get transformed into micro decisions? In the Fund, it wasn't hard to see how central banking monetary policy was transformed into individual decisions by the firm in development economies, which caused the entire range of sectoral behavior and macro-economic behavior: How did decisions on policy on the macro level get down to the firm? I was fascinated with that question. (In fact, after I ceased to be in charge of the economic work, I made that my special field of inquiry ten years later.) When I came into the Bank, I was interested in the subject very much, and we had a couple of discussions in the Economic Committee. To me it was an operational question. If we made a loan for a rubber plantation in Malaysia, how did we know we were making a sensible loan? It's one thing to have a project evaluation. Fine, no argument with that. It is then necessary to integrate the project evaluation with economic policy at the macro level. How to know that a peculiar policy was really the policy that fitted in, and vice versa, with this particular decision you were making about rubber plantations?

I got a research project started with Guy Orcutt. We actually got PEMEX in Mexico to cooperate. We investigated the oil sector in Mexico and how the oil sector operated as a model for the communication or transmission system from the one level of economic activity to another. I was enthusiastic about this long-term research, but never gave it personally the same high priority as my applied work. I just assumed that long-term research was part of my responsibilities. Andy Kamarck and I were responsible. We set up a group for such research. Guy Orcutt was the first person in charge. He was succeeded by Dubey or Jorge Cauas.

This research group was completely divorced from policy in the sense that it had no day-to-day operational responsibilities. It's job was long-term research, and I tried to get funding for having proper staffing and statistical assistance and even travel money to Mexico to be able to do proper research, but I did not try to involve myself. What I did was to father it, to sponsor it, to make it possible for other people to do. Because of my relations with Woods, I knew I could get that much done.

By the end of Wood's administration, the economic work was well established. We had begun the periodic country assessments. McNamara was very interested. One of the things he had me do was a more elaborate outline of the country assessment work. He wanted everybody to follow this outline which I did for them. He also wanted detailed scheduling and staff assignments. He was much more interested in the management process we used. The country work became more or less

routine as in the Monetary Fund. It became sort of self-perpetuating.

We did have a good economics staff. We had good economists in the World Bank to start with, and we recruited many more. We had the necessary staff capability. I know you haven't asked me the question, but I will volunteer at this point, I don't know whether or not, had I stayed in the Bank longer, I would have found myself doing much more of the quantitative research admired by McNamara.

OLIVER: Who besides Guy Orcutt did you work with in the Bank on quantitative kinds of long-range economic-development studies?

FRIEDMAN: Well, we had many individuals who were quantitatively oriented, but to say that I worked with them would be to exaggerate. There were people I knew, people like Herman Van der Tak, Wouter Tims, David Henderson from Cambridge and others.

OLIVER: There was a David Henderson who succeeded Andy Kamarck and was the head of the Economics Department *per se* in 1970.

FRIEDMAN: The Henderson in the development field was always conscious of the fact that I never regarded myself as strong in quantitative analysis in the development field. I never tried in the Bank to give the intellectual leadership to quantitative analysis that I have given to other things. I left that methodology for others to lead. I helped other people to have that role. My intermediary on this was largely Andy Kamarck and other individuals like Ben King, but they were not very good at it either. We did have a few people, like Wouter Tims, who were first rate in development quantitative analysis by world standards. For myself, as head of the economics work, I was not identified as an econometrician or mathematical economist and didn't try to be identified with those kinds of analysis.

OLIVER: Do you know whether input-output analysis was ever contemplated in the Bank so as to show the relationship between a given project and the total economy? Was it that kind of technique?

FRIEDMAN: Sure it was. I was very familiar with it from my work in the Monetary Fund. Leontieff's work was quite well known to us.

OLIVER: How about concern for the distribution of income? The effect of Bank projects on the distribution of income, or the lack of Bank projects on the distribution of income?

FRIEDMAN: I think the question of concern with poverty comes more during McNamara's administration. You will recall that it wasn't until the 1970s that such issues became fashionable in development economics as contrasted with growth, employment, etc. It was a subject McNamara pushed pretty hard.

One of the major changes that took place in the World Bank was that, before Woods came, the World Bank did not have a preeminent position as it did later in the field of economics. When we went out to recruit people for the World Bank, we did not have the reputation among the economics profession that had already been achieved in the Monetary Fund. By the time the early years of McNamara were over, but largely accomplished under Woods, we were already the single most important group of economic talent in the development world. It did not come about by accident, and it didn't come about automatically by the evolution of world events. It came as a deliberate decision that

a development finance institution had to be the intellectual center of the world in its field.

OLIVER: How did you know that it was the intellectual center of the world?

FRIEDMAN: Because, from then on, there was no intellectual controversy in development in which we were not deeply involved. For example, when NASA had a major conference on methodologies used in the evaluation of their own projects, I was invited to be a leading speaker. I think I was invited because I was Head of Economics in the World Bank. I think anybody who was Head of Economics in the World Bank would have been invited, because, by 1968, we were regarded as a group that always had something important to say in the field of economic and social development. When there was a meeting in Beirut of the World Council of Churches and the Catholic Church represented by the Vatican, they wanted to have two economists as advisors. The two people who were invited were Jan Tinbergen and myself. Now, I would like to think that the invitation was partly personal, but it also reflected my position as head of Economics at the World Bank.

I don't believe the Head would have been invited to such events three years before. I think I had become the personification of the World Bank's economic staff and work. It doesn't matter. We were one of the great groups for economic work, and I think that has lasted to this day. Hollis Chenery came and improved it. Anne Kruger came, and she improved it further. Other people will make it even better and better, different and better, I'm sure. But the fact is that the roots of this progress was a deliberate decision reflecting a special view of the role of economic work.

I keep coming back to the fact that economic work is not just an academic exercise. The Bank should not try to be another MIT or another Caltech. It should try to be different. It is demonstrating that the profession has a major role to play in dealing with the social, political, and economic problems of our times and can do so without surrendering its professional integrity. This is something I feel very strongly about. I brought it from the Fund to the Bank. I brought it to Citibank where it exists to this day in the field of country risk work. It's one of the things of which I am very proud. One of the few achievements of my life is this idea that intellectual work can be married with practical day-to-day decision making. Not merely in technology where everybody recognizes it, but in real thinking about practical problems and logical reasoning, there is a critical role, not just an advisory, glossary, or additional role. You cannot make good decisions without this kind of intellectual input.

I see this now in my work in the African Development Bank. The World Bank has become the model of how economic work becomes integrated with decision-making of a day-to-day character. That was something that came in the Woods Administration which Woods personally greatly welcomed and seemed fully to understand: the difference between that and thinking of the Bank as another place where you have some leading intellectuals who do very interesting work, but to whom you really don't pay much attention. That is what he was doing. He

was not paying attention to leading intellectuals who were not integrated into the work of the bank, but he was very much paying attention to those intellectuals who were integrated.

When I pointed out to Woods, which he didn't seem to know, that Burke Knapp had started as an economist and had had a successful career in economics before he became a loan officer, he was quite impressed. It sort of gave him a new light on Burke Knapp.

I think I did a lot to make it possible for people like Jerry Alter to have important professional relationships with Woods. I gave them credentials: with their kind of training and experience, they were able to deal with practical problems and their views were worth having on day-to-day problems with which Woods was dealing. I believe that this view of economics has permeated many other major institutions of that kind. I think it is something that will last for a long time in the World Bank.

I'm trying to give an example, Bob, of my views on economics and how it contrasted with what came later, as you asked. I had become quite convinced that the Bank ought to do more in the way of balance-of-payments financing. I had been all along urging that the Bank play more of a role in advising governments and influencing governments on development management, on economic policies and financial policies which were important for the development process. I had come to the conclusion that you can never have a real influence if you just do project financing. I had more or less persuaded Woods of this, though not his senior staff. This was reflected in the Supplementary Finance

Proposal done for UNCTAD.

When McNamara came in, he put a stop to the discussions on supplementary finance and indicated that he didn't think he could support it at that time. It was still a live issue in international relations. During our discussions on this matter, he asked me, "Can you do this proposal with projects?" I said, "Well it can be done; it is possible to have a shelf of projects which can be called upon to provide additional lending if desired. Really, when it is all said and done," I said, "that's very close to balance-of-payments financing; it's just another way of describing it." He said, "I'm not convinced of the desirability of balance-of-payments financing for the Bank." I called on Hollis Chenery, who had recently been the assistant head of the foreign-aid agency, assistant administrator for economic work. I had heard that Hollis had himself been a champion of balance-of-payments financing while he was in AID. I got Hollis in and told Hollis what the issue was. The issue was really a major issue within the Bank. Would he like to write a memorandum on it? I would appreciate it very much if he would.

Well, he wrote it, but it was completely inadequate; it would not have been worthy of an Economics One student, and yet it was written by one of the best brains in our field. I can only understand it on the ground that he wasn't really interested. McNamara finally turned me down decisively on the Bank's doing balance-of-payments financing on the grounds that it could not be evaluated in precise quantitative terms.

In an institution like the World Bank or the Monetary Fund, I believe that whatever research is done needs to be integrated into the operational needs and work of the institution. It doesn't mean good decisions are not otherwise being made, but they are being made by people who are either non-economists or, even if they are economists, they are not being made to meet professional standards in the way in which economists use their economic tools and background in making those decisions.

OLIVER: I can tell that you substantially increased the importance of economists in the bank, that you substantially increased the importance of economics and the awareness of economics, but I still can't tell whether you also substantially increased the economics research that was being done at the Bank.

FRIEDMAN: I'm not sure what you mean by economics research. We increased the amount of economic work that was done on economic problems. We did more work on pricing to judge an internal rate of return, assessing development strategy, judging investment programs. Is that economic research? These kinds of subjects were investigated more in depth as the expansion of economics work went on.

In addition, there were other areas of work which we expanded. We expanded thinking and knowledge like on the problem of export short falls and their impact on development. We expanded knowledge about the implications of different forms of development finance for the development process. People knew much more about it after our work than they did before. It wasn't labeled a research project, but the product was something that might well be considered a study -- for example, the Supplementary Finance Proposal which, in my opinion, was an original study. The reason why I hesitate to call it a research project is because I knew there were many things at the time that, if we had an indefinite amount of time, I would have liked to have looked into more deeply.

A research project in my mind is one that exhausts the product; you feel confident that you have looked at everything that you could look at before you come to conclusions. It's hard to do what I regard as true research in an institutional framework, because that institutional framework tends to give you a guideline, if nothing else a time limit, which imposes a constraint that, I think, a true scientific research worker finds very, very onerous to live by.

OLIVER: I think maybe one way to get at this another time (I think we ought to stop now) is to put down a list of the kinds of issues that were dealt with by the economists and your staff over a period of five years. What were the questions they were seeking answers to? Maybe by talking about that a little bit, we can illuminate this. But I think we'd better do that another time.

FRIEDMAN: Fine. I would urge you to talk also to Andy Kamarck about this.

OLIVER: Oh indeed.

FRIEDMAN: Because his memory might just be better than mine, or surely supplementary.

OLIVER: Well, I think, another time, we ought to talk about your work

with Andy Kamarck and other specific economists as well.

FRIEDMAN: I think so, because that also helps recall.

OLIVER: I think this has been a very good session. Thank you.