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Albert O. Hirschman, Europe, and the Postwar Economic Order, 1946–52

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# Albert O. Hirschman at the Federal Reserve, 1946-1952

Michele Alacevich and Pier Francesco Asso\*

## 1. Introduction

The first thirty years of the life of Albert O. Hirschman were anything but boring. Born in 1915 in Berlin, he left Nazi Germany before turning eighteen, then was an active antifascist in France and Italy, fought for the Spanish Republic in 1936, helped organize an underground rescue network for antifascist and Jewish people in occupied Marseille, fled to the United States, and fought World War II in North Africa and Italy as a volunteer in the US Army. Meanwhile, he studied political economy in Paris, London, and Trieste, published articles and reports on demographic trends, the French and Italian economies, and trade policy, joined a research group on international economic relations at Berkeley (Alexander Gerschenkron, another émigré from Europe, was his senior colleague there) and wrote his first book, *National Power and the Structure of Foreign Trade* (1945, though completed in 1942).<sup>1</sup>

In the fall of 1946, 31 years old, Hirschman landed his first stable job as an economist in charge of the Western European desk of the research branch

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\* University of Bologna and University of Palermo. For contacts, [michele.alacevich@unibo.it](mailto:michele.alacevich@unibo.it) and [francesco.asso@unipa.it](mailto:francesco.asso@unipa.it).

<sup>1</sup> He also married Sarah Chapiro, like him an émigré to the United States, in 1942. By 1946 they had two daughters, Katia and Lisa. The standard biography on Hirschman is Adelman 2013.

of the Federal Reserve Board in Washington, DC. Development economics hardly existed, and Hirschman had no idea that he would soon become a pioneer in the field. At the time, finally reunited with his family, Hirschman was happy finally to settle down in DC and work as an economic analyst on issues of European reconstruction.

As this period predates Hirschman's major works in development, political economy, and the social sciences, scholars have largely ignored it.<sup>2</sup> Partial exceptions are a book edited and introduced by Asso and De Cecco (1987, see also Hirschman 1987a), published in Italian, which offers a selection of Hirschman's writings on Italy and chapters from *National Power*, and Adelman's biography (2013), which carefully describes the vicissitudes of Hirschman's life at the end of the war, but offers only a cursory discussion of his work at the Fed.

Our goal is to offer a comprehensive analysis of this early phase in Hirschman's career, and to show its importance for understanding debates and policy decisions about European reconstruction and international monetary cooperation at the time. By examining Hirschman's work at the Fed, we are able to reconstruct that debate through the eyes of an expert and perceptive participant. Like Dean Acheson, Hirschman too was "present at the creation" of the postwar international system, contributing novel and at times visionary analyses on European reconstruction, the Marshall Plan, exchange convertibility, and a proposal for a monetary

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<sup>2</sup> His 1945 book was long overlooked, too, except by international political economists who rediscovered it in the 1970s, see Cohen 2008.

authority that anticipated a number of important issues related to intra-European and transatlantic cooperation.

Moreover, we will discuss how those early analyses informed Hirschman's subsequent, more famous work on development. Focusing on a period when Hirschman was still shaping his analytical tools, our study reveals a number of elements that illuminate his intellectual trajectory. During his years at the Fed, Hirschman sharpened his ability to examine processes of policymaking in difficult times, rejecting prefab recipes and developing a sensitivity for inverted sequential processes, inducement mechanisms, and apparently paradoxical solutions in an uncertain environment. As we argue, the roots of what would become the distinctive "Hirschmanesque" style of thought (to use an expression by Walter Salant) are clearly visible in this early period. So, even though there is a clear discontinuity in the subject of Hirschman's work between the 1930s-40s, when he studied international trade and monetary policies, and the 1950s-60s, when he joined the fast-growing new disciplinary field of development economics, we highlight a continuity in terms of methodology and attitude.

The structure of the paper follows the evolution of the debates on the economic and monetary problems of postwar European reconstruction. As Hirschman formed his own perspective through direct participation in those debates, we will be able to follow the evolution of his analyses, and how he contributed to the general discussion. After a brief historical account of the economic conditions of Europe at the end of World War II, Sections 2 and 3 discuss two major fields of inquiry of Hirschman at the Fed, namely, economic and monetary policies in France and Italy (the subject of Section 2) and the problem of the dollar shortage in Europe (the subject of Section 3). As positions differed on whether the dollar shortage

was a real problem or a futile concern, we first present the major strands of the debate, and then examine Hirschman's position. In Section 4 we introduce the related debate surrounding the attempts at overcoming the problem of bilateralism by creating a mechanism of multilateral clearing. A number of failed attempts were finally superseded by the establishment of the European Payments Union (EPU) in 1950. We then devote section 5 to an in-depth discussion of Hirschman's "Proposal for a European Monetary Authority", an important document that Hirschman prepared for the Economic Cooperation Administration (ECA), in charge of the Marshall Plan. Not only is this document important for understanding Hirschman's view on intra-European cooperation, it offers fundamental insights into the conflicts among different US departments and governmental officers about the European institutional configuration and its economic and monetary policies. In Section 6, we discuss the political debate around EPU in Europe and in the US, and the way Hirschman contributed to solving certain technical problems that threatened the birth of EPU. Towards the end of his tenure at the Fed, Hirschman began to study even broader issues, such as how industrialization in other countries would affect the United States in the long-run and, from an opposite perspective, the influence of US economic conditions on the international system. This work is the subject of Section 7. Finally, in Section 8 we discuss how the years at the Fed refined Hirschman's analytical abilities and prepared the ground for his work on development.

## 2. The Political Economy of Reconstruction in France and Italy

The terrible, destructive consequences on Europe of World War II are well known. As remarked in the 1945 *Strategic Bombing Survey* compiled by a commission headed by John K. Galbraith, between 1940 and 1945 the monthly bomb delivery capacity of allied forces on Europe augmented by a factor of 150, with a huge surge in 1944 and 1945 (US-OEED 1945: 1).<sup>3</sup> In France, between 70 and 85 percent of locomotives were destroyed, all major canals, ports, and riverways were unnavigable, and 20 percent of its buildings (almost two million) were damaged. In Germany, 90 percent of railways and 40 percent of buildings had been damaged (though these were averages, as the bombing of Dresden and other major cities in Germany testify). In Italy, 85 percent of the merchant marine and more than 30 percent of the railways were wrecked. Industrial production was 40 percent of prewar levels in France and Belgium, and a mere 20 percent in Italy and Germany (Eichengreen 2007: 54-55; Van der Wee 1986: 26). Air raids, wrote Galbraith's commission, were "The most important single cause of Germany's ultimate economic collapse" (US-OEED 1945: 13).

As for the "terrible accounting" of human losses, economic historian Paul Bairoch estimates the direct death toll of the conflict to be 37 to 44 million individuals (of whom 20 to 27 million were civilians), to which one must add 28 to 30 million displaced people (Bairoch 1999: 985; see also Maddison 1976). In the synthesis of a historian, "Europe in the aftermath of

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<sup>3</sup> The members of the commission included, in addition to Galbraith, Burton H. Klein, Paul Baran, James P. Cavin, Edward F. Denison, Samuel J. Dennis, Thomas Dennis, G. Griffith Johnson, Jr., Nicholas Kaldor, James W. McNally, and Roderick H. Riley.

the Second World War offered a prospect of utter misery and desolation” (Judt 2005: 13).

Indeed, people were worn out and exhausted. Yet, despite its immense destructive power, the war’s impact on European productive capacities was limited. According to the United Nations, by 1947, a mere two years after the end of hostilities, industrial production in Europe had returned to its 1938 level, and by 1948 it surpassed the prewar level by about 13 percent (excluding Germany; including Germany, the figures are 83 and 96 percent respectively, see United Nations 1949: 137).<sup>4</sup>

Albert Hirschman joined the Division of Research and Statistics (International Section) of the Board of Governors of the Federal Reserve on October 1946, with the principal task of reporting on France and Italy (as we will see, in due course he would become responsible for the entire Western European desk). In the second half of the 1930s, Hirschman had built a reputation as an expert on these two countries, writing several articles for magazines and journals and longer reports for international organizations. His biographical vicissitudes, moreover, had made him deeply familiar with the social, political, and intellectual life of the two European countries (Hirschman graduated and took his first steps as a researcher in Italy, and lived in Paris for several years, speaking French like a native). In a number of reports issued in 1947 and 1948, Hirschman

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<sup>4</sup> Based on this kind of evidence, Alan Milward concluded that “the great boom started in 1945” (Milward 1984: xv).



discussed the patterns of reconstruction of these two countries, often in comparative perspective.<sup>5</sup>

As far as France was concerned, the Monnet Plan, published in 1946, was obviously at the forefront of economic debates. The first element that Hirschman underscored, however, was the political dividend of the Plan. As a student of interwar French history—in 1938 he had graduated from the University of Trieste with a thesis on the Franc Poincaré—Hirschman knew how France was historically characterized by bitter political factionalism. Yet, parties across the entire political spectrum rallied around the Plan. Always alert to the political culture of the countries he visited, Hirschman noted, “It may be that the idea of a national economic goal appeals strongly to the French people because of the frustrating lack of direction from which they suffered during the interwar period” (Hirschman 1947a: 366).<sup>6</sup>

This political convergence would be impossible in Italy, burdened by political deadlock, incomplete sovereignty, and the problems left by the legacy of the Fascist *ventennio* (Hirschman 1947a). And yet, despite a better political landscape and the vision of the Monnet Plan, Hirschman saw several shortcomings in the French economic policies. Surely, the simultaneous presence of price inflation, currency expansion, and credit shortage posed difficult problems of policy making—but then, the shallow rhetoric of the French Ministry of Finance, who claimed that no monetary inflation existed in the country, did not help. Hirschman brazenly likened

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<sup>5</sup> These and following reports were circulated through the *Review of Foreign Development*, a Fed in-house publication, for internal use and marked “Confidential”.

<sup>6</sup> Hirschman’s thesis has been published as Hirschmann 2004.

this statement to the sophisms of German economists in denial of the inflation of 1920-23 (Hirschman 1947b). More convincing (and realistic) was the decision to slow down the investment program envisioned by the Monnet Plan, and at the same time use a limited amount of inflationary finance to maintain a reasonable level of planned investments.

As inflation appeared to be permanent, *pace* the Ministry of France, and had clearly negative consequences on French exports, Hirschman anticipated the need for an adjustment of the exchange rate (Hirschman 1947c). The French government capitulated only in January 1948, operating unilaterally a differential devaluation that privileged exports to the dollar area and made French multiple exchange rates possibly more complicated than they already were. Necessary though the devaluation was, it had been badly conceived, and no effort was made to explain it to foreign governments or to the new Bretton Woods institutions (the International Monetary Fund and the British government raised loud protests). Hirschman circulated an insightful analysis to explain the substantive reasons behind what he, too, considered a needlessly confrontational move (Hirschman 1948a).

Italy's exchange rate policies, in contrast, seemed to Hirschman both well-conceived and effective. As he wrote, "The least that can be said about postwar Italian exchange rate and exchange control policies is that they have displayed remarkable inventiveness" (Hirschman 1947d: 6). The Italian government, Hirschman noted, had hardly regained sovereignty over foreign trade and monetary policies when it introduced a bold scheme of incentives to exporters, which permitted them to retain or sell 50 percent of their hard currency earnings, provided they would be used for the purchase of licensed imports (this was called the "50 percent system").

Despite a number of shortcomings, the system seemed effective, both for the positive expectations that it helped create about the country's future trade policy, and for its flexibility with regard to a number of different problems: "The original objective of this arrangement was to provide an incentive for exports without an open depreciation which would have had unfavorable psychological consequences and would also have put more lire [sic, the Italian plural for lira] into the hands of the then still numerous Allied troops in Italy. Its principal merit proved to be the flexibility it afforded at a time when both internal Italian and world prices were subject to wide fluctuations" (Hirschman 1947d: 6; on the 50 percent system, see also Hirschman 1947e).

Hirschman recognized the same flexibility and inventiveness in the Italian policies to fight inflation, and in particular in the credit restrictions put in place between August and October 1947 by Luigi Einaudi, the Minister of the Budget and former Governor of the Italian Central Bank (and, from May 1948, first President of the Italian Republic). Hirschman had high praise for the mix of orthodox and expansionary measures for their ability to foster economic growth while preserving monetary stability. In fact, the shortages of cash, deflationary tendencies, and difficulties of the productive system caused by Einaudi's orthodox policies triggered large scale governmental compensatory spending. As Hirschman noted, "the Italian Government became involved in the contradiction of having its Minister of Industry undo what had been done by its Minister of the Budget", and added, tongue in cheek: "It is certainly curious to notice how Einaudi's 'orthodox' policy

actually led to more State intervention in, and greater State control of, Italian economic life” (Hirschman 1948b: 8).<sup>7</sup>

But despite this apparent paradox, the combination of deflationary credit restrictions and expansionary subsidies in selected fields (in particular in the heavy industry) was indeed a rational policy in the wake of the violent inflation that Italy had been experiencing. As Hirschman explained, “Initially, the ‘open’ postwar inflation . . . probably permitted reconstruction to proceed more rapidly than might have been possible under conditions of monetary stability. But as the pace of the inflation quickened, an increasing portion of the investment . . . was wasteful and often competed successfully with genuine reconstruction and modernization activities. It thus became actually easier *and possibly tempting* to carry on these activities in a deflationary environment” (Hirschman 1948b: 8, emphasis in the original). In other words, for Hirschman it was of little use to reason in terms of absolutely correct or incorrect policies. More interesting was to devise a sequential process in which apparently incompatible policies responded to specific needs, resulting in more complex but perhaps more realistic analyses of policymaking processes.

And this was not all. With an optimistic attitude that would become a signature of his work, Hirschman highlighted the possible beneficial and unintended consequences of a difficult situation. Following Einaudi’s credit restrictions, “the temporary recession had another consequence which may prove beneficial in the long run: it exposed the profound maladjustments in

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<sup>7</sup> Adelman (2013) mistakenly interprets this consideration as the demonstration that Hirschman disagreed with Einaudi’s policy.

Italy's industrial structure which had remained hidden as long as prices rose" (Hirschman 1948b: 8). Thus, a temporary setback was not necessarily negative, if it offered the opportunity to spot and correct distortions that were previously invisible.

In sum, as Hirschman noted, the Italian government had managed to maintain monetary stability for over a year and expand production. Of course, that was only a first step. Further investments were needed, but there was also a widespread concern that an excessive acceleration in the investment rate would lead to renewed inflationary pressure. What was the optimal level of investments? Typically, Hirschman refused to embark on this line of research, which dominated contemporary growth theory. As he wrote, "The answer to this question can be found only by trial and error" (Hirschman 1948c: 13). And continued: "It is an over-simplification to present the whole argument only as the question: How much investment can the Italian economy stand without inflation? Rather than to engage in a futile search for the 'correct' aggregate volume of investment, one should concentrate upon locating those investments which permit the breaking of important bottlenecks and will thereby lead to increases of output and improvements of performance out of proportion to the investment itself" (Hirschman 1948c: 13).

Several important points stand out here. First, Hirschman gave pride of place to processes of learning by doing, and considered theoretical analyses of only limited efficacy. As he wrote in another passage devoted to the reconstructions strategies of the Italian economy, "action implies the taking of certain risks. . . . *a priori* deductions, while instructive, can only yield extremely rough guesses and are not able to replace as yet the method of trial and error" (Hirschman 1948c: 3). Second, a static analysis was of no

use, as it was impossible to ascertain the “correct” policy measure or the “correct” volume of investments. He feared that “much time may be lost in looking for a simple formula that will ‘set things right’” (Hirschman 1948c: 3). The point, instead, was precisely to avoid this elusive quest for a univocal remedy and to recognize that “the necessity to walk on a very narrow path between deflation and inflation” required the development of new methods for using foreign aid and domestic policies (Hirschman 1948c: 3). In other words, Hirschman argued, “the therapy to be prescribed is thus quite likely to be unorthodox” (Hirschman 1948c: 3). Third, this unorthodox therapy called not only for sequential solutions based on a method of trial and error, but also for selective policies. In a situation in which available resources were severely limited, Hirschman recommended privileging those investments that, by breaking bottlenecks, would unleash further investment opportunities. Ten years later, Hirschman would coin for this process a new label—“backward and forward linkages”—that granted him a place among the pioneers of development studies (Hirschman 1958). But the concept was already crystal clear in his mind in 1948. The unexpected dynamism that the Italian economy showed in postwar reconstruction and the way the Italian people reacted to the right policy incentives in hard times would later serve as an inspiration to study how poverty and underdevelopment could be successfully tackled.

### **3. Postwar European Reconstruction and the Dollar Shortage**

The lack of resources to support basic consumption and to reactivate production was a fundamental problem in early postwar Europe.

Obviously, the problem existed already in the war years, but rationing,

economic planning and, for the sterling area, the Lend-Lease program (started in 1941) mitigated its effects.<sup>8</sup> These, however, emerged abruptly after the war. In its first annual report, drafted in a hurry after having opened for business in May 1946, even the International Monetary Fund (IMF) recognized that there was “a severe shortage of goods of all kinds that must be obtained from abroad”, and that for several countries “exchange restrictions are unavoidable . . . in order to assure that the most essential requirements for consumption and reconstruction will be met out of their limited foreign exchange resources” (IMF 1946: 11). But the problem was not so much limited foreign exchange in general, as limited reserves of hard currency, that is, dollars (see, e.g., Hansen and Kindleberger 1942; Kindleberger 1943, 1949). By the spring of 1947, the “dollar shortage” had become *the* problem for economists and government officers working on European reconstruction and recovery (labels multiplied quickly: dollar famine, dollar grip, dollar crisis).<sup>9</sup>

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<sup>8</sup> For contemporary discussions of the dollar problem and the postwar international monetary system, see for instance Crowther 1941, Bryce 1942.

<sup>9</sup> All these definitions can be found in Chatham House, various years. The same documents show that preoccupations about the dollar shortage grew steadily in the spring of 1947 and took off in August 1947. On September 19, 1947, the UK Chancellor of the Exchequer told the press that his government was planning to purchase dollars from the World Bank, though in fact the Bank was highly undercapitalized, see Chatham House, various years, issue of September 8-21, 1947: 534. On October 2, 1947, French Foreign Minister George Bidault announced the US press that France would exhaust its dollar reserves within a month, see Chatham House, various years, issue of September 22-October 5, 1947: 575. Three weeks later, on October 23, 1947, the British government announced “immediate reductions in dollar expenditure on food”, Chatham

Truth be told, not all agreed. Fritz Machlup, for instance, had been maintaining for years that the idea of a dollar shortage was “faulty”. As commodities can become scarce only at an excessively low price, he argued, an appreciation of the dollar would suffice to eliminate any shortage and restore equilibrium (Machlup in Haberler et al. 1942: 209; a similar position was held by Ellis 1948).<sup>10</sup> Roy Harrod dismissed the idea of a dollar shortage as “one of the most absurd phrases ever coined”, “nonsensical”, and “one of the most brazen pieces of collective effrontery that has ever been uttered” (Harrod 1947: 42-43). In any event, even those who considered this a false problem felt compelled to write about it. A veritable “flood of contributions” to the discussion of postwar international monetary problems quickly developed (H. W. A. 1944: 217).

In mid-1948, Hirschman observed that monetary explanations of the phenomenon had acquired particular relevance after the slowing down of European recovery in 1947, as domestic inflation had caused a deterioration of the balance of payments of several countries. This position had considerable appeal, as it offered a solution to balance of payments difficulties through an adjustment of exchange rates, clearly an easier

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House, various years, issue of October 6-26, 1947: 605. It was expected that by the beginning of 1948 also Austria and Italy, in addition to France, would exhaust their dollar reserves. US Secretary of State George Marshall called for an interim program of loans to let the people of these three countries “continue to eat, work, and survive the winter”, see Chatham House, various years, issue of November 10-23, 1947: 672.

<sup>10</sup> This, however, would not be particularly effective with commodities whose price elasticity of demand was very low, such as tin and rubber and in general inputs to industrial production (Crowther 1941).



proposition than that contemplated by scholars focusing on issues such as the industrial structure and trade patterns.

Yet Hirschman claimed that, precisely because the task of structural industrial reforms was difficult to embrace, the difficulties encountered by European countries might offer an unexpected opportunity. As he wrote, “The relaxed tension of domestic demand, the greater availability of labor, and the symptoms of depression in nonessential activities, all of which characterize at present the economic situation in a number of European countries, are merely presenting these countries with an opportunity to carry out such readjustments in their productive structure as may help to render them eventually independent of foreign aid” (Hirschman 1948d: 6-7). Present difficulties, in other words, could activate the political resources to restructure the national economy—a proposition that that governments would happily disregard in easier times.

Moreover, Hirschman posited that the causal relationship between inflation and balance of payments disequilibria worked both ways, that is, not only were balance of payments deficits caused by domestic inflation, but inflation was, in turn, a consequence of balance of payments deficits. Net imports from the US did not have an unequivocal deflationary impact. Surely, grants and loans aimed at jump-starting reconstruction and investment activities would eventually result in an increased flow of goods, but in the short run they might well have an inflationary effect. “Because of their ‘bottleneck’ nature”, Hirschman explained, they created the conditions to employ idle domestic labor and raw materials while individual savings remained very low and speculation in inventories became common practice (Hirschman 1948d: 7).

Undoubtedly, this analysis made the effects of imports on domestic monetary dynamics less easy to forecast. But what was lost in immediate clarity was gained in realism, making it possible to classify imports according to their deflationary or inflationary impact. Replacement of damaged machinery would not have any inflationary effect, but new machinery would. Foodstuffs would have a deflationary effect, unless they created the conditions to divert labor resources to new investment activities. Imported “essential luxuries” such as films and tobacco, characterized by rigid demand, high prices and high consumption taxes, drained domestic purchasing power and thus had a strong deflationary effect.

At first sight, calling for both monetary stability and increasing output might seem incongruent, like calling for deflation and inflation at the same time. Yet Hirschman’s analysis helped clarify policy options: “If disinflation is brought about and is maintained by a reduction in essential investment expenditures, the cure may be worse than the disease; if, on the contrary, it is caused by a curtailment of expenditures for non-essential investment and consumption, and if the resources thus released are gradually channeled into export industries and essential investments, disinflation can indeed make a considerable contribution to the economic rehabilitation of the areas now dependent on aid from the United States” (Hirschman 1948d: 8).

This conclusion was clearly relevant for a broader audience than the Fed staff, and Hirschman republished the report on the *American Economic Review* (Hirschman 1948e). In his discussion of the relationship between recovery and monetary problems, Hirschman tried to complicate economic analysis to gain in realism. In turn, this greater realism made it possible for

him to discern between different types of imports and their effects on domestic inflation and on the balance of payments, thus offering a useful compass for policymaking. Because of this approach, moreover, Hirschman was able to reflect on how apparently contradictory measures, when applied in sequence, gradually and for limited periods, could work in practice. In the same vein, he observed that working on dichotomic alternatives (e.g., monetary stability versus productive expansionism) was often misleading. More useful was to develop a feeling for sequences or combinations of different policies tailored to specific situations. All these elements, so visible in Hirschman's analyses of postwar European reconstruction, would become important features of Hirschman's trademark style of thought.

Important as they were, however, balance of payments problems were only one of a constellation of critical issues for European recovery. Strictly related to them was the problem of currency inconvertibility.

#### **4. The Problem of Bilateralism**

The Marshall Plan, announced in mid-1947 and operative in 1948, "solved the Catch-22 of having to export in order to pay for imports but being unable to produce for export without first importing materials and machinery" (Eichengreen 2007, p. 65). The Marshall Plan, in other words, helped jump-start domestic production and reactivate market mechanisms, since countries accessing to American aid "had to commit to putting in place the prerequisites for a functional market economy" (Eichengreen 2007, p. 66). Moreover, by reducing the burden under which European countries operated, the resources made available by the Marshall Plan

helped defuse potential social tensions and conflicting claims by laborers and enterprises, facilitating the domestic distributional compact of the postwar period.

As we will see, another step to reinforce this compact would be the establishment of the European Payments Union (EPU) in 1950.<sup>11</sup> But in 1948, while the domestic side of recovery was in motion, international economic relations remained extremely difficult. The problem of inconvertibility seemed intractable, and the failure of British policy only worsened the prospects for a quick return to multilateralism and monetary stability. As Eichengreen wrote, “By the late 1940s, Europe’s trade resembled a spaghetti bowl of more than two hundred bilateral arrangements” (Eichengreen 2007, p. 73; see also Diebold 1952). These agreements reproduced those used in the 1930s, with very limited credit facilities to finance imbalances; once the credit limits were reached, gold and dollar payments were required. As a consequence, in the eventful year of 1947, the volume of intra-European trade declined significantly. France ceased importing from Belgium in 1947, and from Sweden in 1948. As one of the policy makers involved in international negotiations wrote, “the ghost of the 1930s was still there, live and daunting” (Carli, 1988, Oatley, 2001).

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<sup>11</sup> Standard references on EPU are Triffin 1957 and Kaplan and Schleiminger 1989. A new wave of literature on EPU was occasioned by the collapse of the Soviet Union and the related question on whether EPU might work as a template for monetary arrangements among former Socialist countries. There is no need to refer to that literature here. A fine short introduction to that debate is Eichengreen 1993.

European governments made several attempts at building a multilateral clearing arrangement, establishing a First Agreement on Multilateral Monetary Compensation in November 1947 (involving Belgium, Luxembourg, the Netherlands, France and Italy) and two Agreements for Intra-European Payments and Compensation in October 1948 and June 1949 (for all OEEC countries). The problem was so serious that US authorities tried to support the functioning of the 1948 and 1949 Agreements by allowing the use of Marshall Plan funds for intra-European trade settlements—a scheme known as “the Little Marshall Plan”. The results, however, were modest, as these schemes were unable to overcome the structural imbalances between surplus and deficit countries and did not offer any compelling incentives to foster continental cooperation. No additional resources to extend credits were committed, and on top of that, all sorts of flaws crippled the system. In the words of Robert Triffin, “this new system considerably modified the relative bargaining strength of the various countries in their negotiations, stimulated bilateralism at the expense of competitive forces as the determinant of the intra-European trade pattern, paralyzed and discouraged successful readjustment policies, and led in a number of cases to a further aggravation of the intra-European payments problem” (Triffin 1957: 153; see also Eichengreen 1993; Kaplan and Schleiminger 1989).

By the summer of 1948, Hirschman’s duties encompassed more than the preparation of country reports on France and Italy (and occasionally other European countries, such as Switzerland). Invitations to make critical assessments of broader systemic problems of intra-European cooperation multiplied. Tellingly, they arrived not only from the Fed, but also from other agencies based in Washington, DC, most prominently the Economic

Cooperation Administration (ECA), in charge of managing the Marshall Plan.

Hirschman offered original and impactful contributions to the discussions that shaped the road to multilateralism and European integration under the stimulus of the Marshall Plan institutions. As mentioned in Section 2, these were fields of research that had figured prominently in Hirschman's experience as a young economist in 1930s Europe. His early studies on trade policy and exchange controls provided strong evidence of the economic and political effects of international disintegration, and of the discriminating use of the network of bilateral agreements that characterized European trade relations. In particular, Hirschman demonstrated that bilateralism was not merely a second-best solution in times of shortages of international liquidity. Instead, the essence of bilateralism rested on a strategy designed to conquer and exert political supremacy and influence, and all the leading powers—not only Nazi Germany, but also Great Britain—were more or less openly committed to this practice. What Hirschman's studies from the interwar period contributed most to that debate was the statistical inventiveness for measuring the numerous varieties of bilateral agreements. The elaboration in 1939 of a "Hirschman index" of bilateralism soon became familiar in the scientific literature and reached a wider audience (Hirschman 1939; see also Asso 1988). The quantitative evidence he carefully provided in his monograph *National Power and the Structure of Foreign Trade* (1945) unveiled the subtle and widespread connections between international value chains and the escalation of nationalism. Since bilateral agreements had figured prominently in the disrupted postwar scenario, Hirschman's

knowledge of their intricacies became particularly useful for understanding postwar trade relations.

Economists from the ECA and the State Department in Washington played a crucial part in steering Hirschman's research agenda toward these most challenging debates on the future of a new European order. At the beginning of 1949, as he later recalled, "my office was virtually transplanted from the Federal Reserve Board to the new ECA building. I much enjoyed taking part in this manner in the 'activism' of this group [Van Cleveland, Ted Geiger and John Hulley], which constantly invented new functions for the Marshall plan and its dollars" (Hirschman 1997: 39; see also Hirschman 1993: 78-79). In this stimulating environment, Hirschman found support to the view that the US had a fundamental interest in seeing European countries converge to a unified economic and political platform, so that the US could deal not with multiple positions but with a politically consistent counterpart. A number of governmental offices in Washington, DC, embarked on the task of promoting ideas and solutions to realize this project, and Hirschman became a regular member of the ECA seminars and meetings.

## **5. Hirschman's "Proposal for a European Monetary Authority"**

On October 31, 1949, Paul Hoffman, the head of the ECA, gave a speech in Paris in which he emphatically insisted on the need for European "integration". The speech is remembered as the beginning of a new phase in the history of the Marshall plan and of European integration. Among the ambitious goals enumerated by Hoffman to his audience at the Organization for European Economic Co-operation were the reduction of

intra-European trade barriers; the restoration of multilateral agreements; the coordination of monetary and fiscal policies; and, in due course, the formation of a single market. In the same weeks, the small group of ECA economists assisting Hoffman in Washington, informally invited Albert Hirschman to write a proposal for the establishment of a new European Monetary Authority (EMA).<sup>12</sup> Hirschman's proposal, submitted between the end of October and the very first days of November 1949, was not a "book of dreams" but an audacious though realistic attempt at devising a possible path of European monetary cooperation in the postwar years.<sup>13</sup>

As Hirschman warned, times were not ripe for major institutional innovations or any substantial surrender of national sovereignty over monetary affairs. Moreover, on fiscal matters, distances between European countries appeared insurmountable. According to Hirschman, this implied that all references to terms like "a common currency" or "a common reserve bank" or a "common monetary policy", should be carefully avoided in official documents, let alone in the public debate. At this stage, it was simply "futile to ask whether we are for or against a 'common currency' for Europe": the power of central banks over their national economies, beginning with the control over the monetary base or over the legal

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<sup>12</sup> Hirschman's paper was also written as a follow-up to the proposal for a "Reserve bank for Europe", prepared by the Financial Sub-committee of the European Assembly that reunited in Strasbourg in August 1949, see Albert O. Hirschman, "Proposal for a European Monetary Authority" (henceforth, "Proposal"), Albert O. Hirschman Papers, Box 65, Folder 7, "Federal Reserve Correspondence and Papers", Mudd Library, Princeton University (henceforth, AOHP).

<sup>13</sup> Hirschman, "Proposal". On November 2, 1949, H. Van Cleveland transmitted Hirschman's memorandum to the Program Secretary "for study and comment".



framework for credit supervision and financial stability, would not be curbed for a long time.<sup>14</sup>

A successful move toward greater European integration was thus only possible if the US could convince European governments to accept a functionalist approach. European integration could be realized in stages, and the first step was the creation of a European authority in charge of facilitating stronger policy coordination, gradually promoting solid political ties, if only as a reaction to “the failure of the partial attempts undertaken in the economic area”.<sup>15</sup> By sowing the seeds for endogenous processes of integration and by building “new institutions in ‘the interstices’ of the national prerogatives”, policy cooperation would foster economic convergence. These processes, in turn, would “become prerequisites for greater political unification”.<sup>16</sup>

Built upon this general background, the core of Hirschman’s proposal discussed the internal and external functions with which to equip the new Authority. Among the former, Hirschman emphasized the crucial importance of building an organization characterized by a high degree of transparency in its operations, and excellent statistical expertise. The Authority should design and implement standard procedures and instruments for the production and elaboration of statistics across all

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<sup>14</sup> Hirschman, “Proposal”: 2, AOHP.

<sup>15</sup> Hirschman, “Proposal”: 1, AOHP.

<sup>16</sup> Hirschman, “Proposal”: 2, AOHP.

member countries. As Hirschman pointed out, it was of the utmost importance that “its decisions were based on comparable data”.<sup>17</sup>

The coordination of national monetary policies implied that the new Authority held advisory functions on the use of traditional instruments of monetary policies, such as the management of interest rates, reserve requirements, the control of new capital issues and other forms of qualitative interventions over monetary aggregates and the behavior of commercial banks. Under limited circumstances, as in times of crisis or of major imbalances, this advisory role could take the more proactive form of “veto powers over all decisions taken in this field by national monetary authorities”.<sup>18</sup> As for the possibility of gaining some voice in deficit financing, Hirschman recognized that this was a thorny issue, also because the matter of central banks’ independence was very loosely defined or guaranteed by most European countries. In this respect, it was quite unthinkable that the new Authority could exert any fiscal moral suasion, not to mention any direct power, over national central banks. As a more realistic option, Hirschman suggested that the Authority be allowed to lend funds for public projects functional to increasing European integration, particularly in the fields of infrastructures and public utilities. But Hirschman also acknowledged that in terms of feasibility and efficiency, a specialized credit institution such as a new European Investment Bank would be more fit to fulfill this function than a reserve bank.<sup>19</sup>

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<sup>17</sup> Hirschman, “Proposal”: 3, AOHP.

<sup>18</sup> Hirschman, “Proposal”: 2, AOHP.

<sup>19</sup> Hirschman, “Proposal”: 3-4, AOHP.

Fiscal policies were another sensitive matter, and it would be unrealistic to imagine that they could fall under the domain of the new European Monetary Authority. Yet Hirschman believed that the new institution could have important advisory functions in this field, discussing with national governments the general aims of fiscal policies and offering its help on matters of sustainability of public debts. As he put it, “it would be quite impossible for a supra-national body to meddle in national affairs to the point of objecting to (or of promoting) a particular public expenditure or of asking for the introduction or abolition of a particular tax”.<sup>20</sup> Nevertheless, the Authority could exert moral suasion to inhibit practices of excessive debt monetization through inflationary financing, and develop forms of conditionality in order “to make it more difficult for the national governments to pursue irresponsible fiscal policies”.<sup>21</sup>

The second part of the proposal discussed external functions—a somewhat easier and more realistic goal, Hirschman believed. The first step was the partial pooling of Europe’s foreign reserves for exchange intervention and the management of ECA dollars. The new Authority could act as a European Exchange Equalization Account, having the same functions in managing interventions and sterilization policies in the foreign exchange and gold markets as the many national Accounts created in the 1930s. At a later stage, the Authority would acquire responsibility for approving exchange rate variations, including the power to recommend parity changes if deemed necessary for greater stability and integration. Though Hirschman conceded that this would be a “bold step” that trespassed into IMF

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<sup>20</sup> Hirschman, “Proposal”: 4, AOHP.

<sup>21</sup> Hirschman, “Proposal”: 4, AOHP.

prerogatives, he did not see—or decided to ignore—its disruptive potential.<sup>22</sup> In fact, one year earlier, the IMF had deeply cooled its relations with ECA on matters of surveillance and conditionality, denying the use of Fund resources to members of the European Recovery Plan (see Horsefield 1969: 219; James 1995, 1996).

In the discussion of external functions, Hirschman introduced several elements that better defined the general strategy and vision of the Authority. In his view, the new Authority should behave more as a producer of public goods and services on behalf of the whole continental area, than as a policy maker preoccupied with growth policies or with fostering international convergence, perhaps at the risk of creating difficulties for—and discontent on the part of—its member states. For instance, the Authority would be in a perfect position to promote the development of an efficient European interbank market, necessary for refinancing development banks and other credit institutions. Moreover, Hirschman imagined that the new Authority could incorporate the Bank for International Settlements, thereby acquiring responsibility for a smooth management of intra-European monetary imbalances and more in general for exchange controls within and outside the area.

A crucial point was the coordinated management of European reserves. Again, Hirschman cautioned against the dangers of possible conflicts of national interests. First, the Authority should use reserves as shock absorbers, offsetting extra-European pressures and promoting stability on exchange and monetary markets. While in the short run, this would help reduce pressures due to the dollar shortage, in the long run (and in

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<sup>22</sup> Hirschman, “Proposal”: 5, AOHP.

particular after the end of the Marshall Plan) it would provide collateral for stabilization loans. As Hirschman put it, the pooling of reserves would increase the leverage for obtaining stabilization loans before the financial community, particularly if these loans were not conceived for specific investment purposes but “were designed to induce greater confidence in European currencies”.<sup>23</sup>

Finally, to further enhance its power over national countries, the new Authority should have a voice over the approval of IMF loans to European countries. By no means, Hirschman concluded, should reserves coming from one country be used to finance an increase of imports or investments of another country, thus favoring artificial convergence. This, he warned, would be the very end of the European project: “the best way to doom any move toward European Union is to conjure up the vision of equalization of the Swedish and Italian standards of living”.<sup>24</sup>

As for the governance of the Authority, Hirschman remained vague, recognizing the novelty of “a central monetary institution without a central government”.<sup>25</sup> Two points, however, received specific attention. The first had to do with the voting rules, of which Hirschman was adamantly opposed to any idea of unanimity; to guarantee promptness and effectiveness, “the Board would vote by majority rule”.<sup>26</sup> The second had to do with the composition of the governing body, which, according to

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<sup>23</sup> Hirschman, “Proposal”: 6, AOHP.

<sup>24</sup> Hirschman, “Proposal”: 5, AOHP.

<sup>25</sup> Hirschman, “Proposal”: 8 AOHP.

<sup>26</sup> Hirschman, “Proposal”: 8, AOHP.

Hirschman, should be formed by national central bankers and government officials, together with a number “of outstanding Europeans with knowledge of financial and economic affairs”, who would represent “the interests of the European area as a whole”.<sup>27</sup> This mix of governmental *grand commis* and members of the professions and civil society would become, according to Hirschman, an important precedent for the architecture of other European institutions.

Clearly, the proposal contained several novel elements, combined with a strong dose of political realism. More in general, Hirschman’s proposal represented “a half-way house”, as he put it.<sup>28</sup> The surrender of economic sovereignty would remain initially limited to the management of reserves, though it was expected that the Authority would in due course expand its powers over monetary policy and, eventually, over fiscal and economic policy. At the same time, the real mission of the European Monetary Authority—or “EMA’s goodwill”, as Hirschman put it—was the production of public services for the construction of a united Europe. To this extent, it was crucial that improper interferences into the affairs of member countries be carefully avoided.<sup>29</sup>

On December 4, 1949, the group of ECA economists that had commissioned Hirschman’s proposal signed a memo endorsing the establishment of a European Monetary Authority. Van Cleveland, Geiger and Hulley acknowledged their debt to Hirschman’s study, which had provided both

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<sup>27</sup> Hirschman, “Proposal”: 8, AOHP.

<sup>28</sup> Hirschman, “Proposal”: 8, AOHP.

<sup>29</sup> Hirschman, “Proposal”: 8, AOHP.

vision and technical insights. Though the proposal was boldly described as “a first critical step toward the objective of a single market and a common market”, the ECA economists admitted that its priority was the restoration of a multilateral regime in intra-European trade and payments, providing a solution to the problems of the gold and dollar shortage.<sup>30</sup> The new Authority would speed up the liberalization of trade, increase intergovernmental coordination, and convince reluctant countries to avoid excessive imbalances. A payments union would soon see the light of day, but the more creative vision of a monetary authority was too far ahead of its times.

## **6. The Political Economy of European Cooperation**

By the end of 1949, Hirschman felt more in agreement with the ECA than with his direct employer, the Fed, in particular as far as the ECA’s attempt to restore a limited European area of multilateralism and convertibility was concerned. Of course, Hirschman’s biography mattered. First, he had a close acquaintance with the OEEC general secretary, Robert Marjolin, whom he had known since his days in Paris, when Marjolin asked Hirschman to write regular reports on the Italian economy (Hirschman 1987b; 1997). Second, and more importantly, Hirschman was deeply influenced by the leaders of European federalist thought, beginning with his two brothers-in-law, the late Eugenio Colorni and Altiero Spinelli. Finally, the message conveyed by his first book on *National Power and the*

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<sup>30</sup> V. Cleveland, T. Geiger, and J. Hulley, “Proposal for the Establishment of a European Monetary Authority (EMA)”, April 17, 1950, AOHP.

*Structure of Foreign Trade* provided substance for second best policies, regional integration, economies of scale, and the creation of a common market.

Historians have long acknowledged the role of the ECA and the OEEC in fostering not only European reconstruction but also cooperation. According to Eichengreen, if in the early postwar years European countries were able to go through a rapid economic expansion based on “catch-up growth” and “convergence”, this was due to a specific set of institutions particularly well suited to sustain capital formation in an age of “coordinated capitalism” (Eichengreen 2007). At the international level, in particular, institutions promoting regional integration acquired a major propulsive force, especially at a time when the quickly escalating confrontation between the two superpowers and the onset of the Cold War provided unique conditions for European cooperation. Not only did Europe’s military dependence on the two superpowers free additional resources that were funneled to capital investment, but the very logic of bloc confrontation made the superpowers particularly eager to promote regional integration. Indeed, many officers involved in the administration of the Marshall Plan agreed that perhaps the most important result of US aid to Europe was not physical reconstruction, but intergovernmental cooperation.<sup>31</sup>

With the establishment in 1950 of the European Payments Union (EPU), the discriminatory policies that had suffocated trade relations in the early postwar years were, for the first time since the end of the war, superseded by a truly multilateral clearing system. If between 1945 and 1950 economic

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<sup>31</sup> See for example Bissell 1996; on the European side, see Carli 1996. Useful analyses are also Toniolo 2005 and Yeager 1976.



recovery was often endangered by a pervasive tendency to bilateralism, frozen balances, and new protectionist policies, the EPU paved the way to increasing trade and economic cooperation and became one of the elements that lay the foundations of Europe's postwar "economic miracles" (Hennessey, Lutz, and Scimone 1964).

Already with his proposal for a European Monetary Authority, Hirschman had showed his unabashed support to European integration based on the reduction of trade restrictions and the restoration of multilateral payments. Though the project for a European Payments Union was less ambitious, Hirschman considered it a fundamental step in the right direction nonetheless. As he wrote in a Fed report, either Europe would move ahead on its path toward regional multilateralism, or a destructive backlash would set in: "in the absence of positive steps, further disintegration is the likely course of affairs . . . At every shock, cyclical or otherwise, the national economies are likely to look to further insulation as a way out" (Hirschman 1950a: 18).

As mentioned, early postwar attempts at recovering multilateral relations had all resulted in a fiasco. More aspirational than real in their effects, they were unable to restore confidence and smoothness in payments. The first schemes of intra-European agreement remained essentially bilateral and failed to achieve any advance in crucial issues such as the transferability of bilateral balances, the extension of credit facilities, the liberalization of policies, and the management of external crises. By the end of 1949, data showed that multilateral compensation represented only 5% of gross imbalances (Hirschman 1950b). If the Marshall Plan was helping Europe to restart its productive capacity, no solution had yet been found for reviving trade relations. As Hirschman wrote, "in the course of 1949, it became clear

that the main European problem had shifted from the area of production to that of trade and payments” (Hirschman 1950b: 2; see also Yeager, 1976).

In early 1950, thanks to the activism of the ECA, the project of a new Payments Union started to take shape, and Hirschman “became deeply involved” in the negotiations (Hirschman, 1997: 37). As he recalled, “my point of view coincided with that of the ECA. That view wholly supported the European Payments Union, but was opposed vehemently by the Treasury and, to a somewhat smaller degree, the Federal Reserve” (Hirschman 1997: 40).

Despite the lukewarm official position in Washington, Hirschman was not shy about expressing his position. As he wrote, the EPU project represented “a radical innovation in the mechanism of intra-European payments”; moreover, it offered substantive prospects for the revival of trade, the reconstruction of international solidarity, and the establishment of policies of mutual assistance (Hirschman 1950b: 1). Even more than the Bretton Woods organizations, the EPU could achieve important objectives. First, it could create the conditions for higher flexibility in offsetting external imbalances, with the consequent reduction in the use of hard currencies. In this sense, one of its advantages was “that a country does not have to be concerned by deficits with some other countries, provided that these deficits are offset by surpluses in other direction. It thus eliminates bilateral bargaining and permits an expansion of useful trade”. Countries will feel “no need to resort to quantitative restrictions” (Hirschman 1950b: 2).

Secondly, the payments union could become the guarantor of a fair distribution of sacrifices among member countries, and of mechanisms to

redress imbalances between surplus and deficit countries. From this perspective, the EPU resembled closely the original “Keynes plan”, going well beyond the “scarce currency clause” with which the Bretton Woods agreements had watered down the prospects of multilateral surveillance and the principle of equilibrium in the distribution of the burdens of adjustment. Thirdly, the EPU would represent a major step forward in the effectiveness of intergovernmental relations. Under its provisions, rules and procedures were of an automatic nature, and discretionary margins were limited. This reduced potential conflicts both among member states and between the EPU and the IMF. As Hirschman observed, “This arrangement did not seem likely to result in a powerful supranational monetary board whose authority would supersede that of the Fund” (Hirschman 1950b: 4).

From a strictly theoretical perspective, the establishment of the EPU did not imply the surrender of monetary sovereignty and the transfer to the supranational level of policy instruments that were considered advantageous from a national perspective. Yet Hirschman warned against the use of trade policy for the pursuit of full employment.<sup>32</sup> As he wrote, the idea that “new restrictions may be imposed on trade to safeguard employment” was only a bad reformulation of the new economic theory, something that “Lord Keynes branded in his last article as ‘modernist stuff gone wrong and turned sour and silly’” (Hirschman 1950a: 18). Multilateral trade relations, he argued, were the main path to increasing productivity, economies of scale, and investment opportunities, ultimately leading to full

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<sup>32</sup> As Ikenberry 1989 shows, this proposition gained wide currency during the negotiations over the ITO and then in the approval of GATT.

employment. The return to multilateralism augmented the capacity of countries to exploit fully the dynamic forces inherent in international trade, as well as the gains from specialization. Together with Folke Hilgerdt, Frank Graham and other international economists, Hirschman emphasized the growing importance of the changing structure of foreign trade. In his view, intra-industry trade would soon become the main driver of growth in international exchanges, while traditional patterns based on a static division of labor between industrial and non-industrial countries did not represent the future course of European trade. As he wrote, “the multilateral pattern never stood still” and the representation of a static division of labor between industrial and agricultural countries could “be seriously misleading” (Hirschman 1950a: 2). Thus, European countries had nothing to fear from their different rates of growth and industrialization. A well-functioning scheme of multilateral settlement was a necessary condition to lift quantitative restrictions that, together with bilateralism, represented the most tangible, and poisonous, legacy of the 1930s trade and power policy. It was through these passages that Europe could turn reconstruction into recovery, enhancing economies of scale, and growth: “possible harmful effects are more than compensated by a number of beneficial indirect effects”, due to higher competition “and income generating aspects” (Hirschman 1950c: 8).

More than on its theoretical rationale, however, the success of the EPU rested on technical details and, in his reports, Hirschman tried to solve some of the most difficult ones. First, Britain’s participation as a full member was of paramount importance. This required addressing the problem of the sterling balances that many European countries had accumulated after the unfortunate and ill-timed attempt to restore sterling

convertibility. Here, Hirschman suggested, negotiators should cautiously and gradually provide the right incentives to all players in the field. Being “the most problematic debtor” (see also Eichengreen, Fischer and Grilli 1993: 318), Britain ought to be sheltered against excessive pressures on its gold and dollar reserves. At the same time, it was important that sterling maintained a credible key currency status in world markets and in reserve accounts. Credit ceilings, ECA resources and other ad hoc measures should be employed as a buffer stock against the likelihood of gold and dollar losses, to help preserve confidence in sterling in case of extraordinary, unforeseen event (Hirschman 1950b).

As a sign of solidarity, Hirschman proposed that creditor countries should reacquire the possibility of using sterling on a multilateral basis only if they held a net deficit position with respect to the EPU, while at the same time the ECA would allow central banks to deposit sterling balances as part of their reserve requirements within the EPU. Initially, as a form of collective self-reassurance, Hirschman considered it vital to maintain forms of compensation against the use of sterling, and to leave open the possibility to restore restrictions. Way-outs clauses were psychologically important though they would soon become irrelevant by the acceleration of growth: “everything in this sphere will depend not on present commitments, but on the progress of European countries towards balanced payments and on the future growth of European unification” (Hirschman 1950d: 8).

A second crucial issue regarded the old question of the relations between creditor and debtor countries, and the difficulty of finding a compromise between those who believed that credit facilities were excessively generous toward deficit countries, and those who believed that they were inadequate. From this perspective, EPU represented a cooperative solution,

which capitalized on the lessons of the Bretton Woods negotiations and the wavering start of its new institutions. Anticipating IMF hostility against the project, Hirschman suggested that EPU should not become a “soft currency union”, characterized by inflationary pressures, chronic imbalances, and a growing network of discriminatory restrictions against the US. When credit margins were exhausted, the alternative was clear: payments should be made in gold or dollars, and a “sliding-scale” program of structural adjustment should be put in place.

In other words, as Hirschman put it, too soft settlement measures would result “in too large an injection of credit into the intra-European payments system” with inflationary pressures and monetary overhang. Some credit must be granted to deficit countries, but “their gold obligations must increase as their deficit gets bigger” (Hirschman 1950b: 7). Thus, once the first credit tranche was exhausted, the progressive increase in the use of gold and hard currencies would strengthen EPU’s anti-inflationary commitment. At the same time, it would extend creditors’ responsibilities, through a further liberalization of their imports and foreign exchange regulations. As Hirschman observed, these mechanisms had the advantage of increasing symmetry to an unprecedented extent and went further “than any other previous international monetary mechanism in placing responsibility in maintaining international balance on the creditor as well as on the debtor” (Hirschman 1950b: 7). As some later interpreters have argued, the credibility of the commitment reduced uncertainty over a future reversal of European trade relations and transformed the EPU into an actually “Keynesian” clearing union. Flexibility of creditor-debtor relations took place “much more effectively than what the Bretton Woods Agreements had established for the IMF” (Daunton 2008; Oatley 2001).

In his memos on the EPU, Hirschman also urged reluctant countries to consider carefully a third aspect. Besides the financing of imbalances and the saving of hard currencies, the EPU could generate productive externalities and strengthen indirectly the overall competitiveness of European firms. As the reasoning went, a vigorous approach to regional integration would create economies of scale that in turn enhanced innovation and growth: the establishment of a European market “would create greater adaptability and mobility; it would make possible the economies of large-scale productions; and, most important, it would increase competition and would be a spur to entrepreneurial efficiency and initiative. As a result, productivity would be substantially increased and Europe’s competitive position in world markets would be immeasurably strengthened” (Hirschman 1950a: 13). Moreover, Hirschman believed that the EPU would also help strengthen the social compact between capital and labor, a fundamental ingredient for long-term growth. Under its umbrella, countries would be able to reduce the deflationary bias of conservative budgetary and fiscal policies, and they would be more effectively insulated from economic fluctuations originating abroad, particularly in the US (Hirschman 1950a). At the same time, regional integration would promote the creation of a “center of strength” in Europe, through the progressive lifting of intra-European barriers with “trade creation” effects that, eventually, would spill over into the external world (Hirschman 1950a). Hirschman emphasized the dynamic, supply-side elements underlying European construction. The removal of intra-European restrictions would produce “the emergence of new types of commodity flows tied to the curtailment of certain types of output and the expansion of other types within the various European countries. . . This will bring about (and

reflect) that more efficient specialization and distribution of productive functions which is the prerequisite for the strengthening of Europe's competitive position in world markets" (Hirschman 1950a: 15 and 17).

Finally, if successful, the effects of the EPU would go well beyond the mere economic realm. Greater integration would be a solid basis for enduring peace, friendship and cohesion. European multilateralism would lead "to the general strengthening of the competitive spirit and of entrepreneurial initiative and in the productivity effects of an improved morale that would come with a free and united Europe. . . . The success of European integration thus hinges on the continued vitality of the Western European society" (Hirschman 1950a: 19).

The EPU, in sum, was meant to embody European solidarity and the sharing of sacrifices. More than the IMF, it could serve "as a ready instrument for equalizing these burdens by the channeling of EPU credits towards those countries shouldering the largest direct burdens and vice versa. In this way, the total volume of credit in the system need not be increased; but the available credit volume would be used and, if necessary, rearranged" so as to provide a more balanced approach to a common effort (Hirschman 1950b: 8). In his last article before the launching of the EPU (August 1950), Hirschman anticipated that the new institution would provide a powerful contribution "to the creation of a single European market" and play a part "in the setting of a common defense effort" (Hirschman 1950b: 8). In a word, it promised to achieve the most difficult objective in the postwar scenario: to become "a genuinely alive international institution" (Hirschman 1950b: 8).



## **7. Beyond Europe: Hirschman and the Postwar International Economic System**

The establishment of the European Payments Union stirred much controversy in the United States, in particular among different branches of government. The Treasury Department, as noted by many commentators, was opposed to it, fearing anti-American trade discriminations, as did the Department of Agriculture. The collaboration between the Fed and the ECA on the EPU became increasingly difficult, and on top of this, the group that had involved Hirschman at the ECA began to dissolve in 1950, when their boss, Paul Hoffman, left for the Ford Foundation. Though in 1950 and 1951 Hirschman continued to write on European matters, he also began to reflect on broader postwar economic issues that went beyond Europe. In two reports, in particular, he discussed how industrialization of less developed regions would affect industrial countries—chief among them the US—and, from the opposite perspective, how US economic trends would affect the development of less developed countries.

For their breadth of analysis and detachment from contingent policy issues, these two reports stand out from Hirschman's coeval production. After three years deeply involved in policy analysis directly related to pressing current debates, here Hirschman made an attempt at examining some longer-term structural elements of global development. Also, these two reports show clear linkages to the studies Hirschman did before and during World War II about the relationship between the structure of international trade and national power politics, and the field of studies that he would address in his next phase, namely, the development of less developed countries.

The first of these two reports, as its title reveals, is about “The Long-Run Effect of Development and Industrialization Abroad on the United States”. Later, Hirschman would describe it as his first incursion in the new field of studies about the development of less developed countries, but this is somewhat misleading.<sup>33</sup> In fact, the article is more about the reaction in the United States and other Western countries toward the prospects for industrialization in less developed regions of the world. The historical record, Hirschman argued, offers several examples of the recurring fears that the catching up of less developed countries triggered in more advanced ones, though the actual reactions, he added, were far from consistent: “In truth, the technically more advanced countries have been remarkably inconsistent in their attitude toward the less advanced countries ever since the rise of manufacturing: they have alternatively and often simultaneously helped, feared, and attempted to block, the efforts of these countries to acquire industrial techniques and equipment” (Hirschman 1950c: 1-2).

The only country constantly to support the development of other regions had been, according to Hirschman, the United States, perhaps because its exports of consumer durables, capital goods, and industrial raw materials would have benefitted from increasing imports by newly industrializing countries. And yet this explanation sounded not entirely convincing. After all, Hirschman reflected, the differences in the structure of foreign trade between the United States and, say, Germany, were not so great as to be able to explain these different attitudes toward industrialization abroad.

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<sup>33</sup> Albert O. Hirschman to H. W. Singer, March 29, 1982, AOHP; Hirschman 1950c.

As he had done in his studies of international trade in the 1930s and 1940s, and as he would do in his studies of development policies in Latin America in the 1950s and 1960s, Hirschman found a better explanation in the role of ideology and in cultural values: “The truth is that German writers took a certain delight in showing that the industrial countries were digging their own grave through the export of machinery and industrial techniques. This propensity for discovering apocalyptic historical vistas has been a general trait of German historical and sociological writing since the 19th century” (Hirschman 1950c: 7). As Hirschman noted, “These numerous prophecies of doom do not teach us so much about the real nature of industrialism, capitalism, and competition as about the state of mind of their intellectual authors, ill at ease in the industrial age, and therefore inordinately fertile in finding proofs for its inevitable dissolution” (Hirschman 1950c: 7). The United States, grown in a different relationship with capitalist development and lacking the many conflicts and strains that had characterized Europe, showed much less intellectual hostility toward the spread of industrial capitalism.

Tellingly, Hirschman, relatively new to the United States, was eager to write in the first person plural when discussing the prospects of the country: “Instead of casting an uneasy eye toward the industrial advances of other countries, we have always believed in the possibilities of further economic and technological progress and in our ability to maintain industrial leadership. Moreover, our economic history testifies abundantly to the benefits of vigorous industrial expansion; and a theory maintaining that any further extension of industrialism, be it within or without our borders, is disastrous or even dangerous, is *prima facie* suspect to us” (Hirschman 1950c: 8, emphasis in the original).

And not only were cultural traits “at least as important as the purely economic ones” (Hirschman 1950c: 8). The rhetoric of economic discourse was also important, and Hirschman devoted several pages to dissect rhetorical figures, such as “The market-destroying effects”, according to which the newly industrialized country starts to compete in third markets and perhaps even in the market of the very country that originally supplied it with the capital necessary for industrialization. “Is it not natural enough then to cast the industrializing country in the role of the snake reared and nursed at the bosom of the older industrial countries?” Hirschman asked. But, he noted, the substance of the issue was more rhetorical than real: “The strength of this argument lies in its simplicity and directness” (Hirschman 1950c: 9).

Hirschman retorted that data showed a different picture, and that the alleged conflict between countries of old and new industrialization was a flawed proposition. International statistics unequivocally showed that imports of manufactured goods increased with the process of industrialization, and that two-thirds of international trade consisted of the exchange of foodstuffs and raw materials against other foodstuffs and raw materials and of manufactures against other manufactures. Hirschman had already demonstrated this pattern in his 1945 book with reference to the interwar period; now it helped understand the implications of the postwar industrialization of less developed regions (Hirschman 1945). In conclusion, Hirschman argued, “*on balance* industrial countries have nothing to fear, and much to gain, from the industrialization of other countries” (1950c: 12, emphasis in the original).

The geostrategic dimension of this process was also very clear to Hirschman. First, in a bipolar world, the Western world and in particular

the United States should not miss the opportunity of using technical and financial aid as a means to keep less developed regions away from the allure of Soviet-style economic growth. As Hirschman put it, “undeveloped countries . . . do not need to buy economic progress at the exorbitant political and human cost which has been paid by the Russian people” (1950c: 14). Second, Hirschman did not abandon his hope for federative processes in Europe and elsewhere. “Closer forms of political association may be required to convert what is today international trade into the interregional trade of tomorrow”, he wrote (1950c: 17).

In another essay, Hirschman and his colleague Robert Solomon addressed the same question of the relationship between the US and the rest of the world, this time focusing not on the effects of industrialization abroad on the US economy, but on how the behavior of the US economy would affect foreign countries (Hirschman and Solomon 1950). Not unlike his 1945 book, this report discussed the unbalanced relationship between one large and powerful economy and a number of much smaller and weaker countries. Not only was the United States the country that produced and consumed most in the world, but, most importantly, the rest of the world was highly dependent on the US economy both as a final market and a source of supplies, whereas the opposite was not true. Furthermore, this unbalanced relationship was not merely quantitative; for less developed countries, access to US technology and financial markets would often mean the difference between being able to increase directly the standards of living of their population and implement large infrastructural investments, and remaining locked into what would be soon called a low-level equilibrium trap (Nelson 1956). For the same reasons, the slowing down of growth in the United States would have immediate negative effects abroad,

not least in the political realm: “For all the world to see”, Hirschman wrote, “Democratic Capitalism would have lost in its ‘competition of performance’ with Totalitarian Planning” (Hirschman and Solomon 1950: 10).

Once again, however, Hirschman aimed at separating actual facts from the rhetoric of unbalanced economic relations. As he put it, “a certain amount of fiction has grown up around the general theme of the devastating foreign effects of a U.S. depression” (Hirschman and Solomon 1950: 9). Indeed, the “obsession” that was developing in some quarters about the mere possibility of a US recession was beginning to produce real effects even in the absence of actual causes. Hirschman could not help reminding his colleagues of the oafish French fictional character of Gribouille, “who . . . threw himself into the water in order not to get wet from the rain” (Hirschman and Solomon 1950: 11). On the strength of his studies on the balance of trade of European countries and on transatlantic economic and monetary relations, Hirschman showed how a US depression would not only provoke problems in other countries, but also open up unexpected possibilities. These might include an improvement of the terms of trade in favor of countries importing from the US, or the implementation of stabilizing policies and other countermeasures that would make them more independent from fluctuations in the US.

As mentioned, in 1951 Hirschman continued to analyze the working of the EPU, for example publishing a report on the surplus condition of Belgium (Hirschman 1951), amid increasing conflicts on the right policies to support European recovery. But he also began to feel that his work was becoming increasingly repetitive. As he later recollected, “A considerable polemic occurred within the government . . . This type of conflict did not seem to go away, and at a certain point I got tired of circling around the

same problems” (Hirschman 1993: 80). Also, in conjunction with rising McCarthyism, his social-democratic and antifascist activism in 1930s Europe made him suspect to the FBI. Though unaware that the FBI had opened a file in his name, Hirschman must have felt that the atmosphere was changing, and he started to look for a new job (Adelman 2013). In 1952, the possibility of going to Colombia as an economic adviser arose, and Hirschman seized it.

## **8. Concluding Remarks: Hirschman’s Analytical Framework from European Reconstruction to Development Debate**

The discussion of Hirschman at the Federal Reserve offers valuable insights on several issues. First, it provides an insider’s perspective about the way the debate on postwar European reconstruction and monetary problems took shape. As we have seen, economists had the difficult task of interpreting an economic landscape that was very uncertain and quickly evolving, and even more than their theoretical proficiency, it was the ability to develop a feeling for specific measures and ad hoc policies that made them capable of elaborating thought-provoking analyses and effective, though often only temporary, solutions.

Together with Robert Triffin, Guido Carli, Per Jacobssen, Alec Cairncross and a few others, Albert Hirschman can be credited as being one of the architects of the new system of European trade relations and multilateralism. This paper shows how he contributed to the theoretical and technical construction of the European Payments Union that soon became the most successful symbol of European integration and, as Richard Bissel claimed, “the supreme organization achievement of the

Marshall Plan” (Bissell 1996: 64). By February 1951, less than six months after the foundation of the EPU, member countries reduced trade barriers, initially by 50, then by 60 and finally by 75%. By 1955, the share of quota-free European trade had risen to 90%. Between 1952 and 1958 three quarters of the member countries’ balances were successfully offset with a very limited use of dollar payments (Rojas 2021). Throughout the 1950s, intra-European trade increased from 10 to 23 billion dollars—much faster than production—fueling the recovery of Western Europe (Eichengreen and Braga de Macedo 2001).

The EPU became much more than the first international monetary institution that functioned effectively after the war. As Hirschman wrote in his recollections, the EPU was “a different and higher form of altruism than the simple commodity aid that had been the essence of the Marshall Plan. It permitted and encouraged temporary discrimination against imports from the US, providing a significant exception to the rule of no discrimination” (Hirschman 1997, pp. 42-43). Though less ambitious, the EPU was an effective embodiment of the spirit that characterized Hirschman’s project of a European Monetary Authority in the Fall of 1949.

Secondly, the discussion of Hirschman’s years at the Fed makes it possible to examine in detail an important phase in the formation of Hirschman as a monetary and economic analyst. By the mid-1930s, Hirschman had become a “freelance economic researcher with a specialty on the Italian economy, living in Paris”.<sup>34</sup> In 1938-39, he had worked on exchange controls in Italy and trade bilateralism in Europe under the supervision of John B. Condliffe,

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<sup>34</sup> Albert O. Hirschman, personal communication to Pier Francesco Asso, 1988 (see also Asso 1988).



whom he would join at UCLA in 1940 to write his first book on the political foundations of international trade relations. Thanks to these formative experiences, Hirschman was able to develop an accurate interpretation of the postwar predicament of monetary and trade authorities, and a feeling for the rationale behind policy choices that at first sight might look contradictory, inconsistent, unwise or simply unorthodox. Clearly, it helped that he was a European himself, as he immediately understood the skepticism of European policymakers toward the quick elimination of trade barriers and discriminatory policies that was proposed by several US quarters. The Special Assistant to the US Secretary of State, for instance, had argued that “responsible statesmen *do* advocate . . . the elimination after the war of those unconscionable trade barriers which inescapably choke the flow of international trade” (Sayre 1943: 13, emphasis in the original). European authorities, however, tended to see the origins of the current malaise in the disruptions that originated from the 1929 Crash of the New York Stock Exchange. As a Chatham House report summarized, the Americans “mistake the symptoms for the disease” (H. W. A. 1944: 218). Hirschman’s ability to “read” the European mindset also better equipped to interpret policy choices in postwar Europe, such as the often apparently disorderly processes of monetary stabilization.

This brings us to the third point, one worth emphasizing: the analytical framework and the attitude for which Hirschman would become famous as a development economist in the late 1950s, based as they were on unbalanced processes of development and other similar metaphors (e.g., putting the cart before the horses and inverted sequences) took shape one

decade earlier in his work as an analyst for the Federal Reserve.<sup>35</sup> In other words, this paper shows how Hirschman's analytical tools developed through an interrelated series of experiences, from the interwar studies on exchange controls, through the early postwar analyses of European monetary and trade policies, to the late-1950s exploits in the relatively new field of development. In a sense, this paper shows how Hirschman became Hirschman.

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<sup>35</sup> This point was central in the analysis of Asso and De Cecco 1987.

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