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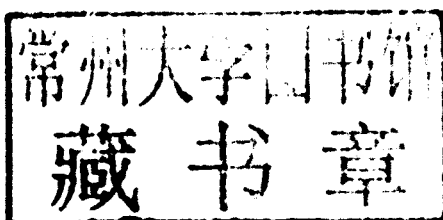
The Financial History of the Bank for International Settlements

Kazuhiko Yago



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The Financial History of the Bank for International Settlements

The Bank for International Settlements (BIS), founded in 1930, works as the “Bank for Central Banks.” The BIS is an international forum where central bankers and officials gather to cope with international financial issues, and a bank which invests the funds of the member countries. This book is a historical study on the BIS, from its foundation to the 1970s. Using archival sources of the BIS and financial institutions of the member countries, this book aims to clarify how the BIS faced the challenges of contemporary international financial systems.

The book deals with following subjects: Why and how was the BIS founded? How did the BIS cope with the Great Depression in the 1930s? Was the BIS responsible for the looted gold incident during World War II? After the dissolution sentence at the Bretton Woods Conference in 1944, how did the BIS survive? How did the BIS act during the dollar crisis in the 1960s and the 1970s? A thorough analysis of the balance sheets supports the archival investigation on the above issues.

The BIS has been, and is still an institution which proposes an “alternative view”: crisis manager under the Great Depression of the 1930s, peace feeler during World War II, market friendly bank in the golden age of the Keynesian interventionism, and crisis fighter during the recent world financial turmoil. Harmonizing the methodology of economic history, international finances and history of economic thoughts, the book traces the past events to the current world economy under financial crisis.

Kazuhiko Yago, Professor at Waseda University, Japan, works on banking history. He published a book on French public sector financial institution, revising his doctoral dissertation “*L'épargne populaire comme fonds de placement public: Caisse des dépôts et consignations (1919–1939)*” which he defended at Université Paris X in 1996.

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Foreword

Basel: a medieval city at the crossroads of civilization and ideas, where the Rhine originating in the Alps transforms into its vibrant middle course. This city, where Erasmus and Nietzsche stood on the university lectern and Hesse set his sights on the world of literature, also is known for the clarity of its church bells. As twilight gradually blackens the current of the Rhine, the sound of the bells ringing at the Münster and the St. Elizabeth Church rises into the European sky.

The primary subject of this book is the history of the Bank for International Settlements (BIS),¹ headquartered here in Basel.

The BIS is an international institution, founded in 1930 with the goal of resolving the reparations problems that arose following World War I. To date, it has functioned as a “forum” for the coordination and drafting of each country’s financial policies. At the same time, as a joint-stock bank the BIS also takes deposits and makes investments. In this book, based on primary materials in the possession of the BIS and affiliated institutions, we will attempt to delineate the history of the BIS, starting with its founding in 1930, from an independent perspective. The focus of this study will be on the BIS’s responses during the various epochs of prewar and postwar international financial history. The main topics of this book are the administration of German reparations, responding to global financial crises, design of postwar international currency systems, policy advice on settlement within the European region, contributions to European currency markets, responses to crises in the US dollar and the British pound and to the system of floating exchange rates, the origin of international bank supervision, and business expansion into Asia.

Let’s review here the history of related studies. While until now historical studies of the BIS have been widespread in a number of areas² – such as its relation to the Nazis during World War II – there have been no studies for a long while that have provided an overview of the entire history of the BIS. In the early period of the BIS’s history, first-rate reportage by contemporary journalists was published,³ and the BIS itself published commemorative works,⁴ but these did not address their subjects as historical studies. In addition, in the period of the BIS’s founding a number of studies were published⁵ including Paolo Baffi’s detailed retrospective study,⁶ and James Baker has attempted a theoretical approach to the contemporary BIS.⁷ Each of these works has covered the BIS

over a limited period of time. While BIS officials assembled an excellent brief history in 1999, it is merely an introduction.⁸

However, in 2005 *Central Bank Cooperation at the Bank for International Settlements, 1930–1973*, by editorial adviser Professor Gianni Toniolo, and Piet Clement, head of library, archives and research support at the BIS, was published.⁹ This achievement by Toniolo and Clement is a voluminous book of more than 600 pages, putting to full use the internal materials of the BIS and truly is worthy of being called an official history. Some important studies followed Toniolo's work, focusing on central-bank cooperation.¹⁰

But why, and how, will we address the BIS in light of the above? Let's elaborate on the motives for this study, from the following four perspectives.

1 The BIS as a “venue” for cooperation between central banks

More than anything else, the BIS was a “venue” for central-bank cooperation. Toniolo's official history too expresses the role of the BIS straightforwardly as an institution that provided “valuable services in international banking and research” while serving also as a “meeting place.”¹¹ Here, for the time being central-bank cooperation refers to cooperative relations for official and unofficial policy coordination by the central banks of each country in the running of international currency and financial systems in international markets. To provide support for these cooperative relations, the BIS has arranged meetings for central-bank governors, in which the governors of the central banks of leading nations gather in Basel for exchange of opinion and policy coordination. In addition, the BIS also has performed the important role of tracing in detail the currency and financial conditions of each country and serving as an accumulation point for information between central banks. But how has the BIS functioned as such a “venue”? That is the first perspective addressed in this book.

From this perspective, a variety of groups of problems becomes apparent. One of these is the issue of just what a central bank is to begin with.¹² Another is the major theme in international currency and financial history of how central banks have cooperated with each other since the establishment of the international gold standard in the nineteenth century.¹³ The theme of why central banks cooperate with each other, or in what situations such cooperation takes place, also has been a subject of recent lively debate in domains such as international political economy and game theory. On this point, “costs” of creation and maintenance of international currency “regimes” such as the IMF are seen to be the standard for review. Perhaps the finest example of such debate in recent years is the debate between Barry Eichengreen and Marc Flandreau on central-bank cooperation.¹⁴

Even when restricting the subject to relations with the BIS, questions such as the following can be asked. How is the central-bank cooperation described above possible at the BIS? How do official and unofficial cooperative relations such as those of the IMF, the Group of Ten (G10), summits between the leaders of

leading nations, or the Group of Seven (G7) differ from those coordinated by the BIS? Or, how “efficient” or “inefficient” has the BIS been among the various “venues”? Toniolo’s official history too treats this issue of the evaluation of central-bank cooperation within the history of the BIS as the most important focal point.

In this book, we will attempt to meet face-to-face the research current described above concerning central-bank cooperation. However, this book will not attempt to use this or that indicator to measure the “success or failure” or the “efficiency” of cooperative relations on the BIS stage. While we recognize the importance of such a debate, what this book will attempt to address is the issue of “interconnectedness,” concerning under what conditions central banks cooperate at the BIS and what kinds of subsequent conditions result from such cooperation. Now let’s look at this approach in greater detail.

The BIS is a joint-stock company in which the governors of the central banks of leading nations serve as directors and each country’s central bank is a shareholder. For this reason, final decision-making authority in the BIS is held by the central banks, and to this extent it could be said that the BIS is an organization subordinate to central-bank policies. However, a full-time secretariat is responsible for day-to-day BIS operations. This secretariat occasionally obtains information overwhelming that of the central banks and executes authority beyond the intentions of the countries. Put another way, while it represents the authority grounded in the currency sovereignty of each country, the BIS also is in an international void beyond the sovereignty of each country. A look at central-bank cooperation in the BIS from this perspective brings into relief the point in dispute of whether this has been active cooperation by the central banks themselves or the table has been set by something else – such as the Monetary and Economic Department that plays a central role in BIS theoretical activities. The actuality of a “venue” for central-bank cooperation has been that of a special stage mixing together the “actors” and the “stagehands” in the shadows. In this book, when addressing the issue of central-bank cooperation we will also attempt to isolate the “interconnectedness” that mixes the actors and coordinators of “cooperation,” focusing on movements in the BIS Monetary and Economic Department in particular.

2 The BIS as a “bank”

At the same time as it promotes cooperation between central banks, the BIS also seeks to earn profits as a joint-stock bank and as a commercial bank. The Banking Department is in charge of the BIS’s activities as a commercial bank. This two-sidedness of the BIS as both a “venue” for central-bank cooperation and a “business” on its own is a unique characteristic not seen in the IMF or the World Bank, both of which were founded later. In this book, as a second perspective for an unobstructed view of the history of the BIS, we will focus on the BIS as a bank, making clear the various phases of its collection of deposits and investment of funds and its distribution of net earnings.

This perspective concerns the following issue domains. The BIS collects deposits and invests them. The counterparties in these activities (i.e., depositors and borrowers) are the central banks of countries and other institutions both large and small. On this point, naturally interest is paid on deposits and loans. But does this interest satisfy the intents of depositors and borrowers? Furthermore, has no conflict of interest arisen with the central banks, who were shareholders at the same time, in decisions on these interest rates? As a bank, the BIS must tackle such issues in which it comes face-to-face with the normal course of events at a bank.

However, as an international institution the BIS also has come face-to-face with issues different than those faced by ordinary banks. Simply put, these issues involve gold. When international markets are in a phase risking a move toward contraction, such as the Great Depression or the postwar sterling crisis, BIS depositors – in other words, the central banks – withdraw their deposits. However, each country converts these withdrawn deposits into gold and, moreover, deposits it (as earmarks) in reliable institutions such as the BIS. Such earmarks deposited with the BIS are under the administration of the BIS although they do not show up on its financial statements. In this way, BIS deposits and earmarks have become an accumulation point for safe-haven currency in the event of a crisis in the international currency system.

The distribution of earnings is also important. As a joint-stock company, the BIS needs to distribute earnings to its shareholders, the central banks. At the same time, as a “venue” for cooperation between central banks it also needs to contribute to the stability of the international currency system. For this reason, the distribution of BIS profits involves various struggles between its motives as a profit-earning company and as an international public agency securing funding for the purpose of central-bank cooperation.

In this book, we will ask some basic questions about banking operations, through consideration of BIS financial statements. These include from where the BIS originally accepted deposits, where it invested these, how much income it earned and how it disposed of this income. While it is essential to rely on such an approach when attempting to address the actual state of BIS operations, the authors make several attempts to extend this approach beyond the history of management of a single bank. This is the historical method known as organizational history. A brief description follows.

Game theory and comparative institutional analysis have contributed to the research on central-bank cooperation seen above. However, historical research on management of a single organization, such as the BIS banking operations studied here, has again attracted attention as the historical research method known as organizational history, beginning in France in recent years. We say “again” because organizational history was a current in management history that first began in the 1970s, centered on Alfred Chandler and Louis Galambos, and the organizational history being conducted chiefly in France today is an extension of this 1970s research current.¹⁵ However, while the past theories of Chandler and Galambos focused on large enterprises and bureaucratic organizations, current revived organizational history attaches importance to more flexible

internal and external “networks.”¹⁶ Its scope too has expanded to the domains of mentality and business culture instead of just narrowly defined rationality and pursuit of short-term profit.¹⁷

Returning to the current subject of the BIS as a “bank,” from an organizational history approach we can identify the following issues. How, and from where, did the ebbs and flows of the banking business impact BIS management? How did the ups and downs in the BIS as a “bank” affect cooperation between central banks? Of importance are the functions of the organization and network distributing management resources and the BIS business culture in which these are contained.

3 The history of twentieth-century economic thought: neoliberalism and Wicksellian economic thought

The third viewpoint of this book concerns economic thought. The BIS has continued its activities over a relatively long period of time, from the prewar through the postwar periods, and today it can be counted – along with organizations such as the International Red Cross and the International Labor Organization (ILO) – among the international institutions with the longest traditions. Thanks to this tradition, and to the tradition of strong ties with not just governments and central banks but also the private-sector banking world – the BIS has formed massive networks with contemporary economists and financial practitioners. The BIS was a major point of intersection between ideas on currency and credit in the twentieth century.

For example, Per Jacobsson, the first head of its monetary and economic department, was one of the central theorists in international finance through the 1960s and he was the starting point of a network linking others including Knut Wicksell and John Maynard Keynes. In addition, the talent that each country sent to the BIS as representatives or staff included theorists and practitioners in their prime at that time or in the near future. Examples included Henry Strakosch from Great Britain, Charles Kindleberger of the United States and Karl Blessing of Germany. In the documents left behind from their day-to-day duties can be read points of dispute surpassing discussions of policy narrowly defined, covering currency and credit theory and further spreading to the broader subjects of capitalism and contemporary society. In this way, the BIS had a presence as a major crossroads at which various economic ideas representative of the twentieth century blended together and diverged.

On this point, the economic ideas focused on in this book as having impacted the BIS are neoliberalism and Wicksellian economic thought. We will review each of these briefly here.

The former ideology, neoliberalism, is a current of thought in liberalism born in Europe upon reflection on twentieth-century liberalism. As is well-known, its scope is quite broad. It calls to mind the neoliberalism that began in Britain at the turn of the century, the new liberalism that attempted to move liberalism in the exact opposite direction and the *neolibéralisme* that appeared in France at the