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THE BANK FOR INTERNATIONAL SETTLEMENTS
AT WORK



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THE BANK FOR INTERNATIONAL SETTLEMENTS AT WORK

BY

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Author of "The French Franc"



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TO
THE MEMORY OF
ALLYN A. YOUNG

PREFACE

RECENT events have made it more evident than ever before that there are grave dangers in the lack of regulation and coördination in international finance. The outstanding new development, aimed to assist financial co-operation, is the Bank for International Settlements. Although it originated in the special problems connected with Reparation, it soon extended its work over a wide field and attacked many urgent questions of money and credit. In fact, it is because the work of the Bank in its early years sheds light on the larger problems of finance that this study has been undertaken.

In describing the nature of the new institution the subject matter, quite naturally, takes two forms. There is, first, a review of the laws, decisions, committees, and transactions relating to the Bank, and, second, a theoretical appraisal of its aims and policies, with suggestions of the probable lines of development in the years to come.

The source material is varied and, in some cases, unique in character. There are, for instance, those documents which determine the general nature of the Bank and the published statements of its acts and financial condition. There are in addition numerous critical and descriptive studies written when the plan was first outlined or during the first weeks of the Bank's existence. Finally there is the less formal body of material which consists of confidential documents, letters, and interviews.

It is evident that a considerable part of this source material is not readily available to the reader.¹ Because of this fact special care has been taken to assure the accuracy

¹ In addition to the collection of material in the hands of the writer, many of the communiqués and documents are available in the Library of the Harvard School of Business Administration.

of statements and the correctness of interpretation by submitting the manuscript to a number of bankers and economists in Basle and elsewhere for criticism and suggestion. The opportunity which this has occasioned for conferring with those connected with the new venture in finance has been a real privilege. Moreover the conduct of my investigation has made it possible for me to talk with leading bankers in New York, London, Paris, Berlin, Geneva, Vienna, Zurich, and Basle.

In acknowledging the help which has come to me from many quarters, I wish to assume complete responsibility for all statements of fact and theory in these pages. No mention of any individual in the preface or in the text should be taken as an indication that the opinions given here are attributable to any one other than the writer.

It is impossible for me to make specific acknowledgment to each individual who has furthered my research. I wish to take this opportunity, however, to mention the names of a few of those who have given generously of their time and interest. Without the courtesy of President McGarrah and his alternate Mr. Fraser this work would have been impossible. In the course of more than a year's residence in Basle I came to know the officers and staff of the Bank and enjoyed many interesting discussions with them. In fact, only such a close association with those who carried on the daily work of the Bank would make possible an appraisal of its significance.

Mr. Leon Fraser was particularly helpful because of his clear view of present and future problems of the Bank. He gave me the benefit of his criticism at many stages of my work. Monsieur Quesnay, Dr. Hulse, Mr. Rodd, Mr. Porters, Monsieur van Zeeland, Signor Pilotti, Dr. Jacobson, Dr. Weiser, Mr. Goodwin, Dr. Blessing, and Dr. von Simon all helped me with stimulating comments on the questions under consideration.

In America, a number of financiers and economists with varied interests advised me as to the plan of my work.

Among these were Dr. W. R. Burgess, Mr. Jackson E. Reynolds, Dr. Walter Stewart, Dr. Joseph Willits, Mr. Shepard Morgan, and Mr. Ferdinand Eberstadt.

I owe a special debt of gratitude, which I cannot hope to repay, to three people who have devoted painstaking attention to my plan of work, and to certain parts of my manuscript. These are my brother, John Foster Dulles, my colleague, Dr. Anne Bezanson, and Mr. Louis Galantieri of the Federal Reserve Bank of New York.

In a number of instances, members of the Industrial Research Department of the University of Pennsylvania have helped me in checking and transcribing material. Miss Gertrude Bancroft, formerly my student at Bryn Mawr College, has given me faithful assistance in revision and proof reading.

The financial grant of the Bureau of International Research of Harvard University and Radcliffe College has been of importance, not only because it helped meet the expenses involved, but because it prolonged an association with a group of scholars at Harvard and Radcliffe which I value highly. The interest of Professor Taussig, Professor Carver, and Professor Williams calls for special mention. I wish, also, to thank the members of the Bureau, and the Chairman, Professor Wilson, for their efforts to further my work through this grant, and to express my gratitude to President Comstock, and Dean Brown, for the appointment as Research Fellow, and, through them, to Radcliffe College for the many opportunities which it has opened to me in the field of economic study.

This book is dedicated to the late Professor Allyn A. Young, whom I knew, first as a student, and, later, in my work for the preparation of *The French Franc* in the years 1926-1929. I hope, in carrying further work in the field of international finance in which he was so keenly interested, I may add some tribute, however small, to his memory.

ELEANOR LANSING DULLES.

Philadelphia, October, 1932.

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**THE BANK FOR INTERNATIONAL SETTLEMENTS
AT WORK**

CHAPTER I

THE ORIGIN OF THE BANK

THE Bank for International Settlements came into existence in May 1930. This unique organization created under the Young Plan grew rapidly and survived the depression years which destroyed many institutions.

The new Bank commands attention everywhere as one of the most important forward steps in economic life of recent years. The results cannot be appraised accurately until some time has elapsed but the past achievements and future programs deserve careful attention. It is because these early steps are important in conditioning future development and because the Bank's history will be momentous to economic institutions that this study has been undertaken.

It is an international clearing house and trustee founded under certain treaties and granted a charter by the Swiss government. Seven of the more important banking systems of the world were concerned in its organization; the Central Banks of Belgium, England, France, Germany and Italy participated directly, while the United States and Japan shared in the undertaking through consortiums of private banks. The occasion for the creation of this new and revolutionary institution was the need for some agency which would take over certain responsibilities in connection with reparation payments. The financiers who created the Bank, however, added many ambitious plans to the limited functions growing out of political debts.

In fact, great hopes had led bankers and statesmen to suggest a very wide field of activity. It was expected by some that the Bank would become a powerful link between

all the more important financial systems of the world. Even those who looked for a slower development expected that it would perform a much needed service in coördinating the policies of Central Banks. They often worked for divergent aims, and there was confusion and uncertainty as to the meaning of discount policies and of capital movements. The widespread use of the gold exchange standard involved grave dangers. There was a fear of a gold shortage. The plan for the new Bank was greeted with enthusiasm in many quarters. Unfortunately, critical events in the next three years and the nature of the Bank's own structure and resources, prevented it from taking an aggressive part in the distressing period of world depression. Many criticized the Bank for what they considered to be a weak or selfish policy. This comment was natural in view of the exaggerated hopes held in some quarters after the first announcement of the plan in 1929.

These criticisms were in the main superficial or occasioned by the lack of knowledge of what the Bank could and did do. It is true that it had not performed miracles. It had not even become at once a dominating factor in the development of monetary policies in the principal countries of the world. On the other hand, it had served in times of terrific stress and had accomplished very real services for a number of Central Banks.

It is possible to indicate very briefly at this point work done in the first two years. Later discussion will show both the exact nature of its operations and the significance of its accomplishments to the financial world.

An appraisal of the first years shows that from the beginning the Bank had carried out loyally and efficiently all the functions assigned to it under the Trust Agreements.¹ It had received and transferred reparation payments; it had handled the financial operations involved in deliveries in

¹ *Agreements concluded at the Hague Conference, January, 1930, hereinafter cited as The Trust Agreement, Cmd. 3484.*

kind; it had floated the Young Loan and discharged various obligations in connection with the Young, Dawes, and Austrian bonds. Later, in 1931, it had called together the Special Advisory Committee under the Young Plan and had materially facilitated its work.

More important than these functions, however, was its assistance to various Central Banks and the fact that it was a regular assembly place for the governors who came to the Directors' Meetings. Thus it became at once the "bankers' club" which had been so much desired. The prompt establishment of these regular contacts made it possible for the Bank to fulfill the rôle of Central Bank for Central Banks in furnishing emergency aid in the summer of 1931. This rescue work was not generally appreciated, for the help rendered at this time and in the months directly preceding could not be heralded abroad—such publicity would have disturbed many delicate financial relationships, and increased general distrust.

There is no doubt that credits granted to distressed banks at this time were very important. In addition the Bank was constantly working on plans and policies which would aid individual Central Banks and which would be of general service in reëstablishing some coördinated system of value when the gold standard difficulties should have passed their acute stage.

Three things can be done in analyzing the first two years of the Bank's existence. It is possible to trace the history of the Bank from the day when it was first suggested in Paris, to the second annual meeting in May, 1932. This narrative of events shows a varied and interesting series of acts modified by changing circumstances in the financial world. Then, it is possible to demonstrate how the intervention of the Bank affected different countries, and changed the course of affairs during this period. For instance, the rôle of the Bank in the reparation problem, in the gold standard crisis, and in the credit panic are all sig-

nificant to the economic world. Finally, it is possible, even at this early stage, to indicate its theoretical powers and also the limits of its influence on basic economic factors such as interest rates, credit, foreign exchange rates, and gold movements. In a general way the region of its future work is already marked out and procedures in the first months will have an important bearing on its functions in later years.

The accomplishments of the early period, however, are no measure of the future power and influence of the Bank. These will grow with time and experience. Decades must pass before all the potentialities now evident will be fully realized. The intervening years will undoubtedly show many changes, but the Bank's continued existence and growing authority seem assured.

THE FIRST SUGGESTIONS

The plan for the Bank had its origin in Paris in 1929. Before that time a number of suggestions for an international financial organization had been made, but these had not been proposed in practical form and had not been favorably received by those who had the authority to put them into operation. The one notable exception to this was the project outlined at Genoa in 1922 which had been considered at length by a number of prominent Central Bankers. Granted this line of influence, an investigation into the purposes which dominated the Young Conference shows quite clearly the important part played by the immediate needs of European finance and the relatively limited consideration given to earlier ideas.

The Young Conference held its first regular session on February 11, 1929.² Owen Young, attending as an independent expert, not as a representative of the United States government, was unanimously elected chairman. A first

² The plan to call the conference resulted from the agreement of the principal countries concerned that it was desirable to reach a definitive settlement of reparation payments. This agreement was reached during the Assembly at Geneva, September 16, 1928.

rapid survey of the views and expectations revealed the fact that trouble was ahead.³ Indeed it seemed that the only way of making progress in the face of irreconcilable difficulties was to focus attention on special problems, so that specific limitations and possibilities would emerge. In pursuit of this policy the conference was divided into three committees.

One of these committees under Sir Josiah Stamp considered transfer and exchange protection, another under Lord Revelstoke took up the matter of commercialization, that is, the flotation of bonds, and the third, under the chairmanship of Thomas Nelson Perkins, studied deliveries in kind.⁴ Each group had to consider sharply conflicting interests. The desire of Germany to throw on the creditor nations the responsibility for exchange stability was in contrast to the wishes of the creditors to have the payments similar to non-political international obligations. The idea of commercializing payments would make the German hope of later downward revision less attainable, and would serve the interest of the French in that Germany could not default without financial suicide. Deliveries in kind were an aid to German payment, but were contrary to the interest

³ Representatives and experts were sent to the reparation conference in 1929 by Belgium, France, Germany, Great Britain, Italy, Japan, and the United States. Among those who attended as official delegates and alternates were: M. Émile Francqui, Baron Terlinden, M. Gutt, M. H. Fabri, M. Émile Moreau, M. C. Moret, M. Jean Parmentier, M. Edgar Allix, Dr. Hjalmar Schacht, Dr. C. Melchior, Dr. Albert Voegler, Herr L. Kastl, Sir Josiah Stamp, Sir Charles Addis, Lord Revelstoke, Sir Basil Blackett, Commendatore Pirelli, Signor Guisepppe Bianchini, Professor Fulvio Suvich, Signor Bruno Dolcetta, Mr. Kengo Mori, Mr. Saburo Sonoda, Mr. T. Aoki, Mr. Yasumune Matsui, Mr. Owen D. Young, Mr. Thomas Nelson Perkins, Mr. J. P. Morgan, and Mr. Thomas W. Lamont. Many other statesmen and bankers took an active part in the discussions and plans. Among these there were a number of well-known Americans, including Messrs. F. Bate, W. R. Burgess, S. N. Crocker, F. Eberstadt, Leon Fraser, Dean Jay, Shepard Morgan, J. A. M. de Sanchez, David Sarnoff, W. W. Stewart. *Report of the Committee of Experts on Reparations* (June 7, 1929), Cmd. 3343, hereinafter cited as *The Young Plan*, Cmd. 3343.

⁴ *Frankfurter Zeitung* (March 5, 1929); *Le Temps* (Paris, March 5, 1929); *The Times* (London, March 5, 1929), p. 15.

of English export trade. The questions were subject to compromise, however, and were matters which had been considered often before. Work on them progressed slowly but with some success during the first two weeks of the conference.

Meanwhile M. Francqui, one of the Belgian delegates, had presented a memorandum to Chairman Young in which he suggested the creation of an international body which could act as trustee for reparation payments, and for other more general purposes.⁵ This plan suggested a number of important functions which could be performed by such an institution, including the clearing of funds and development of backward regions.

On February 24, before this proposal was taken up in detail, another project was given to Mr. Young by Dr. Schacht, President of the Reichsbank. This scheme had been drafted during his trip to Paris, and had been outlined entirely independently of the Francqui plan. The two suggestions were alike in a number of respects. Both held out brilliant hopes for expansion of commerce and increasing prosperity by means of developing a new and powerful financial agent.⁶

Mr. Young was very much impressed with the creative possibilities in these new plans. He called in a number of experts for consultation, and the idea was commented upon by several of his advisors in the next few days. An early hint of the direction the discussion was taking had been made in *The New York Times* of February 21, 1929, which spoke of the establishment of an international clearing house. In general, however, the creation of the new bank was not anticipated and came as a surprise when it was

⁵ M. Francqui had turned his attention to proposals made at the international financial conference at Brussels in 1920, and in meetings of the International Chamber of Commerce.

⁶ Dr. Schacht and M. Francqui consulted together on the feasibility of the two plans. Unfortunately their cordial understanding in these early days of the conference was seriously impaired by the bitter dispute over the mark settlement in a later stage of the conference.

announced two weeks later in Paris. In fact very few people were aware of the amazing nature of the early Schacht proposal even after the Bank was actually organized.

The memorandum presented by Dr. Schacht called for a large issue of new purchasing power to be used for coöperative international enterprises in undeveloped regions.⁷ The basis for the new credit was to be bonds of the German government. These were to be deposited with the proposed bank, and notes were to be issued to participating Central Banks on the basis of these bonds. The Central Banks would then have large sums in currency against which they could open credit. The credit so granted would finance large ventures in backward countries, ventures to be planned by international committees and to be executed under the guidance of the new bank. The profits from these undertakings would be used in part to amortize the bonds issued by the German Reich. In this way it was proposed to wipe out the war obligations of Germany in a painless fashion, and stimulate world trade by a rapid inflation of purchasing power. The profits which were anticipated by Dr. Schacht would have amounted to approximately 300 million dollars a year on the basis of bonds amounting to five billion dollars or more.

There were certain aspects of this plan which were very tempting. It would have freed Germany from heavy burdens without raising the legal questions involved in a marked revision of Germany's obligations. It would have stimulated export trade for a while and lessened England's problem of unemployment. It would have given immense power to a small group of men who were at least as well equipped to run economic affairs as were many whom chance had placed in positions of great authority. The reasons for the rejection of the scheme in the form proposed

⁷ M. J. Bonn, *Der Neue Plan* (Munich, 1930), pp. 257, 258. A memorandum containing some similar ideas, written in 1923 and reprinted here, was known to a number of financiers and perhaps to Dr. Schacht.

are obvious. It would have set in motion the most tremendous upward movement of inflation that the world had ever known. It would have been more disturbing than the excesses of the *assignat* or of German inflation in 1922, because it would have been world-wide and, thus, would have distorted all existing economic relationships and affected production like a poisonous drug.

The hopes and theories embodied in the Schacht-Francqui plans take on a special importance in view of a whole group of projects presented to the world for a period of years which aimed to solve the economic crisis by means of artificial credit creation. Those who believed this possible were continually attempting to influence the development of the Bank for International Settlements, or were outlining suggestions for other banks to do the work which they felt the International Bank was neglecting. A number of directors of the Bank as well as many other financiers held such views. Examples of projects frequently discussed are the "Norman Bank," the Francqui scheme of 1931, Schacht's later plans, and, to a certain extent, the international mortgage banks.⁸ It was the other and more conservative theory, however, which prevailed in Paris, and later in Basle.

Events moved very fast during the first days of March.⁹

⁸ See *infra*, Chapter IX. See also the discussion of the Intermediate Credit Committee of the B. I. S. referred to in Chapters VII and VIII.

⁹ *New York Herald Tribune* (March 1, 2, 6, 10, 11, 1929). The reports of Mr. Leland Stowe of the *New York Herald Tribune* from March 1 to 11 give a clear picture of the possibilities of the new institution. In fact, an indication of the future Statutes of the Bank can be found in these articles. The first comment of importance was dated February 28 and appears in the March 1 issue. On March first *The Baltimore Sun* carried an article by Felix Morley describing the plan for "a Great Clearing House," which would act as an agent for Reparation. A number of other papers in various countries followed with comments on the "international corporate body," the "consultative committee," the "gigantic banking enterprise," and the "office for settling international payments." See also *The Baltimore Sun* (March 2, 1929); *Journal de Genève* (March 2, 3, 5, 7, 10, 1929); *Frankfurter Zeitung* (March 3, 5, 7, 1929); *The Times* (London, March 5, 6, 7, 12, 1929); *Le Temps* (Paris, March 5, 9, 1929); *The New York Times* (March 5, 6, 9, 1929).

M. Quesnay had presented a brilliant criticism on March 1. New drafts of the Bank were drawn up on the second, third, fourth, and fifth. These were presented to Dr. Schacht, as he was in a sense the originator of the plan. He made certain changes in his outline to take account of those embodied in the documents drawn up by different advisors and experts.

ATTENTION FOCUSED ON THESE PLANS

The three committees working on the separate reparation problems had, of course, influenced the first suggestions for an international bank in various ways even though they were not directly concerned with the development of the idea. These groups of experts had worked separately, but they were not completely isolated. Some knowledge of the progress of daily consultations drifted from one committee to another, but the preliminary reports were limited to the particular matters assigned to each. It is, thus, particularly interesting that each group advised the organization of a special agency outside Germany. The transfer committee suggested a clearing house, the commercialization committee proposed a trustee, and the delivery in kind group indicated the need of a special committee to administer the payments in kind along lines already developed in Germany under the Gilbert régime. The third committee also recommended the early termination of this form of payment.

The focussing of all the lines of influence referred to above on the proposed Bank became more evident by March 4 when the three committees presented their reports. These helped to crystallize the plans which were taking definite form very rapidly. At this meeting Owen Young advised the three groups of experts "to direct their efforts toward the creation of a central organization which would take the place of the Reparation Commission."¹⁰ Rumors of differences between the British and American delegates

¹⁰ *The New York Times* (March 5, 1931).

as to the desirability of the new organization were generally attributed to a fear that it might encroach on London's traditional functions.¹¹ This and other doubts led to the calling in of certain financial authorities to consider the risks and opportunities which were involved. Disagreements were quickly reconciled to the extent that a definite proposal for the Bank was before the conference on March 8.

When the advantages of the founding of some kind of international bank had been agreed on by the men holding widely different views, Mr. Young cabled to the Federal Reserve Bank of New York and to the Bank of England asking them to send experts to advise on the details of the plan. Among those who assisted in this work at some time were: Dr. W. R. Burgess, Mr. Eberstadt, Mr. Leon Fraser, Mr. Shepard Morgan, M. Quesnay, Mr. H. A. Siepmann, and Dr. Walter W. Stewart. Others were called in from time to time. The proposal began to take on very definite form by the sixth of March and on that day the name actually chosen, *The Bank for International Settlements*, was used in the draft for the first time. The title will often be shortened in this text to the abbreviation B. I. S., which is one of the customary European names for the Bank.

By this time in the conference discussions, the theories and plans which had developed at the Bank of England came to have an important bearing on the proposal for an international bank. A document had been prepared by Mr. Siepmann (English) and his associates before the Genoa conference which outlined the possibilities of an association of Central Banks. The plans were frequently discussed in London, and were influenced and perhaps inspired by the Norman, Strong, Rist, and Schacht conversations on general money and credit problems which had troubled Europe during these years. The suggested organization was to work for coördinated policies, increased stability, and improve-

¹¹ *The Times* (London, March 8, 1929).

ments in the working of the gold standard. It was to be under the control mainly of the Bank of England, the Reichsbank, the Bank of France, and the Federal Reserve System, although it did not exclude the participation on equal terms of other banks. The idea of a "financial club" was stressed, and the administration of this club was to rotate between these Central Banks. A reserve fund was to be held in trust for the member banks to be used to modify seasonal exchange movements, and to help countries disturbed by sudden emergencies.

Mr. Siepmann's suggestion and those of his associates in the handling of these problems were influenced quite directly by a number of postwar events. The informal meetings of Central Bank governors have been referred to. The stabilization work of the Bank of England and the League pointed to the need of coöperation. In addition to this, a number of loans had been granted in the interests of currency stabilization and the easing of abnormal credit stringency in some instances. Moreover, the conferences at Brussels, Cannes, and Genoa, as well as the many reparation meetings, brought into the foreground the complex inter-connections of international finance. Although the methods of meeting the common needs were differently visualized in each country, there were certain common elements which could be harmonized in Paris in 1929.

OTHER SOURCES

One of the theories which lay behind the establishment of the Bank, that Reparation could be made part of the normal flow of capital, was included in the Schacht proposal, and was accepted by most of the experts at Paris. It was the basis for the hope uppermost in the mind of Owen Young, that the reparation payments might become a normal part of the economic ebb and flow, and cease to have a dangerous political meaning. It was reasoned that, if the proper mechanism could be supplied, money which

would flow out of Germany for Reparation would flow back again to the extent to which it was really needed. It seemed reasonable that if there were a shortage of money and high interest in one country, and a plethora and low interest in another, lending operations would take place for the sake of the immediate gain involved. An organization was needed which would prevent the unnecessary cross currents of payments, lend its stamp of approval to credit, and make the operations regularly and without friction. In other words the money which Germany would pay the Bank, the Bank would be able to relend to Germany if she needed credit, or to other countries if the greater need lay elsewhere.

The official statement of March 10 outlined a number of characteristics of the Bank which were to be permanent working principles.¹² It was to facilitate transfer, payments in kind, and the mobilization of Reparation. It was to be the distributing agent for the annuities. It was to further coöperation and avoid all competition with existing agencies. In addition to this, it was to work at problems of clearing, exchange stability, and the filling in of gaps in the existing financial system. As this announcement was made public, a plenary meeting of the conference on Tuesday, March 11, was addressed by Messrs. Stamp, Moreau, Schacht and others, who discussed the new plan. It began to be realized both in the meetings and outside that the project which was being advanced with such enthusiasm held very important potentialities.

A group headed by the late Lord Revelstoke then took up the special task of examining the proposal. Others on this committee were M. Moreau, Mr. Morgan, Mr. Lamont, M. Francqui, Signor Bianchini and Dr. Melchior.¹³ They were asked in particular to see whether the new Bank with the power to use large sums of money might become a men-

¹² *Le Temps* (Paris, March 11, 1929); *The Times* (London, March 11, 1929); *Journal de Genève* (March 12, 1929).

¹³ *The Times* (London, March 12, 1929).

ace. Meanwhile a further group under Sir Josiah Stamp was engaged in drafting statutes for the Bank. Rumors of disagreement subsided as the studies progressed and the only difference of opinion seemed to be as to whether the Bank was to be a powerless and routine committee, or a tremendous force in international finance.¹⁴ The project for a new bank solved some of the problems before the three committees and facilitated agreements on general policies. At this point, in the middle of March the attention of the conference was turned to a consideration of the amount of the annuities.

Sir Josiah Stamp played a notable part in the evolution of these ideas. He was keenly interested in projects to develop unexploited countries for the advantage of creditor and debtor nations alike. There are hints of the direction his ideas were taking in his report on Reparation in 1925.¹⁵ The committee in Paris in 1929, of which he was chairman, recommended the forming of an international body and he addressed the first conference discussion at which the Bank was considered. Afterwards he was made head of the group of experts who were to draft a detailed plan.

A dozen names might be added to this short list given here of those who played an important part. There is no doubt that the work was coöperative, and carried on by the good will of a large number of the delegates and experts called to Paris.¹⁶ It is possible that the theories behind the Bank had been thought out by isolated economists in past

¹⁴ *Ibid.* (March 13, 1929).

¹⁵ Sir Josiah Stamp, Alberto Pirelli, and Count A. de Chalendar, *Reparation Payments and Future International Trade* (Paris, 1925), pp. 16 and 17. This report was drawn up for the International Chamber of Commerce.

¹⁶ *The Times* (London, March 25, 1929), p. 13. "It would be a mistake to suppose that the idea of this institution sprang like Athena, fully armed from the brain of any single member of the Experts' Committee. It is, in fact, a composite proposal which has gradually evolved during the course of the Committee's discussion as a natural result of the search for some substitute for the present form of financial control imposed on Germany under the Dawes Plan."

years, but the working plan was the result of the joint efforts of a number of men who had the benefit of both theoretical understanding and wide practical experience. Without the ideas and caution of a group, it is unlikely that the Bank would have been brought into being. Further, it is doubtful whether so many able men would have been brought together for a task of this nature unless the menacing problem of Reparation had called them away from the work in which they were normally engaged. The Bank was the foster child of the Treaty of Versailles.

The more exact position of the Bank in relation to former theories and the history of economic thought will become clear when its ultimate rôle is determined.¹⁷ It is possible that its greatest contribution will connect it with one or another of various schools of thought. Even the early functions can be traced back to certain concepts, clearly expressed and generally known. The hopes that the Bank would ease clearings, equalize money rates, stabilize exchanges, and stimulate commercial enterprise, may be linked with the whole line of reasoning about the relation of money, prices, and the exchanges. This was first emphasized by Hume, Harris,¹⁸ and others. It was brought to richer development by Ricardo and a small group of economists in the early nineteenth century. The connection between the Bank for International Settlements and any particular proposal for an international clearing house, or currency, is, however, extremely tenuous and uncertain.

THEORETICAL ANTECEDENTS

Even though the influence of these theories was entirely indirect, nevertheless it is important to recognize that they had been formulated. It might even be possible to link

¹⁷ Detailed studies of this matter can best be undertaken at a later date, when it is clear on what principles and in what direction the Bank will develop in the long run.

¹⁸ J. W. Angell, *The Theory of International Prices* (Cambridge, Mass., 1926).

them directly to the ideas of some of the delegates at Paris if many unrecorded facts could be assembled.

One of the more comprehensive studies of the needs for an international clearing house was made by Julius Wolf.¹⁹ His suggestions were first put forward in 1886, and further amplified in 1892. His later book on an international means of payment covered the subject in a careful way.²⁰ He analyzed the clearing carried on by the post offices as well as other *giro* systems. He discussed the need for the extension of these facilities, and tried to establish the practicability of an international means of payment to meet the balances which would arise. The question of the handling of these balances is clearly the stumbling block on which international clearing is halted, and the future must be scrutinized for any possibility of meeting this need while different monetary policies still prevail within separate nations. Dr. Wolf fails to convince his readers on this important point, but his work was a powerful stimulus both at the Brussels Conference which he attended and in other economic gatherings.

A note presented to the League of Nations by M. A. E. Janssen carries forward these ideas.²¹ He describes the workings of the postal money orders, comments on the monetary unions of the past and dwells on the instances when international coöperation saved the world from calamitous events. He concludes that the idea of a closer monetary connection presents grave difficulties and at the same time recommends conferences which would help to har-

¹⁹ Julius Wolf, *Das Internationale Zahlungsverwesen* (Leipzig, 1913).

²⁰ L. Luzzatti, the Italian statesman, in 1908, advanced a suggestion for an international clearing house. This proposal together with that of Cortelyou, Secretary of the Treasury, and the ideas of Wolf and others were discussed at the Congress of the International Economic Union at Brussels, in 1912. The subsequent International Financial Conference, Brussels, 1920, went so far as to recommend that the League of Nations might well work toward the establishment of some kind of international clearing house.

²¹ M. A. E. Janssen, *Note on the Plan for an International Clearing House* (Geneva, April 8, 1922), E. F. S. 270, A. 158.

monize financial policies in different countries. His somewhat negative findings may be in part responsible for the fact that the League did not carry this idea further. In any case the complicated and specialized task was in no way suitable for the League at that time.²²

In America thought turned toward some unification of world banking systems, as the Federal Reserve gained prestige. It was suggested that the Central Banks of Europe might be linked together in some such way as the different districts were in the United States. For this and other reasons a number of proposals were put forward. As in Europe, they were mainly concerned either with clearing, or with an international money, or with the solution of reparation difficulties. Some of the names associated with such plans at various times are Mr. Norman Davis, Mr. Thomas Lamont, Mr. H. P. Davidson, Senator Owen, Secretary Cortelyou, and Mr. Frank Vanderlip.²³

Nevertheless the real forerunner of the Bank was probably the Genoa conference, and the aims of the new organization were foreshadowed in the resolutions and some of the guiding principles were formulated there. The analysis of the gold standard as the general basis for economic co-ordination, control of credit and better adjustment of gold and clearing operations are covered in forceful statements

²² At about this time Dr. Hans Heymann put forward the idea of an international bank. This was definitely combined with the problem of reconstruction in France and the payment of Reparation, but it was to cover wider problems and outlive this original task. Walter Rathenau submitted this proposal to the Genoa conference. It is well known that considerable attention was turned in this direction but no practical consequence followed the discussion. Genoa conference, *Livre jaune sur la conférence économique internationale de Gênes*, 1922, p. 36-37. See also papers relating to International Economic Conference, Genoa, April-May 1922, Cmd. 1667; Report of the Second Commission (Finance).

²³ Some Europeans who have been said to contribute to this general body of ideas are Messrs. Delacroix, Ter Meulen, Mountain, Frère, Hitchcock, Brianchaninoff, and Otlet. There is no doubt that many people have worked on the general idea of an international bank. The need was widely recognized, the only fear being that the new institution might create greater dangers than those it attempted to solve.

in the report. They undoubtedly made an impression in financial circles.

The strong flow of influence in this direction made the plan as adopted in Paris easier to develop. There was a cordial reception to the new idea in most quarters, the concepts and possibilities were already in many people's minds. The need for something new to guide economic life in the midst of the growing complexities of international finance was generally recognized.

THE STRUGGLE OVER THE ANNUITIES

After the first four weeks of conference there was a moment of calm, when the new proposal seemed to offer unexpected facilities for easing German payments. The delegates were occupied with the interesting task of planning the international bank. There is no doubt that there was a variety of hopes and expectations, but at least a step forward was made by common agreement. Some of the delegates returned to their homes over the week-end of March 16.²⁴ There was an air of optimism which was to be dissipated as attention turned to the controversial question of figures on March 18.

From this time on the conference became a controversy over the total amounts which Germany must pay. There was a wide discrepancy between the first offers of the German delegates and the figures which the Allied powers seemed ready to approve. Dr. Schacht characterizes as ridiculous the sums requested by the creditor countries—"The total of the separate estimates added to almost three billion marks a year, or more than the normal Dawes annuity."²⁵ He writes bitterly of the struggle which followed, claiming that the conference had been called together to find a solution based on economic facts and that it became

²⁴ *The Times* (London, March 18, 19, 20, 1929).

²⁵ Hjalmar Schacht, *Das Ende der Reparationen* (Stalling, Oldenburg, 1931), p. 65.

a political fight of the fiercest kind. The gap between the German offer of about one and a half billion marks²⁶ and the Allied request of nearly three billions was too great to bridge by the intervention of the new international body.

Fears were expressed that the conference might break up without reaching any conclusion. On April 17, Dr. Schacht formally rejected the Allies' proposal and made a counter suggestion. There was a deadlock in Paris. The death of Lord Revelstoke led to a temporary recess in appreciation of his valuable services. Delegates consulted their governments in the interim and returned to Paris with an increased desire to come to some kind of agreement.²⁷ Dr. Schacht came back from Berlin with suggestions which permitted some change in the German offer and the declaration that he had not intended to present an ultimatum in the past week. As a sign of the difficulties a dramatic fall in the exchange value of the mark was followed by an increase in the Reichsbank rate from 6½ to 7½ per cent on April 25.²⁸

The Young Plan was more or less in shape on May 5. Dr. Schacht was in partial agreement by May 15. The details of conditions of payment were determined by May 30 and the Young Plan was signed on June 7. The net result was political freedom for Germany, a reduction of one-third as compared with the nominal amounts of the Dawes Annuities, and the renunciation of the gold purchasing power and transfer protections as well as the "prosperity index." Further than this there were provisions for commercialization and the new Bank. From the point of view of immediate economic gain the conference was a keen disappointment to Germany, although the world was to profit by the new experiment in finance.²⁹

²⁶ *Ibid.*, p. 75.

²⁷ Dr. Schacht goes so far as to say that the German government sold itself for the freedom of the Rhineland, *op. cit.*, p. 84.

²⁸ *The Times* (London, April 26, 1929).

²⁹ The reparation problem and its more specific relation to the Bank will be considered in Chapters XII and XIII, below.

It is probable that Mr. Keynes was right in his declaration that the conference was held too soon.³⁰ Three months of controversy³¹ over the figure to be set had little influence on the origin of the new Bank. It is true that at first some of the delegates hoped that the inflationary powers of a new financial agency would diminish the importance of payments from Germany. Such prospects were eliminated by expert revision of the plan and by the absolute refusal of bankers concerned to consider any such possibility. In one respect the fight over the payments left an unfortunate heritage. The bitterness generated in Paris was to color the attitude of many Germans to the Bank, and the limits set to its capacities bred an attitude of cynicism in the minds of many impartial observers.

³⁰ J. M. Keynes, *The New Republic* (New York, May 1, 1929), pp. 296, 297.

³¹ Sir Charles Addis, *The Stock Exchange Gazette* (London, May 9, 1930), p. 1071: "I remember one night at the close of an exhausting day in Paris, when Mr. Owen Young turned to me and said with a weary smile, 'I wonder if any of us will live long enough to look back upon these days with pleasure.'"

CHAPTER II

BADEN-BADEN AND THE HAGUE

ALMOST a year passed between the signing of the Young Plan and the burning of the original German bonds.¹ The agreement on the general outline of an international bank and a new schedule of German payments in June, 1929, was but the prelude to three major conferences at the Hague and Baden-Baden, and to a number of smaller meetings in Paris, Brussels, Rome, and Basle.

So long a time was needed because careful drafting and frequent compromises were required for the Statutes, the Charter, and the various treaties which brought the Bank into existence. On several occasions the existence of the new institution hung in the balance. The controversies left their mark on the Bank, on its control, its functions, its location, and its management. It ceased to have that form and character which had been outlined in abstract discussions, and took on the solid shape and reality of an organization adjusted to the political and economic facts of the world of 1930. An account of the negotiations which led to this result explains much of the strength and the weakness of the new Bank.

Three principal meetings drew up the documents necessary to make the new plan effective. These were the "First Hague Conference" in August, 1929, the Baden-Baden Organization Committee in October of the same year, and the "Second Hague Conference" meeting in January, 1930. Further acts on the part of the interested governments rati-

¹ *The New York Times* (May 20, 1930). The German bonds, known as the A, B and C bonds, given to the Allied governments in 1919, were burned when the "New Plan" and substitute agreements came into force.

fied and put in force the treaties, and a few informal meetings attended to such matters as the choice of officers for the Bank, the date of opening, and the first steps to put the Bank in operation. This work was finished and the Bank opened its doors in May, 1930.

The first of the conferences called for by the Young Plan assembled at The Hague on August 6, 1929. This group, unlike that in Paris, was composed of government representatives empowered to adjust the exact financial arrangements which would be acceptable to their respective governments. The bearing of this conference on the proposed international bank was only indirect, in that, for a time, it threatened to destroy the whole project because of the sharp disagreements about the financial terms of the settlement.²

The struggle was intensified by the German objections to a sanction clause which was actually included in the form of a provision that Germany would be granted a moratorium under certain conditions if it were clear that she had made efforts to pay in good faith. The future of the Bank was in no way influenced. It was not until this conference was out of the way, however, that the further work of organization could go on. The successful conclusion of the deliberations on August 31 was, therefore, a relief to every one.

The next event of consequence to the Bank was on September 10 when the proposal came up for discussion in the assembly of the League of Nations.³ It is obvious that public opinion attached considerable importance to the new Bank. The interval which had elapsed since the first suggestion had given time for widespread comment, and the

² The main bone of contention was the modification made in the Spa percentages by the arrangement in the Young Plan to have the larger share of the unconditional annuities go to France.

³ League of Nations (Geneva, September 28, 1929), *Extracts from the Minutes of the tenth Annual Assembly*, C. 494, M. 158, 1929, II; see also Chapter V, pp. 87-91.

plans for the sessions of the Organization Committee, following close on the heels of the Hague decision, kept the matter in the public eye. Delegates assembled at Geneva wished to scrutinize the question of the control of an organization destined to exert a powerful financial influence. The matter lay beyond the province of their immediate action, however, so nothing decisive was done.

The problems of Baden-Baden were almost as difficult as those of Paris. The nature of the task was very different, and the work less political than technical. Lawyers had to cast the plan into exact form and make precise the methods, aims, and limits to action. The controversial question of the location had to be decided as well as the relation of the Bank to the various governments. The negotiations threatened to be broken off at some of the more difficult moments, and the members of the committee wearied of the long and contentious debates. The result was a compromise on many points, and although the statutes are a loyal transmutation of the Young Plan into legal form, the representatives of several countries were disappointed with the location, legal limits, or the failure to set forth more ambitious aims.

THE ORGANIZATION COMMITTEE

Men of long experience and large responsibilities were chosen for the Organization Committee. The chairman was Mr. Jackson Reynolds of the First National Bank, New York.* The delegates met in Baden-Baden, in the Black Forest, on October 3, 1930, and continued their debates until November 16. They were forced to recognize certain

* Among the delegates to the Baden-Baden conference were MM. Delacroix, Louis Franck, Paul VanZeeland, Maurice Frère, and Marx from Belgium, MM. Moret, and P. Quesnay from France, Dr. Schacht and Herr Vocke from Germany, Sir Charles Addis and Sir Walter Layton from Great Britain, Professor Beneduce and M. Azzolini from Italy, Mr. Tanaka and Mr. S. Sonada from Japan, and Mr. Jackson E. Reynolds, Mr. Melvin A. Traylor, Mr. J. A. M. de Sanchez, and Mr. Walter Lichenstein from the United States.

dual or conflicting aims in the Young Plan which made their work more difficult.⁸ The attempt to take Reparation completely out of politics met a further check as a decision between the interests of different countries became necessary.

The main questions to be decided at this time were: (1) the location; (2) the relation of governments to the Bank; (3) the currency in which funds should be accounted; and (4) the objects of the Bank and the functions which would be consistent with conservative economic practices and monetary stability.⁹ The argument with regard to the fundamental object derived its special significance from the conflict, referred to above, between the German desire that the Bank should bring about commercial expansion, and the objections of most of the other delegates to such a plan. Traces of this discussion are to be found in Articles 3 and 4 of the Statutes.

As these various points were raised, it was evident that conflicting national interests, as well as different theories, led to sharp differences of opinion. The prohibitions which hem in the future activity of the Bank show in a measure the way in which the necessity of compromise narrowed the scope in deference to special interests here and there. The article which provided for the distribution of the profits of the Bank was in part a concession to the Germans in that it indicated that a theoretical excess above normal earnings would go to reduce reparation payments. This was a vestige of the original Schacht plan, but in the form which it took in Baden-Baden, held out no hope of substantial benefit. A natural accompaniment of these political efforts was the series of difficulties in the attempt to arrange the work and

⁸ *The Statist* (November 2, 1929), p. 625. ". . . And let it be remembered in this connection that even in the Young Committee the various delegations viewed the project from different standpoints, whence arise the ambiguities in the Report."

⁹ *The Economist* (London, November 16, 1929), p. 899; *The Statist* (London, November 2, 1929); *The New York Times* (October 6, 1929); *The Times* (London, October 11, 1929).

management of the future institution so as to serve the interests of both creditor and debtor nations.

Opinion was divided on some other of the more important questions in two ways. There was, for one thing, the divergence in point of view between the bankers and the politicians. This resulted in a struggle over the right of governments to interfere, and the exact definition of the powers of the Bank.⁷ There was another division of opinion based on national rivalries which disturbed the debates on the location of the Bank. It is small wonder that the progress of the negotiations was not smooth sailing for no clear concept of the future nature of the Bank could be invoked to clear up the difficulties. It is a mistake to overemphasize the continuing importance of past alignments, but it is none the less essential to understand what forces led to the decisions made in 1929, despite the fact that opinion may have been modified on these questions, and some of the differences may have faded or changed with the passage of time.

THE PROBLEM OF LOCATION

For instance, some of the various influences that made the choice of the location peculiarly difficult were the questions of the geographic situation relative to the various capitals, the atmosphere and tradition of the center to be chosen, and the possibility of competition or coöperation with existing financial organizations. The representatives from England wished, of course, to have London as the seat of the Bank, with Amsterdam as a second choice. The French delegation wanted Paris, with Brussels as a second possibility. The Germans, knowing that Berlin was practically impossible, wished Amsterdam as the first choice, and Zurich as second. Those who spoke for Belgium held

⁷ Sir Charles Addis, *Stock Exchange Gazette* (May 9, 1930). "It was naturally the aim of the Baden-Baden Committee, composed as it was of bankers, to provide the Bank with complete freedom of administration and to exclude as far as possible any political interference with its procedure. But this at once gave rise to a very difficult question. . . ."

firmly to Brussels, and would not at first consider any other location.

The Italians, on the other hand, did not have a strong preference in the matter, although they did not oppose the German point of view, and the Japanese did not commit themselves to any choice. The Americans held a neutral position and were able to work toward a compromise, although they preferred a northern European center. The firm opposition of the French and Belgians eliminated both London and Amsterdam. The English and Germans absolutely refused either Brussels or Paris. The practical possibilities were, therefore, narrowed to a Swiss city, partly as compromise, and partly because of the sound financial structure of the country, its central position, and its traditional immunities and neutrality which would offer some special protections to the Bank.

Even the choice between Swiss cities was not easy to make.⁹ The Germans and some of the others preferred Zurich. The French preferred Lausanne and did not object to Geneva. The English would have liked Zurich, but objected in any case to Lausanne and Berne. They considered Lausanne too much under French influence and Berne dominated by the diplomatic corps. Insofar as the bankers expressed their views as financial experts rather than as citizens of different countries, they eliminated Geneva for fear it might lead to political interference or too close association with the League.⁹

The choice therefore turned to the other most important Swiss city, Basle. This has the obvious advantage of an old banking tradition and good railroad connections.¹⁰ It

⁹ As the difficulties proved almost insurmountable, Dr. Schacht made the humorous suggestion that the Bank should be situated in some small mountain village where it would be free of all outside banking and political influence. *The Statist* (November 2, 1929).

⁹ See *infra*, Chapter V, for discussion of the relation to the League.

¹⁰ Basle has a fairly central position in Europe, being 14 hours from Berlin, 9 from Brussels, 4½ from Geneva, 17 from London, 5 from Milan, 7½ from Paris, and 15 from Vienna.

was acceptable to the French partly because it was on the French border and therefore easily accessible. The Germans were not unwilling, as it touched their territory also, and because it was in certain respects under German influence and had connections in German-speaking countries. The English did not oppose it for any special reason, nor did the Japanese or Italians.

London had more reason to be disappointed than the other cities because of its position as a clearing and banking center. Some of the Central Banks not represented on the Committee, such as the Scandinavian, were also known to regret the choice as inconvenient and out of the way for them. The distance from all the more active money markets, such as London, Amsterdam, and Paris, certainly did not make the placement of short-time money or exchange transactions technically easy. The long journey necessary from centers such as Hamburg, Stockholm, and Amsterdam, where banking was highly developed, was only partly compensated by the advantages of the Swiss center.

The *Statist* comments on these struggles in pessimistic vein:

"The case for choosing some existing financial centre is so obvious, that it would appear to require no pleading; yet each centre, London, Paris, Amsterdam, Brussels, Berlin, has hitherto had to be turned down for purely political reasons. The choice obviously should have fallen without any questioning upon the centre possessing the greatest international prestige and the most highly-developed money and capital market. Confronted with this petty nationalism, the ideals of an international bank are likely to receive a fairly severe buffeting."¹¹

It is probable, however, that the difficulties which resulted from choosing Basle were less serious than was anticipated.

The stability of the Swiss currency was merely a nominal advantage, and did not really affect the Bank. Neutrality in case of war was not a major factor since the operations

¹¹ *The Statist* (November 9, 1929), p. 669.

of the Bank in such a crisis would be hampered wherever it was situated. The Swiss government offered certain concessions and privileges which the Bank would have asked for in any center. On the other hand, the city of Basle was free from any particularly overwhelming influences, or danger of interference. The group that came together in the B. I. S. was helped in some measure by the very fact of isolation so they could develop an atmosphere of harmony and coöperation in the early years. It is generally agreed, however, that from a technical standpoint the Bank was badly placed.

THE RELATION TO GOVERNMENTS

The English point of view met with more success in defining the relation of the governments to the Bank. Their representatives brought forward a memorandum at Baden-Baden, supported by some of the delegations, which resulted in the separation of the Statutes into two parts.¹² One group of articles could be amended only after a change in the treaty.¹³ This gave any one government the power to prevent changes in the major functions or in the control of the Bank.

The result was more rigidity in structure than most of the men in Paris had foreseen.¹⁴ Moreover, this step assured the reparation countries the dominant voice for many years to come. The part of the Statutes which was more easily changed was that which concerned the strictly banking operations within a definite sphere. Those which could not be changed related to the location, object, reparation functions, capital, shareholders, powers of Central Banks, prohibitions, composition of the board, meetings, profits, settle-

¹² See *infra*, Chapter V and the *Statutes*, Article 57.

¹³ The treaty making effective the Hague Agreements put the convention into force.

¹⁴ See Appendix. The *Statutes* state that the following can only be changed by a change in the treaty; see Articles 59 and 60, and Articles 2, 3, 4, 9, 15, 20, 25, 28, 46, 53 and 56.

ments of disputes, and the manner of amending the Statutes.

Any danger of an early or sudden change in the line of progress was thus eliminated. The Bank was assured a fixed constitution. The composition of the Board of Directors made it plain that some control was to be exerted by Governors of Central Banks, as well as by the nationals of those states known to favor only the more conservative type of operations. Hopes and fears of a radical departure or new and aggressive methods were dissipated. It is true that the Bank still had a wide field of operation, and that within the scope of permissible functions assigned to it, much could be done. Nevertheless, the nature of the supervision to be exerted by the Board of Directors was very comprehensive.¹⁵ This Board in its turn was guided inevitably by national interests at some points. Moreover, the cautious tradition of some of the Central Bank Governors, as well as fear of competition, expressed in some quarters, pointed to delay in the assumption of vigorous leadership.

The very care which was taken to prevent changes and to limit the practices of the Bank to conservative lines was the greatest safeguard which could have been devised. It marked a victory, not for those who opposed the Bank, but for those who hoped for a long existence with growing power. If the Statutes had been easy to change, conflicting provisions might have been introduced. It would have been possible for the Board of Directors¹⁶ to bring about the self-destruction of the Bank, without appearing to do so. It was even presumed by some that those who suggested the widest aims, had in mind the weakening of the Bank through a dissipation of its efforts. There is no doubt that there were some governments, and some private bankers who were reluctant to contemplate the growth of the new organization.

Further caution was evident in the safeguards against in-

¹⁵ See *infra*, Chapter III.

¹⁶ See Article 59 of the *Statutes*.

flation. The alignment of opinion cut across national borders, and was grouped according to divergent views on economic action and monetary theory. The majority agreed very quickly to eliminate rapid expansion of purchasing power as far as possible. Nevertheless, a few who had favored the easing of debt burdens hoped, even in Baden-Baden, that the Bank might, directly or indirectly, bring about inflation.

Their views did not gain many adherents, however. The prohibition of note issues, the power of the Central Banks to veto actions in their markets, the strict observance of the gold standard, and the forbidding of both acceptances and advances to governments, as well as the insistence on liquidity, all limited the expansion of purchasing power through the B. I. S.¹⁷ In fact, it was clear that "inflation" is a word taboo at Baden-Baden."¹⁸ Thus, although post-war experience has proved that it is never possible to prevent inflation completely by law, several regulations against it were included in the Statutes.

THE UNIT OF ACCOUNT

It was at Baden-Baden, also, that the question of the unit of account was discussed. Although this matter is of great theoretical interest, it was not the subject of long discussions as were the political issues connected with the responsibilities of the Bank. A number of memoranda were presented to the conference, and some of the suggestions aroused violent opposition, but the decision, when it was actually made, was guided mainly by the desire to leave the Bank free to adapt itself to the location which was about to be chosen, and to avoid the introduction of new or experimental factors.

The most original proposal with regard to the unit of account was introduced by M. Quesnay. The suggestion

¹⁷ Paul Einzig, *The Bank for International Settlements* (London, 1930), pp. 74-83.

¹⁸ *The Statist* (November 2, 1929), p. 625.

was to adopt a new unit to be called the *grammor*, based on a gram of gold. This would have meant the creation of an international unit of account.¹⁹ The project was put forward and analyzed in a memorandum presented at an early stage of the conference.²⁰ It did not meet with approval, because the committee thought it would be too radical an innovation, and certain to alarm the public.

The choice of the "swiss franc *at par*," as the unit of account, was not, in fact, very different from the French proposal. The link to the Swiss currency was merely apparent and had no direct economic influence on the value concerned. If, in any unlikely event the swiss franc should depreciate, it could not alter the Bank's accounts, since its statements would still be issued on the basis of the number of times assets and liabilities could be divided by a certain *weight* in gold, that is, the amount of gold in the nominal and par value of the swiss franc. Since this was also defined in terms of weight, even a legal change in the gold content of the swiss franc would not make a change in the Bank's accounting.

The German delegation had originally proposed that the currency should be the swiss franc. This preference met with general support, once the seat of the Bank was tentatively placed in Switzerland. The ultimate specification of the gold content as the basis, meant that the Bank was as free as possible from the effects of fluctuations caused by any arbitrary changes in legal definition or by economic conditions. This was most important for a bank with a truly international character. The result was that the Bank really enjoyed the advantages of the two proposals. It gained a certain prestige from the nominal asso-

¹⁹ Gold bullion or coin has been the general medium of international payment ever since the adoption of the gold standard.

²⁰ This memorandum has never been published, nor was the authorship announced. M. Mendès-France prints in the appendix of his book, *La Banque Internationale* (Paris, 1930), a memorandum; this was substantially correct. See pp. 283-290.

ciation with one of the most stable currencies in the world, and it was at the same time abstracted from any actual connection with this currency by taking the gold content of 1930 as the real measuring rod. This refinement was not at first widely understood, but those who had business connections with the Bank came very quickly to realize the security which this arrangement gave.²¹

These were not easy matters to decide but after difficult weeks there emerged a definite plan and a workable mechanism. The long hours of debate led to the first materialization of the hopes formulated in Paris. Even though the whole project had been hedged about by precautions and limited in form so that it seemed far from some of the looked-for goals, it was still new and exciting. Sir Charles Addis has shown in his analysis of the prohibitions that although these restrict the choice of the Bank in method, they do not, in themselves, deprive it of funds, influence, or possibility of action in any essential respect.²² The exclusion of "accepting" for instance does not prevent the use of rediscounting in such a way as to exert almost the same influence on money and credit.

FIELD OF ACTION INDICATED

The tasks were made clear by limiting the field of action. The essential functions of the Bank as described by *The Statist* were to be ²³ the development of intelligent coöperation, the advisory function of the Bank, the extension of earmarking of gold, the clearing of international funds, the stabilization of money and credit, and the carrying out of the reparation tasks assigned to it. The addition in this summary in *The Statist* of the further claim that the Bank was to control credit and prices was an assumption based

²¹ Gold itself varies in value (i.e., purchasing power), but the additional possibility of any arbitrary legal change or of economic fluctuations, caused by inflation or deflation of the currency, was practically excluded.

²² Sir Charles Addis, *op. cit.*, pp. 1065-1071.

²³ *The Statist* (London, November 9, 1929), pp. 669-670.

not on the Statutes, but rather on the aims vaguely implied in the Young Plan. *The Economist* stresses the fact that the Bank was not to work for profit.²⁴ Some critics said that the Bank had been much changed from the description in the Young Plan, others that the Statutes were simply the transformation of the Plan into legal form.

The efforts of the committee were directed to maintaining a large degree of independence for the B. I. S. They wished to keep it free of established business connections, or of political intervention as far as that was possible. Insofar as they were successful the Bank was placed in a unique position. The results may be appraised by a study of the aims, functions, location, legal nature, management, resources, and unit of account of the new organization. The brief survey, which results from a knowledge of the steps in organization, takes on new meaning in the light of the actual operation of the Bank during the early years. Judgment must be suspended until accomplishment is compared to plans, until the early history is checked off against the first sketch found in the Statutes, the Convention, and the agreements prepared in advance of the actual working machine.

Further difficulties arose through the attempt to link Reparation and European debts to the United States very closely through the Bank for International Settlements. This desire, political in origin, was defeated by those who hoped to see the Bank survive the immediate responsibilities assigned to it as Trustee for reparation payments. The plan was, more specifically, to create a pool for all incoming payments under the head of Reparation, out of which payments should be made directly to the United States. This would have obviated the need for any budget provisions for debts to America in the creditor countries. The plan was strenuously opposed by the Germans, who did not wish to see themselves linked up to the debt payments in

²⁴ *The Economist* (London, May 10, 1930), p. 10.

this way, and who realized that their position would become more difficult in regard to the United States, while the creditor nations would avoid responsibility for the effects of these heavy burdens on Germany. The idea was abandoned even though the money coming from Germany actually flowed fairly directly into the debt payments to the United States. This inevitable connection between payments was not provided for by an international treaty, nor indicated in the Statutes of the Bank.

One of the principal topics of discussion and disagreement was the insistence on the part of Dr. Schacht that certain phrases be incorporated in the Statutes, and by the equally strong objections of other delegates to the inclusion of these provisions. Dr. Schacht had claimed in Paris that the annuities agreed to there exceeded Germany's capacity to pay. He was, therefore, anxious that the Statutes should be so worded as to imply obligations on the part of the creditor countries, and should provide a basis for the reopening of the reparation question later by Germany if the creditors should not carry out these duties. The Germans won their point to the extent that the Statutes stated that the Bank should carry out the provisions of the Plan which indicated measures to expand commerce and to lessen national trade barriers. The Anglo-Saxon point of view prevailed, however, inasmuch as the phrases added, "within the limits of the present Statutes."²⁵ Since the Statutes went on to prohibit a number of activities which might have stimulated foreign commerce, it is clear that the Bank could do very little to carry out the more ambitious suggestions which would have benefited Germany as the world's main debtor country.

Another problem introduced informally led to some disagreement. This was the nationality of the General Manager, who was to be chosen at a subsequent meeting. At one of the sessions of the committee, it is said that the

²⁵ See *The Statutes*, Article 4.

name of a French economist was suggested for this post in the course of private conversations. The Germans at once made it clear that they would oppose this on principle.²⁶ Although this matter was not within the scope of the committee's activities, it aroused antagonisms which may have hindered an early decision on other matters such as the site of the Bank.

Even when the Organization Committee completed its work in November, further arrangements were necessary.²⁷ The hopes for an agreement were ruffled by German opposition.²⁸ There was a direct attack on the Young Plan in Germany. Dr. Schacht criticized the new settlement in December. His objections were followed shortly by the Hugenberg referendum on the Plan. This was instituted by the two Nationalist leaders, Herr Hugenberg and Herr Hitler. The vote of December 23 did not support their contention and the way was cleared for the next preparatory steps.²⁹

OTHER PRELIMINARIES ARRANGED

The next stage after Baden-Baden was the second Hague conference in January, 1930. It was marked by a further crisis caused by Dr. Schacht's objections. On January 14 he announced that the Reichsbank would not coöperate in the founding of the new Bank. It was only when the government of Germany stated that some other group of banks would participate if the Central Bank refused, that he withdrew his objections and the arrangements could proceed as at first planned. The work of putting the Trust

²⁶ See Chapter I. Actual decision was made on April 22, 1930. Germany made a formal protest.

²⁷ A group of lawyers met at Brussels in December to amplify the Trust Agreement in certain respects, particularly Article XII, but no fundamental change was made. The men who did this work were Mr. J. M. Marx, Signor Pilotti, Sir John Fischer Williams, and M. Jacques Lyon. Mr. Reynolds also helped in this work.

²⁸ See also *infra*, Chapter XII.

²⁹ *The New York Times* (October 17, 1929).

Agreements into final form progressed smoothly since most of the controversial questions had been decided in the Hague conference and at Baden-Baden. The matter of Eastern Reparation was still troublesome but was settled in most of its details. The main questions were successfully arranged by the middle of the month and the agreements were signed on the twentieth.

This series of meetings and list of documents give striking evidence of the complicated nature of international coöperation. In order to put the Young Plan into force, fourteen separate agreements had to be signed by the representatives of twenty governments. Those which concerned the Bank more nearly were Annex VIII (p. 68) of the Reports which contained the draft of the Trust Agreement and Part 3 containing the Convention with Switzerland, the Charter, and the Statutes. These documents became operative when the treaties putting them in force were signed by specified numbers of the powers concerned. The granting of the Charter by the Swiss government occurred on February 25, 1930,³⁰ and a contract was executed in Rome by the Governors of Central Banks.

The Trust Agreement,³¹ the first of the two principal documents just mentioned, gives in detail the responsibility of the Bank in the carrying out of the Young Plan,³² and its duties as Trustee. It also provides for the remuneration of the Bank and the settlement of disputes. The contract was duly put into force later in the spring as soon as signed by the Trustee and four of the following five powers: Belgium, France, Great Britain, Italy, and Japan; and after the German laws prescribed were enacted.³³

³⁰ *Message du Conseil fédéral à l'Assemblée fédérale relatif à l'approbation de la convention concernant la banque des règlements internationaux et à la prolongation de cet accord pour toute la durée de la banque*, no. 2542, and *arrêté fédérale* (Feb. 7, 1930).

³¹ Cmd. 3484, pp. 68-79.

³² See *infra*, Chapter XIII.

³³ Cmd. 3484, p. 25.

The second main document, the Convention ⁸⁴ between Switzerland and the six main reparation countries ⁸⁵ included the Statutes and made them legal and binding. This action was taken in view of the adoption of the Young Plan, and the expressed intention of the Central Banks and banking groups of seven countries—including in this case the United States—of “founding an international bank.”

⁸⁴ See Appendix, or Cmd. 3484, pp. 110-112.

⁸⁵ Belgium, France, Germany, Great Britain, Italy, Japan.

CHAPTER III

THE ECONOMIC NATURE OF THE BANK

A SMALL group of men met in Basle in April and again in May 1930, to decide on the nature and work of the new International Bank. There was a difficult road before them and there were few signposts to mark the way. There were, however, a number of significant facts and conditions on which they could base their plans. Such were, for example, the funds available for immediate use, the location of the Bank, its relations to governments and other organizations, and indications in the Statutes and elsewhere of the functions which it was to perform.

These factors were indicated, either directly or indirectly, in the documents which brought the Bank into existence. They may be divided into four main groups: first, the financial resources; second, the functions and prohibitions outlined in the Young Plan and the Statutes; third, the controlling influence exercised by various groups; and, fourth, the traditions in the banking world which were applicable to the new institution.

Some of the special characteristics which were evident at this time were inherent in the situation out of which the Bank developed. Others, such as the location, the accounting unit, and control were made definite in Baden-Baden. Many of them introduced a high degree of artificiality into the work of the Bank.

This was especially true in regard to the lack of a "home currency" for the Bank which was the result of the absence of any natural domicile and also of the particular accounting device, swiss francs at par, adopted in Baden-Baden.

This decision meant, for instance, that every transaction of the Bank involved an exchange risk and although losses could be avoided to a considerable extent in theory by keeping assets and liabilities balanced in the various currencies, the difficulty could not be eliminated in practice since the Bank had to move its investments in view of differences in money rates as well as in consideration of special needs for exchange assistance. This characteristic was obvious to those directing the Bank but its repercussions on policy were not always observed because it seemed to some to be mainly a technical factor, whereas in fact it influenced the economic nature of the Bank at every turn.

Then again, the activities of the B. I. S. were conditioned directly by the financial resources at its disposal. These set definite limits to its ability to affect the price level, interest rates, exchange fluctuations, and economic conditions generally. The sums it held during the first two years were, for instance, less than one-tenth of those of the Chase National Bank of New York. A comparison with the resources of the seven founder Central Banks and the Bank of Switzerland shows that B. I. S. funds were smaller in many cases but still far from negligible.

CENTRAL BANK RESOURCES ¹

TOTALS IN LAST WEEK OF DECEMBER

(in thousands)

	1930		1931	
	<i>In the National Money</i>	<i>swiss francs</i>	<i>In the National Money</i>	<i>swiss francs</i>
Belgium	3,441,382	2,479,914	4,001,351	2,883,436
France	102,999,562	20,914,061	115,318,736	23,415,469
Germany	6,429,785	7,938,006	6,868,474	8,479,598
Great Britain ...	561,945	14,173,117	556,593	14,038,131
Italy	50,469,094	13,766,424	46,771,047	12,757,710
Japan	2,195,543	5,671,819	1,771,768	4,577,067
Switzerland	1,377,001	1,377,001	2,643,220	2,643,220
United States ...	5,200,648	26,952,969	5,728,855	29,690,464
The B. I. S.		1,578,134		1,040,831

¹ Bank for International Settlements, unpublished statistics.

It is obvious from this table that the B. I. S. had less money at its disposal at this time than any of these banks except, in 1930, the Bank of Switzerland. The funds were derived from various sources. They could be increased under certain conditions but not in every case at the will of the Bank. Taking these categories in order as they appear in the monthly balance sheet they may be divided into four groups. First the capital, which was one-quarter paid up, yielded the Bank approximately 77 million swiss francs. This original amount increased as new participants subscribed to the shares allotted to them until it reached 125 million with the issue of the remaining authorized shares in May, 1932. A call for the other three-quarters payable on shares outstanding could be made at any time and would, if made, increase the funds to a total of 500 million swiss francs.

The second main group of resources consisted of long term deposits under the Trust Agreements which totaled approximately 300 million swiss francs. These were not subject to any notable increase or decrease unless a new reparation agreement should be made. The third group of resources available to the Bank was treasury funds left on deposit through Central Banks and the fourth was the money deposited with it by Central Banks for their own account. Considerable uncertainty existed in regard to these latter sources of funds and the amounts to be put at its disposal could not be known in the early weeks of the Bank's development. Other ways of increasing its funds were permitted under the Statutes, for example, the floating of securities, but this was not a practical possibility in 1930 and 1931. Moreover, the building up of additional working funds from profits and commissions was bound to occupy a minor part in the Bank's first plans.

The outstanding feature of this situation was the passive position of the Bank. The aggregate of treasury and Central Bank deposits were not mainly subject to the control of

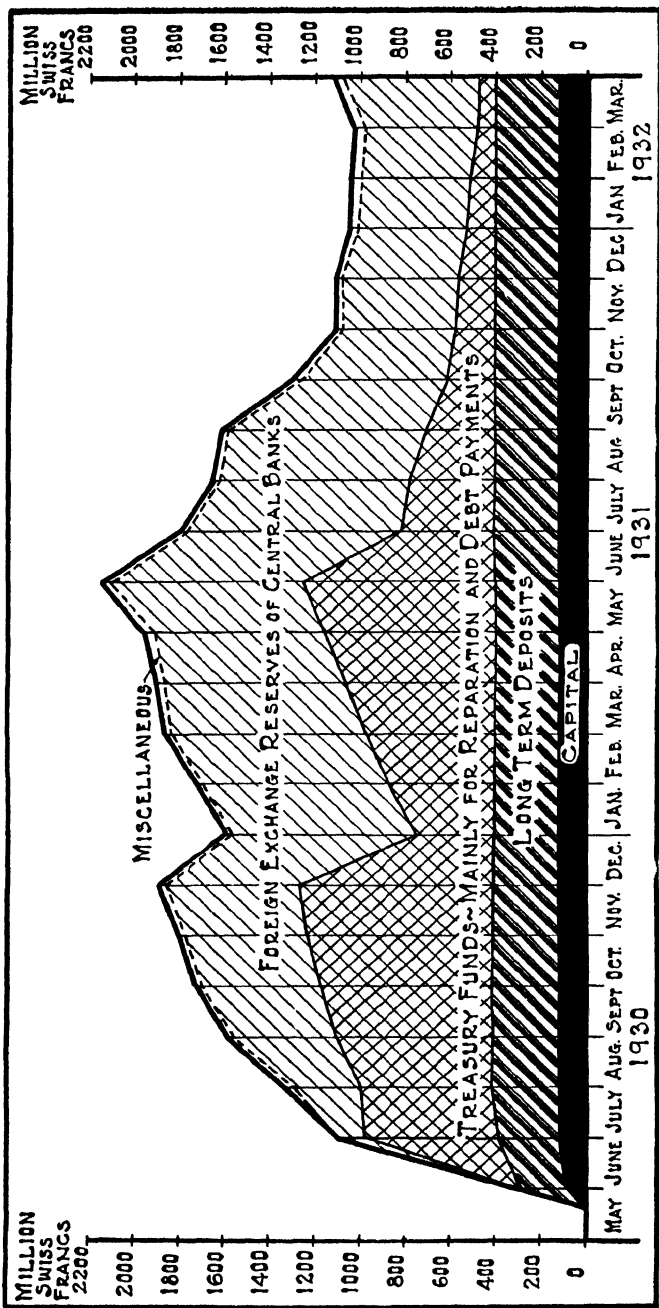


CHART I*
 SOURCES OF THE B. I. S. FUNDS
 * See monthly financial statements published in the Appendix.

the Bank even though they were the most flexible part of its resources. The trend of these deposits was, in fact, upward during the entire first year. This was natural as the knowledge of the new undertaking spread and new countries participated. Three of the motives for making these deposits were the desire to share in the venture, the prestige that came with association with the B. I. S., and the financial gain which might come from the interest paid. It is clear, however, that the first two reasons did not call for large deposits, and the third might fail to be operative if the B. I. S. could not pay a better rate of interest than was secured outside. Other advantages designed to attract funds, such as clearing facilities, could be offered to depositors but no rapid or sure development of such facilities was possible.*

In contrast to the situation which the Directors found in the case of the B. I. S. Central Banks have mechanisms whereby they can direct deposits in or out by means of the bank rate or open market operations. Moreover the possibilities of note issue give them greater leeway. Commercial banks, on the other hand, can give tempting conditions in rates and terms of loans. These the B. I. S. cannot offer without impairing the soundness of its policy. Its strongest weapon is probably its general appeal to the support of the Central Banks, and the promise to develop those clearing and exchange facilities which might prove desirable with the passage of time. The interest rate incentive might easily fail entirely in a time of tight money.

The location determined the fact that business must be carried out mainly if not altogether through agents in the separate markets, and the Central Banks were clearly indicated for this rôle. Other limits to the manner of doing business became evident as contacts were developed in many directions.

It is not necessary to outline the various influences ex-

* For a more complete discussion of the motives leading to participation see *infra*, Chapter VII.

erted on early development by the personnel available and other similar concrete factors. It is perhaps enough to suggest that such things served as guides and limits to the program outlined in May 1930.

DOCUMENTS SERVED AS GUIDES

The documents referred to above gave the Directors and Management further indications of the line of development to be entered upon although many of the suggestions were not immediately practicable.

The Young Plan set forth very ambitious suggestions. The Bank was to develop backward regions, promote new ventures in export trade, and fill in the gaps in international finance. The suggestions were not supplemented by precise indications of how these things could be done, nor the manner in which such endeavors could be carried out without competition with existing organizations. Nevertheless, those who were managing the B. I. S. kept these ideas before them as possible ends.

Most of the aims set forth in the Young Plan were made definite in the Statutes and were carried further by some conference, proposal, or work accomplished by the Bank. The first steps toward their realization can be noted in the sequence of events during the first two years. It is true that lack of publicity led to an underestimation of what was done, but the beginnings made in Basle were by no means insignificant. The attempts to (1) improve the working of the gold standard, (2) increase the stability of currency and prices, (3) equalize the distribution of credit, (4) increase understanding, (5) meet sudden crises with reserve resources, and (6) develop new facilities for credit and trade, must be judged in the light of the beginnings made.

THE STATUTES

The Statutes were very clear on a number of the functions of the Bank and definite with regard to certain things

it could not do. The directors of the new enterprise were left in no doubt as to the two main responsibilities assigned to it. These were the execution of certain duties in regard to reparation payments and the development of Central Bank coöperation. A number of related tasks were suggested in a more general way.

For instance, the Bank was to improve the working of the gold standard, to extend its province, and introduce order into the gold exchange standard. In the second place, there are indications, specific in some cases, more vague in others, that the Bank was to work for the stability of prices and of currency.* In the third place, the Bank was to bring about a more even distribution of credit, by facilitating clearing, lessening the discrepancy of money rates, and building up confidence.

In connection with coöperation the B. I. S. was to encourage uniformity and understanding of banking practices by conference, study, and personal contacts between various financial centers. This work was to encourage similar methods in handling gold, in rediscounting, in investment standards, and the development of broader bill markets. Then the Bank was charged with the task of holding funds and influence in reserve, so that it could avert the acute crises that might threaten from time to time in various countries. These functions were not clearly separated from each other but were interlocking.

This work was, in many respects, the expansion of the efforts of Central Banks to meet the needs of international finance. The main difference lies in the fact that each Bank, within its own sphere, was trying to protect the business and currency of one nation. This was a narrower aim, and could, in prewar days be pursued without necessarily working for universal stability. In many respects, however, it was possible for the Directors and Management who were outlining the future work of the B. I. S. to adopt the

* *Stability* was not defined.

methods which had been developed by the older Central Banks and apply them to the world of closely interdependent nations.

MAIN FUNCTIONS OUTLINED

Later events were to prove that the Bank's capacities were not equally great in all directions. The reparation tasks, clearly specified and carried out without question or difficulty, showed the facilities were well suited for this work, although the early hopes that the B. I. S. could make available large credits and support the reichsmark on the exchanges were disappointed. In the realm of Central Bank Coöperation, on the contrary, success was limited by the fact that Central Banks had to move cautiously in supporting weak institutions. The chapters on clearings (X), the emergency help (XIII), the gold standard (XIV), and coöperation (XV) give some indication of the reasons for progress made and for setbacks experienced in certain cases.

The men who outlined the plans could not foresee the events of 1931 and 1932. They naturally took all the major possibilities into account and developed a broad program guided by the Statutes. Thus, all the specific acts permitted under Article 22 were carried out at some time in the first two years. These were, briefly, as follows:

1. To buy, sell, earmark, and hold in custody, gold.
2. To purchase and discount bills.
3. To buy and sell securities, except shares.
4. To buy and sell exchange.
5. To open deposits, make and receive deposits.
6. To act as agent for Central Banks.
7. To act as trustee.

These operations in various forms and instances made up the bulk of the business done.

Article 24 hints at new and untried efforts to ease international transactions. It is one of the suggestions carried over from the Young Plan which stimulates the imagina-

tion and points to new ventures. It provides that the B. I. S. can enter into special agreements to facilitate international settlements. This paragraph was much discussed at the Bank. It was quoted during the conferences on clearing, and whenever foreign exchange questions were under discussion. It is too vague to indicate just what might be done, but is specific in pointing out a gap in economic institutions and functions.

Article 25 gives a further positive injunction. The B. I. S. is to carry on its business so as to assure a high degree of liquidity. This emphasizes once again the similarity between the B. I. S. and Central Banks, and limits its activities in the direction of long term loans, or of any attempt to take on the functions of an investment trust. A hint is given in the phrasing of the paragraph that liquidity is to be a relative matter, and adjusted according to the term of the Bank's liabilities. In fact, the more usual definitions might give way to a broad policy if the Bank should secure a considerable proportion of long term deposits. Otherwise, the ninety-day tradition would be presumed to hold for a large part of its assets so the Bank could be ready to meet the unexpected, and serve in the sudden crises.

In carrying out these varied tasks the Bank was not to bring about inflation, at least not through note issues, was not to upset existing agencies through competition and was to avoid political connections of all kinds. It was indicated that the Bank was to avoid all destructive action, and to add new safeguards by becoming a further bulwark to existing monetary systems. The possibility of going beyond this field of action is held out in the permission to float bonds, although the demands of long term credit did not harmonize easily with the express mandates to the Bank.

PROHIBITIONS

Article 26 outlined a number of things which the Bank could not do. It prohibited note issue, accepting bills, ad-

vances to governments, accounts in the name of governments, acquiring predominant interests in business undertakings and dealings in real estate.

Public opinion was apt to attach considerable importance to the statutory limitation. Closer examination, however, shows that much was left which the Bank could do. The prohibition of note issues was essential. It was out of the question for a detached and inexperienced organization to have the right to create purchasing power without the special responsibility of safeguarding a particular economic system, or the checks and powers that come with the close link to the financial policy of any one fiscal system. The prohibition of acceptances was, on the other hand, of no great significance. It was a concession to those interests which feared competition and was in line with long established Central Bank policy. It did not deprive the B. I. S. of any essential function.

The further restriction, forbidding loans to governments was one which saved the Bank from embarrassing problems.* It would have been impossible to lend to any one government without at once opening the question of aid to all other countries. Any government which could secure a large loan from the B. I. S. would thereby gain a power over the Bank which every other state would be anxious to equal. Any such transactions would be counter to the essential aims and spirit of Central Banking—that is, the determination to protect monetary standards as far as possible from political influences.

The Statutes did not prevent the Bank from handling treasury money, but it was held as “Central Banks for the account of others.” It was the responsibility of the Central

* In 1931 the complicated adjustment of the “Hoover Debt Holiday” to the New Plan led to nominal transactions which had no economic meaning. In 1931 the relending of unconditional payments to the German railroad was to preserve the principle of continuity. The French position was that the funds were relented by France and the other creditors and the B. I. S. merely executed these transactions.

Banks and did not occasion direct dealings with government officials. Most of the funds under this heading during the Bank's first year were sums accumulating in anticipation of the half yearly payments to the treasury of the United States.⁵

In agreement with the spirit of coöperation and public service which was intended to guide the Bank, it was urged to avoid competition with existing institutions and predominant interests in any business concern. In practice, indirect competition could not be avoided entirely, but the intention expressed was a clear guide to the Bank in determining more exactly its functions, and to a certain extent, its methods of procedure. The further restriction against holding real estate is one of minor importance, and not likely to affect the B. I. S. in any significant way.

These precise admonitions and prohibitions in the Statutes have stood the test of the first months of the Bank's activities. It is obvious that they have not narrowed its work too much. Many tasks were left: the development of coöperation as a long run proposition, the clearing of reparation and debt funds, and assistance in special emergencies. Moreover, the steady progress of the first year is ample proof that the B. I. S. was saved from the worst dangers and pitfalls which surrounded it. The Statutes formed, indeed, a very useful chart for mapping out the progress of the new Bank. The Directors and Management found them sufficiently inclusive, and at the same time really suggestive of the course to be followed.

DIRECTION AND CONTROL

Other indications of the most effective line of progress were to be found in the influence exerted by the various groups having a voice in its plans or a right to check its development.

Control was vested in four groups. In the first place the

⁵ See *infra*, Chapter VII, for an analysis of Bank statements.

seven founding governments had definite treaty rights in connection with the Bank. Then, within the limits prescribed, the representatives of Central Banks and the other Directors from participating countries determined the policies and programs and were called on to approve the specific acts. In addition to this each Central Bank could veto any operation in its own currency.⁶ Finally, there was a fourth group, the Managers themselves, who guided the Bank in its daily work, and by their knowledge of all its business exercised a predominant influence upon its development.

This complicated system of restraints was unusual in the banking world. No Central Bank was under such definite restrictions with the possible exception of the Federal Reserve System. In any case, however, the technicalities appeared more formidable than they actually proved to be. Thus, in the first two years of the B. I. S. there was no instance of the use of the veto power given to Central Banks. Governments did not interfere in any way with the conduct of its affairs. The Board of Directors, following closely the work in Basle, gave valuable advice, but the link between the Managers and the Board was so close, the aims so well adjusted that there was no sharp conflict, no need for a reversal of policy, or change of program. The actual working situation was, therefore, not unlike that of other banks.

The composition of the Board of Directors was a factor which was bound to influence the course of the Bank in the long run.⁷ The two outstanding features were the predominance of reparation countries, and the fact that representatives from outside Europe would be at a disadvantage. The first situation resulted from the granting to both France and Germany one extra Director for the duration of the

⁶ *The Statutes*, Article 28.

⁷ Three new Directors were elected in May 1931. They represented the Central Banks of Holland, Switzerland, and Sweden. See *infra*, Chapter IX.

New Plan.* Moreover, Directors from the founding countries, all concerned in Reparation, had the extra advantage of being able to send alternates to the Board meetings. Other Directors, subsequently elected,⁹ had to turn over their votes to some one who would be present at regular meetings, and could not send temporary representatives. Since the meetings of the Board must be held ten times a year, a representative from South America, for instance, would probably be forced to reside in Europe or to give his proxy to some one else at some of the regular meetings.

These provisions had two disadvantages. For one thing they may have tended to keep alive the animosities and bitterness arising from the war. In addition to this they tended to develop political blocs within the Board of the Bank. It would be difficult for the more distant non-reparation countries to have any influence unless they could unite with those Directors who were both historically and geographically closer to the Bank. Moreover, the right to be represented on the Board of Directors, open to three other Central Banks, would perhaps be shifted from country to country at the time of new elections, in order to stimulate interest. The original group, on the other hand, would more easily build up the experience and power that comes with continuity of office. None of these arrangements exerted any harmful influence during this early period, but were held by some to involve potential dangers.

There were advantages arising from these conditions. The Bank was assured a certain continuity. It was certain to have the Governors of the Banks of France, Germany, England, Belgium, and Italy represented at most of its meetings. Even if the Governor should send an alternate his own view would be expressed and his policy continued.

* "The New Plan" was the official name for the Plan which came into force in May 1930. It included the "Young Plan" and the "Hague Agreements."

⁹ See *The Statutes*, Article 28.

This small and closely coördinated group could probably work together to better advantage than a larger and more rapidly changing Board. In any case, there was little likelihood of an early revision of the Statutes.

It is interesting to note that the wish of the administration in Washington to keep clear of the Bank¹⁰ led to a possible increase in the authority of a group of private banks which subscribed to the shares of the B. I. S. This power was not at once evident but it was apt to increase with the development of the Bank. In 1930 the larger part of the Bank's deposits were in New York, and most of its investments were in dollars. It is inevitable, therefore, that the representatives of American banks should have as much to say in the running of the B. I. S. as the Governors of some of the larger Central Banks charged with the protection of public welfare. It is true that the Federal Reserve had the power to veto operations in America. It is also true that the Bank was operated on principles which met the approval of those in charge of the Federal Reserve. Nevertheless, the power centered in the American market was not properly balanced by responsibility for the B. I. S., and the semi-public Federal Reserve System did not have the authority in the council of the new Bank which its potentialities demanded.

These controls were in a sense negative signs of the field of activity. Even after the resources had been appraised and the Statutes and directing influences taken into account a further search had to be made to determine the methods and procedures which could be adopted. Unfortunately there were no clear patterns which could be followed.

BANKING TRADITIONS

A comparison of the Bank with those organizations which were most like it makes it plain that although it was frequently called a "Super-central Bank" it differed from

¹⁰ See *infra*, Chapter V.

Banks of Issue in many vital characteristics. Moreover, the B. I. S. was very different from commercial banks and it had little or nothing in common with less specialized international organizations. Both the legal and economic characteristics were unusual.

Thus in comparing the Bank with Central Banks it is evident that they possessed a number of powers denied to the B. I. S. The most notable of these was the ability to issue notes. Further than this, their rate-setting function formed the corner stone of their control of credit. The Bank in Basle was prohibited from setting any such decisive rate.¹¹ Moreover the open market possibilities of the Central Bank in its own country could exert a powerful influence whereas the B. I. S. was hampered by its limited resources, the exchange risk, and the veto power from engaging in a strong action in this realm. Then, the relation of the Central Bank to the government made possible, on the one hand, rapid inflation and, on the other, prevented any possibility of insolvency. In general the stronger Central Banks were very free as to the nature of their investments, and the type of operation undertaken. The B. I. S., in contrast to this, was limited and restricted in a number of ways. The significant similarity between the new Bank and Central Banks, was their common aim to serve the public good through increased stability, lessened friction, and the prevention of sudden shocks to the economic system.

Even though it was unlike Central Banks it differed markedly from commercial banks as well. The B. I. S. was a private business undertaking but it was unlike the other private banks in origin, in structure, and in the fundamental aims which were to be followed. It did not have at its disposal the same methods of doing business.¹² The origin and structure, dependent on the special international forces which brought it into existence, require no further com-

¹¹ This prohibition is in the Young Plan and not in The Statutes.

¹² See *The Statutes*, Article 25.

ment. The peculiarities of aim and method are less obvious but very much more important.

Then, in the third place, the Bank was an international organization but it differed very much from its neighbor, the League of Nations. The League was a political instrument, whereas the Bank was private and as far as possible free of government interference. The League Finance Committee was in a position to consult and advise, but in many cases it could not carry out the actions which it prescribed. The Bank, on the other hand, had to follow up its theory by action. It was not designed primarily as a research organization or a consultative body; the only theories that were significant were those made effective by action in regard to money rates, loans, or exchange operations. Furthermore, specialized tasks and obligations limited it to one realm of activity, whereas the League could enter any field of economics, hygiene, law, politics, or other branches of human activity.

The two organizations were similar in that they must both build up a loyalty and *esprit de corps* which would weaken nationalism and establish a sense of unified aim. They had the advantages and disadvantages of drawing their personnel from a number of countries. Their choice was wide, but on the other hand each Manager, or Head of Department must be expatriated from his own country for a while. There would always be the question as to whether the organization could hold its best officers. These difficulties might have seemed very serious in the abstract, but in actuality, both organizations were able fairly quickly to develop a spirit of their own, and to draw and hold able men.¹⁸

Other points of similarity and difference between the Bank and existing organizations are important in apprais-

¹⁸ The salary scale for the Bank was high compared with European scales. The President received \$50,000.00 a year, his alternate \$40,000.00, and the General Manager \$30,000.00.

ing the Bank, and in forming a judgment of its later possibilities. When the many peculiarities are realized it becomes obvious that the future of the Bank is hard to predict.

These peculiarities emerge from a closer study of the Bank's history and are evident in all the documents from which it sprang. The essence of the new venture, however, must be sought not in these documents but in the spirit of the men in Paris and Baden-Baden. They saw the problems of adjustment and the limits to its powers, and yet in spite of these difficulties they conceived of a new kind of monetary coöperation. At an opportune moment an unusual combination of circumstances made possible an experiment which the world would probably not have tried if there had been no reparation payments. Here was the first hope of a widespread and effective influence for coördinating monetary policy. Here was the first step in preventing international economic crises.

CONCLUSION

The influence of the Bank must come from its leadership, from its position as a central point in the many fluctuating relationships. It was impossible for it to exert power merely because of the size of funds, or the mechanical pressure it could put on markets. It could negotiate and coöperate in loans, it could call together representatives of large monetary powers, but it must not rely on its own funds or machinery. Its moral influence could be great, its timely intervention critical, but the lack in resources, relative to its need, would have to be offset by great vigilance and judgment. In a certain sense it can be said that a Central Bank is never wrong. It can always maintain its own solvency and even its own earning power by inflation or by other methods at its disposal. In the same sense it might be said that the B. I. S. could always be wrong, since it would be dealing with varying and conflicting forces, and could

neither compel acquiescence nor harmonize differences. The road must, therefore, be long and difficult, and only the need could justify the daring nature of the attempt.

The astonishing thing was that this abstract plan, outlined in the Statutes, conditioned by limited funds, and hemmed about by various controls, actually worked. The group of bankers and economists who conferred together in Basle in the spring of 1930 found a new invention traced on paper, with working parts vaguely specified according to a new untried pattern, and yet in a few weeks they had set the machine in operation; it functioned smoothly and without interruption.

CHAPTER IV

THE BANK'S ORGANIZATION

ON May 17 the Bank performed its first official act in receiving the funds turned over by the Reparation Agent General. On the twentieth, it opened its doors for business and began the daily work of one of the most unusual organizations in the world. Its assets at that moment consisted of about 200 million swiss francs, a board of directors, a group of managers, staff taken from the Berlin office of the Agent General and elsewhere, and many hopes bequeathed by the Young Conference, as well as by hundreds of bankers, financiers, and economists.

An account of the use made of the resources, staff, and plans is given in a series of official communiqués which furnish a condensed outline of the B. I. S. This skeleton outline must be amplified in the light of a multitude of unofficial statements. The history of large organizations is usually reconstructed in retrospect, but in the case of the Bank, it is possible to follow from the beginning the development of a significant and unique institution. The daily work, the structure and methods, the adjustment of internal and external relationships supply valuable data for the student of international finance.

A description of the Bank, as it appeared in May 1930 and gradually adapted itself in the early months to changing tasks, makes it possible to understand the working of the intricate machinery of later years and to get clearer insight into the broad problem of its economic nature and destiny. This growth was natural and unspectacular. The active life of these early weeks began with the second

official act which was the issue of Capital shares on May 20. This increased the resources by about 77 million swiss francs. The capital of the Bank consisted of 200,000 shares of a nominal value of 2,500 swiss francs each. In May, 125,000 of these were issued to five Central Banks and the two banking groups in the United States and Japan. Further issues were made to other Central Banks until in 1932 there were in all 26 participants. In two cases, France and Belgium, the shares were sold to individuals; in all other cases they were held by the bank to which they were issued.¹

The purchase of shares was the technical basis for full participation and determined in the main the nature of the system of outside contacts.

The Board of Directors was the most important of the control groups. This consisted of sixteen financiers, only two of whom, Mr. McGarrah and Mr. Fraser, resided permanently in Basle. President McGarrah had been formerly chairman of the Federal Reserve Bank of New York, and a foreign Director of the Reichsbank. Mr. Leon Fraser, his alternate and American co-Director, had been counsel for the execution of the Dawes Plan. The others came together at intervals of about a month for ten meetings each year, with an intermission of about three months in the summer. The original Board consisted of Messrs. McGarrah, Fraser, Luther, Melchior, Reusch, Franck, Francqui, Moreau, Brincard, de Vogüé, Norman, Addis, Stringher, Beneduce, Tanaka, and Nohara. The Board was changed on September 25, 1930, when M. Moret took the place of M. Moreau, who resigned from the Bank of France, and again on December 24 when Signor Azzolini took the place of Signor Stringher, who died in that month.² The Governors of the

¹ See Chapter XIV for quotations of the value of shares.

² Further changes were the election of Messrs. Bachmann, Rooth, and Vissering in 1931, and the resignation of Sir Charles Addis, whose place was taken by Mr. Otto Niemeyer in 1932. Dr. Trip succeeded Dr. Vissering in January 1932.

seven founder Central Banks were *ex officio* Directors with the power to substitute nominees or alternates. These Governors had also the right to appoint seven other persons representative of finance, industry, or commerce to the Board (in the case of France and Germany, two persons instead of one were appointed). Not more than nine other persons were to be elected from a group of nominees submitted by the Governors of the participating Central Banks.*

The internal organization of the B. I. S. was much less widely known than these outside connections. The structure was, in fact, simple and adaptable to the changing situations which called for different kinds of action.

During the first two weeks the staff expanded from a small group of officers and their secretaries to 85 persons. They came from ten different countries. The representatives of the Central Banks appointed some and others were chosen from a large list of applicants. There was great eagerness for posts with the new organization; no less than 13,000 applications were received during the first weeks. Selection was difficult, since the exact work was not yet determined and a small, but highly efficient, staff was needed. It is interesting to note that the numbers at work in the B. I. S. were less than the staff which had carried out the reparation work in Berlin.⁴

There was, of course, a slightly different division of labor under the New Plan. Deliveries in kind were handled largely by commissioners appointed by the separate governments. Some of the work was done at the Reichsbank, as it had been before—that is, handling of Reichsbank balances received, and the payment of German producers in connection with deliveries in kind. Most of the accounting and handling of funds went through Basle, however, and

* *The Statutes*, Article 28.

⁴ Criticism was brought forward of the "large" organization in Basle, but actually almost the same work, plus some additional functions, was done by a smaller staff. See *Report of the Agent General for Reparation* (May 21, 1930), p. 19.

was administered by some of the same individuals who had attended to these tasks in Berlin.⁵

The new adventure of the Bank in an unexplored field required men of broad experience and keen imagination. Technical proficiency was not of primary importance, because there was very close coöperation with Central Banks through which most of the transactions were executed. Different national points of view and varying economic theories had to be represented, but, other things being equal, a small staff was more effective than a large one.

There were many reasons why the B. I. S. was simple in organization compared with other banks. In the first place it had no direct dealings with the public. It had no need for cashiers or customers' men, for tellers, or agents seeking new business. In the second place, the actual operations were carried out by banks in other centers. This fact meant that, once a decision was made in Basle as to the nature of a transaction and the sums involved, telephone or letter forwarded the request to the Central Bank concerned where it was executed by their specialists.⁶ Orders were carried out at existing rates, so that only in special circumstances did the B. I. S. make a separate offer, or an arrangement which could not be executed in the normal course of business. This state of affairs relieved the Bank of the necessity of building up a duplicating organization or of staffing itself with experts in all types of exchange and credit dealings.

Simplicity in administration was paralleled by directness of dealing within the organization. It was considered important that each manager and officer should know what was being done in every department. The desire to develop a well-coördinated and harmonious organism made frequent conference necessary. Those who had direct contact with the B. I. S. at this time remarked on the friendly consulta-

⁵ Mr. Goodwin (English) was in charge of this work, and had several years of experience with it in Berlin. For a description of this part of the Bank's activities, see *infra*, Chapter XIII.

⁶ There were few dealings with private banks. See *infra*, Chapter VII.

tion and constant exchange of views between the different departments. This was the more notable because the men who were called together on such short notice came from different countries, had widely differing experiences, and had theories which varied, often, in sharp contradiction. Some had known each other before, in Berlin, or Paris, while some had met only occasionally or perhaps had no acquaintance with each other.

The composition of the personnel indicates in some small degree the trend of development in the early months. Those who came from the Berlin office of the Agent General carried on their work in much the same way as before.⁷ There was no occasion for hesitation or disagreement. A number of those in the Central Banking department had helped in the rehabilitation of Banks of Issue and special problems of postwar finance.⁸ Many of those who were directing the Banking department had been experts in their own Central Banks and had been sent on special missions in connection with reorganizing other banks, or granting special credits. All had carried out work requiring great initiative and in many cases, unusual adjustments in special situations.

All the men at the Bank had enjoyed a wide experience and had developed many international contacts. Some had been connected, directly or indirectly, with the financial work of the League of Nations.⁹ Only one or two, however, had been in commercial banking. No one was a teacher, writer, or research worker in economics, except as this was a part of an active rôle in financial life. Several were lawyers and had held official positions on regular or special commissions. In fact, a summary of the previous work of the personnel points emphatically to experience with special

⁷ President McGarrah had been a foreign director of the Reichsbank. Mr. Fraser had been counsel for the execution of the Dawes Plan. Others who had been in Berlin were Messrs. Goodwin, Colenutt, Bourgeot, and of course Mr. Hulse and Dr. Blessing.

⁸ Some of those who had carried out these special tasks were Messrs. Quesnay, Simon, and van Zeeland.

⁹ Messrs. Quesnay, Simon, and van Zeeland.

postwar problems and a wide international acquaintance rather than association with competitive banking. Although in a sense it was a specialized group, it was well equipped to handle general problems and unexpected crises.

The staff so constituted may be classified into four groups. There were, first, the "Directors" who performed the work of Managers, or Executive Officers, in American terminology. These were Monsieur Quesnay, Dr. Huelse, Signor Pilotti, Mr. Rodd, and Monsieur van Zeeland.¹⁰ President McGarrah and Mr. Fraser, his alternate, met with them but were not included among the Managers.¹¹ These two, however, were Directors according to American terminology, or members of the Administrative Council. Then, in the second place, each of the Managers had a number of Assistants working with him. In some cases these Assistants had been associated with the Managers before coming to Basle, and in others were brought in on the advice of Central Bankers to widen the contacts and experience of the group as a whole.

In addition to the Managers and their assistants, there were two other groups of workers, the technical men, and the clerical staff. The lines drawn between the different kinds of work were not clear cut. There was an informality which derived from the newness of the Bank and from the simple way in which it was organized. The specialists included those expert in arbitrage, investment, and exchange as well as those who had charge of the library, buildings, personnel, and the physical arrangements for the conduct of meetings, communication between Banks, and similar work. The clerical staff was notable for its adaptability. Some had worked in London, Paris, and Berlin; some had taken part in previous international conferences. The result was that they possessed qualities of great importance

¹⁰ They must be distinguished from the Directors on the Board of Directors. Mr. Porters succeeded Mr. Rodd as the English Manager in November 1931, when Mr. Rodd returned to the Bank of England.

¹¹ *Christian Science Monitor* (Boston, October 22, 1931).

to the B. I. S. They were versed in several languages and used to the complexities of international adjustment. They had also the sense of adventure which would take them readily from country to country in the interests of their work.

Even the divisions of the personnel which have been mentioned do not indicate a high degree of specialization.¹² The work of the Bank was uncharted; it was always possible that the functions would be so new that it would be necessary to develop a *new* expertness. Meanwhile, in the formative period the staff had an opportunity of learning from one another, and the organization was greatly strengthened by constant intercommunication, criticism, and suggestion.

In addition to those regularly at Basle, a number of men came and went from the different Central Banks. They served to keep the contacts closer and also gave the B. I. S. the benefit of the services of additional experts in certain cases. The arrangement was welcomed as a part of the most important work of increasing Central Bank coöperation. One instance of this type of contact was the arrangement by which one of the staff of the Bank of France was constantly in Basle.¹³

The Reichsbank sent Dr. Fuchs and others to the B. I. S. for special conferences. They frequently stayed for several weeks at a time. The Bank of England sent a number of young men for stays lasting several months, in addition to the experts who came at the time of particular meetings. Dr. Basch from Prague was frequently in Basle. A number of others came from their Central Banks. This practice was encouraged; offices were set aside for the newcomers and

¹² There were further subdivisions of the personnel, but these related mainly to questions of salary, vacations, and overtime, and have no importance for the general development of the Bank.

¹³ Monsieur Guerin and Monsieur Mitzakis assisted in a very able way in the work of the Bank. In 1930 and 1931 they alternated between Paris and Basle establishing a very close link.

secretarial service was put at their disposal. On some occasions Presidents of Central Banks stopped in Basle, either on special visits, or going to Geneva for conferences. It was interesting to observe that no one from the Federal Reserve visited the bank during 1930, although a number of American bankers passed through during the first year. In 1931, Mr. J. E. Crane of the New York Bank made a visit to Europe using Basle as a main center, and Dr. W. R. Burgess came to confer with the Governors in October, the month of the "run on the dollar." On the whole, the contact with America was far from close, and personal connections were impeded by the official attitude of aloofness.¹⁴

Such visitors as came from Central Banks found that lines of authority within the B. I. S. were clearly indicated. They did not correspond to a "line and staff" organization, but rather to a radiating and interconnecting control, centralized in the President. The Chairman of the Board of Directors is President of the Bank. Mr. Gates W. McGarrah of New York was elected to this position in 1930 for a term of three years, with Mr. Leon Fraser as his alternate. He was empowered to propose the General Manager and the Assistant General Manager, and chose for these offices M. Quesnay and Dr. Huelse. The President and General Manager together appoint the staff and the heads of Departments. Four of the Managers and most of the staff were chosen within the first six weeks of the opening. Mr. Rodd, the fifth Manager and representative of the Bank of England, was appointed a few months later. There were few changes in the personnel after July 1930 until the second year. Then a number of shifts and readjustments were made.

Wide powers were vested in the President by the Statutes and these were made more explicit in the first meeting of the Board of Directors, held April 22. It was realized at

¹⁴ Business relations with New York were like those with other centers, but were on a larger scale.

once that it would be impracticable to lay every important question before the Board. The distance of most of the Directors from Basle would have meant an intolerable delay. In fact, most of the decisions had to be made and executed quickly. It was therefore provided that the President could decide all matters permitted to the Bank under the Statutes.¹⁵ These decisions would then be reviewed by the Board in their regular meetings. If any criticism were made or change called for, it would be easy to modify the course of action quickly, since most commitments were of short duration.¹⁶

Since the larger part of the investments were for three months or less, it was possible to alter policy and shift funds with considerable rapidity. Moreover, the details of transactions were not generally known, so that a change would not arouse public comment.¹⁷

All the Directors were kept informed of the transactions of the Bank through reports sent to them individually. This gave them a detailed description of the business done so that each one was in a position to raise questions or suggest changes in policy at the time of the regular meeting. The monthly balance sheet was broken up into more precise classification. For instance, *miscellaneous*¹⁸ was analyzed so that it contained no unknown quantities.

The Directors came to the Board Meetings well informed on the Bank's condition. These gatherings were preceded, as a general rule, by two days of discussion between the

¹⁵ Minutes of this meeting were quoted informally to the writer.

¹⁶ The Statutes require a high degree of liquidity.

¹⁷ *The Financial News* (November 11, 1930) and *L'Information Financiers* (November 10, 1930). See also *infra*, Chapter VI. The alleged criticism of the B. I. S. in the Board Meeting of November, 1930, in respect to Yugoslav credits, is not a case in point, since preparations were not carried to any advanced stage without consulting the Board. It is an indication, rather, of the established principle of consulting the Board on projects involving considerable sums or new types of business before taking action.

¹⁸ This was not, in any case, a large item, amounting to less than one per cent of the total.

Governors of Central Banks. The Governors usually arrived in Basle early on Saturday, and so had time for preliminary conversations before the meeting on Monday. These regular sessions often took the entire day in the early months. It was hoped by some that the length of the formal meeting might be reduced so as to allow more time for the informal talks. At the beginning the B. I. S. had been called a "Bankers' Club" by some, and it was hoped that, if the agenda of the meetings were not time consuming, its main function of furthering coöperation could be more completely fulfilled. In any case all policies and actions were keenly scrutinized by the Board.

The detail of the daily work was handled by one or more of three main departments. The first was called the Banking Department, the second, the Central Banking, and the third, the Secretarial Department. Dr. Huelse was head of the first, Monsieur Quesnay of the Central Banking, and Signor Pilotti of the Secretarial. These three Managers and Mr. Rodd and Monsieur van Zeeland met with President McGarrah and Mr. Fraser in a discussion at ten thirty each morning. All new business was gone over in these meetings, and the result of previous dealings reported.

President McGarrah usually presided over this small committee. Dr. Huelse presented a plan of the coming day's business based on resources available and opportunities discovered on the previous day. This included proposed investments, the amounts of deposits to be credited, and various definite items calling for immediate action. Thus it was possible for the managing group to plan the day's business and to formulate gradually the future policy of the Bank in the light of present opportunities. The report included the receipts, disbursements, and investments up to the previous evening, and was based on data from the other two departments as well as the Banking.¹⁰

¹⁰ Each day's mail would be examined before the meetings, and important matters presented to the group.

Further subdivisions of the work were necessary to expedite the daily business. For instance, the three sections of the Banking Department were based on the language which was used in most of the communications.²⁰ There were the French, German, and English groups. In the case of the second and third, the correspondence was almost entirely in the language indicated. In the first, however, Italian was used, occasionally, as well as French. This separation into three parts did not necessarily associate the countries geographically near, but it happened to correspond in some small measure to political spheres of influence.

The mechanical division of business in these different ways did not influence the policy of the Bank or the nature of its dealings with any country. Some classification was needed for practical purposes, since the transactions were spread over a wide area. The three administrative departments and the language subdivisions made a natural line of demarcation. It was possible that working groups might be based on a different principle later, if monetary characteristics should change in certain countries, or if communication and interchange of securities between money markets called for different alliances.²¹ The language basis was bound to become less important as the influence of the Bank grew into real coöperative achievements. A large part of the conference and discussion within the Bank was carried on in English, although most of the staff understood three languages or more.

The Central Banking Department had no such clearly marked provinces. It was charged with the general con-

²⁰ The exact division was as follows:

French speaking division—Albania, Belgium, Bulgaria, Czechoslovakia, France, Greece, Italy, Lithuania, Poland, Portugal, Rumania, Spain, Yugoslavia;

German speaking division—Austria, Danzig, Esthonia, Germany, Hungary, Switzerland;

English speaking division—Denmark, England, Finland, Japan, Latvia, Netherlands, Norway, Sweden, United States.

²¹ For instance, the establishment of anything similar to the Latin Monetary Union would inevitably modify the practices of the Bank.

tacts, and the work of putting monetary systems on a basis of coöperation, that is, on an effective gold standard. Beyond this it had large tasks and uncertain responsibilities. It was busy with arrangements for conferences and the gathering together of experts to discuss large problems of policy and detailed matters of procedure. Under this department, preparations for currency stabilization were carried out. The matter of loans to Central Banks was taken up here, as well as in the Banking Department. Many new projects were brought forward by Monsieur Quesnay and his assistants. Facts were assembled, methods of adjustment analyzed, and the larger aims of the Bank formulated and reduced, in some cases, to concrete projects.²²

The Secretarial Department had two main divisions, the Accounting under Mr. Goodwin, and the Personnel, Equipment, and Upkeep under Mr. Colenutt. The Library was under this second branch. All of this work was fundamental to the operations of the Bank. The handling of the reparation payments was a preliminary, at first, to investment. As time went on, such payments occupied a smaller place in the Bank's activity, but in the early months, reparation and debt payments supplied a large part of the resources. The "Hoover Debt Holiday," which began in July 1931, changed somewhat the relative importance of the different departments.

A temporary location for the Bank has been found in the former *Hôtel de l'Univers et Savoie*. This was leased for a period of two years. It served the Bank very well. The many small rooms were well adapted for private offices. The dining room was remodeled and used as the Board room, while part of this served as the library. Although it was entirely satisfactory for the beginning, the Board looked forward to erecting a new building on a site offered by the city of Basle. Both the new location and the hotel used

²² See *infra*, Chapters VI, VII and IX. This department was reorganized in the fall of 1931.

during the first two years are near the Swiss Railroad station. This had direct connections with Geneva, Paris, Vienna, and Milan, and it was linked with the German railway station in "little Basle" by a line which passed around the city and provided through connections on most trains.

Some at the Bank were impatient at the slow development during the first few years; others felt that this was the only safe course. Most observers agreed that the B. I. S. was to be congratulated on getting business running smoothly in so short a time, for establishing a spirit of friendly coöperation within the Bank, and for avoiding the pitfalls of political entanglements as well as the dangers arising from the depression. In the early months, there were, of course, some disappointments and setbacks, but the organization developed on a simple empirical basis which sufficed to get it running smoothly in a short period of time.

CHAPTER V

THE LEGAL NATURE OF THE BANK

As an economic institution the Bank is unique. As a legal creation it is almost as unusual. It is, in many respects like other private corporations formed under the laws of Switzerland, and in others it is an independent international organization under the joint control of a group of states and Central Banks. It enjoys some privileges and immunities, but only in certain countries and in limited respects. It might conceivably exert a powerful influence in the world of international affairs, but at the start it was controlled by a small group of bankers and financiers in seven countries subject to the desires and intentions of a few Central Banks.

The formal language in the Treaty and Statutes which clothes the legal personality of the Bank may seem to have little meaning for the layman, but the sound growth and assured power of the new organism depend, to a considerable degree, on these concepts and definitions—there must be a solid framework to support the new creation. Its well-being is conditioned by its relations to the states in which it operates, by the basic principles which govern its dealings with other banks, and the alliances on which it can depend. For this reason it is important to observe the special provisions made for the new enterprise, its legal status, its freedom from, or subjection to, taxation, the privileges or disabilities which might attach to its assets, and the power of states or banks to limit the Bank.

Only a few of the legal characteristics of the Bank can

be mentioned in a study of its economic character. Some of them demand attention, however, because of their bearing on the business of the Bank. Others must be left for the lawyers who will define its character more exactly when the meaning of the contracts and agreements is entirely clear.

The nature of the Bank was the result of a number of different treaties, agreements, conventions and plans. It is possible to separate from the characteristics of the Bank such significant points as throw light on its legal and economic status. These relate to its general nature, its creation and possible liquidation, the enforcement of the basic contract, its right to sue and be sued, and various methods of settling disputes. Further important facts are the immunities from taxation and disabilities, diplomatic or special privileges, and its relation to states. An analysis of these different points gives conflicting evidence of its standing in law, though there is no threat to its right to function freely in the field of its main work. This uncertainty may be ascribed mainly to its organization during a transitional stage in the development of international law.

The Young Plan, for instance, indicates in a number of significant ways that the men in Paris hoped to make the Bank free of governments,¹ just as one of their foremost aims was to take Reparation out of politics. They wished the new organization to be mainly commercial and conducted on business principles, and to have at the same time a broad international basis. A number of statements in the Young Plan implied that the Bank would not be subject to the various governments, but would be, to a certain extent, on a different plane. These hopes were only partially fulfilled.

Recent years had seen the development of varied types of international organizations which gave some encourage-

¹ *The Young Plan*, Cmd. 3343, pp. 5-7, 8, 10, 12, 14, 30.

ment to the idea of making the Bank a special legal entity.^{*} Some of these were international because they had a legal existence in many nations, and some because they attempted deliberately to subordinate national characteristics and allegiances. The B. I. S. was one of the most ambitious of these undertakings. Its constitution made it subject to the seven founder states in one or two important particulars—more so, perhaps, than the Young Committee intended. Nevertheless, by virtue of both its constitution and the nature of its business, it could not be controlled by governments directly, nor did it come into conflict or close contact with them.

Professor Hudson, in his discussion of the legal status of the Bank, says that the governments recognize in the agreements the *personnalité juridique* of the Bank, but apart from special immunities it was "in no sense 'extraterritorial.'" It was "not *ex lex*."^{*} Sir John Fischer Williams claims that the intention was

to establish in the international world a right-and-duty-bearing institution which was not a State. And the Experts' Committee on Reparations, when they sketched the Bank for International Settlements, such at any rate is the submission of this article, made in effect though not in so many words such a proposal.

It was to have no single fiscal allegiance and so "would surely come near to possessing something not wholly remote from international independence," but "the word 'sovereignty' would, of course, be out of place."^{*}

^{*} Sir John Fischer Williams, "The Legal Character of the Bank for International Settlements," *The American Journal of International Law*, Vol. 24, No. 4 (Oct., 1930), p. 666: ". . . there came into existence . . . bodies neither states, nor individuals, nor combinations of states or individuals, but right-and-duty-bearing international creations, to which for want of a better name, the title 'international body corporate,' 'personne juridique internationale' may perhaps be accorded. . . . International Association of the Congo, the European Commission of the Danube, the Pan-American Union, and most important of all, the League of Nations itself."

^{*} Manley O. Hudson, "The Bank for International Settlements," *The American Journal of International Law* (July, 1930), p. 566.

^{*} Williams, *op. cit.*, p. 667.

The Organization Committee carried out the general idea of the Plan in making the Bank the creation of the Central Banks, but did not incorporate in the Statutes any article clearly positing an independent international existence. The Legal Committee, which met in December 1929, to prepare the material still further for the later conference, proposed *

. . . that the States interested in Reparations should by international agreement recognize that the Bank, founded as proposed at Baden-Baden possess the quality of an "international body corporate."

This further action was not taken. The Bank, as Professor Hudson says, was clearly a Swiss corporation.* In many respects, however, the special character of the Bank was indicated more clearly by its acts than by the legal formulas adopted. As long as it carried out its particular tasks it was bound to maintain an independent international existence.

There are, in fact, three different theories as to the act of creating the Bank. According to these theories, the Bank is said to have come into existence on one of three or even four possible dates. These dates are the signing of the Hague agreement on January 20, 1930, the granting of the Charter by the Swiss Federal Government on February 25, the signing of the contract in Rome on February 26, and the coming into operation of the Young Plan and Trust Agreements on May 17, 1930. These different possibilities correspond to different conceptions as to the nature of the Bank and its legal position. The choice between these dates holds considerable theoretical interest, and was a subject of discussion within the Bank because of practical decisions which called for actions within a certain period of its founding. One such act was the issue of the full number of shares within two years of the founding of the Bank. The practical decision on this matter was that the Bank was founded

* Williams, *op. cit.*, pp. 670, 671; see also *supra*, Chapter II.

* Hudson, *op. cit.*, p. 565.

on May 17, 1930, although this decision did not exclude entirely the other theories of the Bank's creation.

Those who stressed the international nature of the Bank made the signing of the Hague Agreement in January an important step in the founding of the Bank, but the coming into existence, according to this theory, was actually May 17 since it was on that date that the Hague Agreements, ratified by the specified number of governments, came into force. This concept made the Bank the creation of a group of governments, and in certain ways on a par with them and not under any one state. The interpretation of Professor John Fischer Williams falls under this heading. There were, however, a number of objections to this point of view. Because of such objections no phrases were included in the treaty or statutes which indicate clearly an international character. Most of the Anglo-Saxon opinion, as well as Continental practice, had been against such special clauses. It was known that the Americans at Baden-Baden and the Hague objected vigorously to a definition of the B. I. S. as an international body which would make it unique in law.

The second view of the nature of the Bank claimed for it a different kind of independence. It was based on Continental corporation practice and might be called the "company" idea of the Bank's nature. Some held, for instance, that the signing of the contract in Rome on February 26⁷ determined the date of creation, although, since the contract read that it was not to become effective until the coming into operation of the New Plan, May 17 would be chosen, as under the first theory, as the date on which the Bank first existed.

The third concept of the nature of the Bank corresponds to the corporation law of Anglo-Saxon countries. According to this idea, the Bank could come into existence only

⁷ This contract was drawn up by Signor Fume.

through the granting of a charter, which was done in this case by the Swiss Federal Government on February 25. To the extent that this was true, the Bank was a national organization, and was subject, unless specifically exempt, to Swiss law. Those who were most influential in bringing this interpretation to the foreground were some of the English and Americans at Baden-Baden and the Hague. In a number of cases the actual operation and business of the Bank conformed to this concept, although it was not at all points contradictory to the other two theories.

A reconciliation of these possibilities was reached by the general recognition of the complex nature of the Bank. That is to say, the Swiss government, and those who held the theory that the Bank was a creature of one state, granted that the Bank held an exceptional position in respect to certain immunities and privileges. Then, again, those who held the idea that the Bank was created by the founder Central Banks, by virtue of the signing of a contract, were aware that it had to bring its business into conformity with Swiss law, special international agreements, and the laws of other nations, in certain cases. And, finally, those who claimed a special international existence for the Bank recognized its dependence on the Charter, Swiss law, and the agreement between founder banks and the group of men which drew up the final plans. As a historic fact, the steps taken to put the Bank in operation were carried out by representatives of the seven founder Central Banks, and even those who held that the creating act was carried out by the Swiss government recognized that there might have been a legal shell provided for on February 25, but never made actual in case the Young Plan had not come into operation. There would have been, under these conditions, no directors, no capital, and no business to make the Bank a real entity. Thus, the act of February was like an offer or a concession. The April meeting was the first concrete

evidence of the existence of the new Bank and the opening day was in May.

Furthermore, it was generally considered that Continental law was to be applied to the Bank in addition to Swiss law wherever purely commercial relations were concerned. This was subject to the provision in Article 57 that disputes about the Statutes with the founder Banks, with the shareholders, and with governments—that is, in respect to the Hague Agreements—should be submitted to the special tribunal indicated. Although the abstract principles involved in these theories and practices seem confused and admit of no dogmatic statement, the practical business conditions were clear. It was admitted that the Statutes should prevail if there should be any conflict between them and the law of Switzerland. A possible concrete case under these general questions was that with regard to the liability of shareholders. That is, usage differed in different countries. In Switzerland it was the practice to consider the original holder of the shares as liable for two years. This idea was adopted at the Bank even though practice differed in certain countries; in some cases the original holder was perpetually liable, and in others the holder of the moment was responsible for any claims which might be made on “the shareholder.” No specific dispute or claim arose on this point during the first two years.

Dependence on the governments is further indicated by the necessity of gaining their consent before the amendments of certain articles of the Statutes could be carried out. This meant that the Bank would have difficulty in altering the fundamental nature of its organization and control, and could not easily take on any of the functions refused it in the first instance. It also meant that the Bank was protected from sudden and arbitrary interference since any alteration of the Charter would require the agreement of all the countries concerned and would be difficult to obtain. This, the most significant of all the links with

the controlling states, was considered a safeguard by some and a handicap by others.⁸

The B. I. S., unlike sovereign states, can be sued or sue "in any court of competent jurisdiction" in cases not covered by the arbitration provision.⁹ This would mean in practice that disputes between the Bank and individuals, as well as between it and ordinary companies, would be settled in the ordinary courts of law, though disputes between the B. I. S. and states, other banks, or its own shareholders might be referred to the Tribunal for arbitration on the wish of either or both parties. Thus, the Bank, though on a special plane in certain cases, cannot avoid the ordinary application of business law or suits that might arise in the course of business dealings. There is probably some justification for Williams' statement:

Thus it was in fact to possess a sort of dual personality; in one incarnation it was to move in a world of states and regulate the financial relations of governments, in another capacity it was to be a commercial or financial institution, even if of a high and hitherto unknown order . . .¹⁰

There were, in this situation of the Bank, certain conflicting elements which could not be eliminated merely by legal forms.

In view of these complex relationships there is little wonder that the exact nature of the new organization was uncertain. The material existence of international organizations requires domicile within a particular state. Moreover, the need of temporal support and of rights to make claims and carry on business under codes of law necessitated the recognition of governments and well-defined relations to

⁸ The Bank was given a special facility in regard to arbitration which might be of value, according to some authorities. See *infra*, Appendix, *The Statutes*, Article 56; *Trust Agreement*, Cmd. 3484, Article 15, p. 23. This Tribunal was established by the London Agreement of 1924, and arrangements were made in 1930 for continuing its existence.

⁹ *The Statutes*, Article 57.

¹⁰ Williams, *op. cit.*, p. 669.

sovereign states. There was no place or time into which internationalism could fit without going through the known mediums of national constitutions. Those who organized the B. I. S. wished to free it from the more arbitrary and narrow political connections as far as possible. They knit it closely to Central Banks, and drew up the Statutes and Charter in such a way that they could not be changed without government consent while leaving the Bank free from later government interference. They sought for a number of special privileges which might help it to grow in power and independence. The two main forms which these privileges were to take were freedom from certain kinds of taxation, and the protection of its assets.

The early idea of the legal nature of the Bank certainly pointed to sweeping exemptions of the B. I. S. from interference. It was perhaps intended to free it entirely from taxation as well as from the threat of seizure or interference with its assets. Two things modified these plans so that the Bank did not enjoy many special privileges. In the first place, the later committees became more and more cautious about claiming a peculiar status for the Bank and let the matter of its *personnalité juridique* lapse.¹¹ Then in addition to this the final drafting of the various articles was neither inclusive nor definite enough in its terms to cover all cases suggested at the time when the agreements were first conceived.

The immunities to be asked for were of two general types, first, freedom from taxation, and second, freedom from interference and seizure of property.¹² On both scores the Bank was given a special status for certain purposes but not for all possible cases that might have been included. For instance, the freedom from taxation applied to the business of the Bank in Switzerland and to salaries and incomes of the personnel accruing to them in Switzerland.

¹¹ Williams, *op. cit.*, pp. 667, 670, 671.

¹² *Constituent Charter*, Article 6, (a) to (e).

There was no general exemption from taxation for business done elsewhere, but only for that connected with Reparation. Moreover, income of the personnel derived from sources outside Switzerland was taxable. Even in regard to exemptions granted by Switzerland there were cases not covered by the Charter and Convention,¹³ and therefore not legally provided for. For example, the article with regard to taxing the business of the Bank and issues of shares and securities did not cover the possibility of future issues of bonds which the Bank might undertake.¹⁴

In a letter dated February 3, 1931, the Bank was assured, *inter alia*, that issues of bonds made outside Switzerland for the purpose of mobilizing German annuities would be exempt from Swiss stamp duty. This was, in effect, a further extension of Article 6 (d), in the Charter. It covered all business carried on in Switzerland with one or two possible exceptions, and these were cases not likely to occur, and which, if they did, would not involve considerable sums. Any exemptions from taxation of business in other countries would have to be the result of special arrangements. In general, the Bank would enter those countries on the same basis as other corporations or as states, and had no more claim than they to special advantages in carrying on its business.

There was also some uncertainty as to the exact interpretation of Article 6 (e). While this provision seemed to exempt the salaries of the personnel from taxation under Swiss income tax laws, it was so phrased that it stated that *the Bank* should enjoy this privilege, and not the employees themselves. The Swiss government agreed to interpret this to mean that the income received from sources in Switzerland should not be taxed. There was further uncertainty as to income accruing from outside sources to foreign resi-

¹³ Williams, *op. cit.*, p. 672.

¹⁴ As the result of this omission, there was an exchange of letters between the Bank and the Swiss Federal Council at Berne.

dents of Switzerland working for the Bank. This matter was still pending at the beginning of 1932. A plan was drawn up by virtue of which the Bank would pay a certain sum to the Canton of Basle and the state would make no effort to tax the personnel on income received outside Switzerland—incomes and earnings which would undoubtedly be taxed once in the countries in which they were received.

The exemptions from taxation, therefore, were important mainly in the case of reparation funds, which were free of levies in all countries party to the agreement.¹⁵ Incomes in Switzerland, and bond issues in general are taxable, while for reparation bonds there is this special exemption. There are, however, no all-inclusive or sweeping exemptions universally applicable. Contrary to the opinion of many people, the Bank would have to pay the same taxes as other financial institutions outside Switzerland, and would have to pay any normal taxes other than those especially provided for within Switzerland.

One of the most important problems confronting the organizing committee was the protection of the Bank's assets, particularly gold, against danger of seizure. The economic ideas on which the Bank must rest called for the security of its assets and the assurance that deposits held with it would maintain their value. This became a pressing problem during the gold standard crisis of 1931.¹⁶

Certainly, safeguarding of the Bank from the danger of seizure or interference with the property or funds was of considerable practical as well as theoretical interest. The articles in the Agreements referred to strengthened the position of the Bank in its contention in 1931 that balances with Central Banks were taken and received as if there were a "gold clause."¹⁷ Restrictive measures such as those

¹⁵ *The Trust Agreement*, Cmd. 3484, Article 10, p. 22.

¹⁶ See *infra*, Chapters XIV, XVI.

¹⁷ See *infra*, Chapter XV.

in this article are unusual, but if they are imposed they interfere with the transfer of Reparation or similar funds and arouse the general protest of other states and Central Banks. This effort to safeguard the Bank was expressed in definite agreements, however, only in the case of the reparation countries and of Switzerland.

The protection of the assets of the Bank as indicated in Article 10 constituted a principal motive for holding gold in custody with the B. I. S. Other reasons expected to lead to such transactions were the prestige enjoyed by the smaller banks if they should take advantage of this opportunity, the greatly increased facility in transferring the metal or in borrowing against it, and the possibility of using it under special transfer arrangements to ease exchange positions subject to sudden pressure. Events in 1931 were such as indicated a probable increase in the use of the B. I. S. facilities once there should be a return to normal international payment conditions. The Bank was ready to lend against gold without delay whereas the attempt to use gold quickly without its aid usually meant the sale of the metal, the purchase of exchange and, perhaps, later, the reverse operations, if it were a short time operation. Thus in some cases the B. I. S. could reduce the steps from four to one and bring about a great saving in time and in commissions.

It is important to note, however, that some of the major countries have not as yet either granted or refused a special status to the assets of the B. I. S. The countries which have given the immunity include all the signatories of the Hague Agreement, and Switzerland. The Bank was in the habit of keeping most of its gold "held in custody" with the Bank of England. There were a few instances when gold was left in Paris, New York, and Cologne. In the practical conduct of affairs, therefore, the special immunity was a minor consideration, in these years, compared with custom and convenience which determined where gold was held. Later cir-

cumstances might increase the importance of this protection.

The fact that the United States was not included in the countries giving special protection had no immediate consequence for the business of the Bank. The likelihood of interference with the property of the Bank because of the absence of a special agreement was almost nil. New York was, in fact, the only banking center where the buying and selling price of gold was the same, and where operations were freely engaged in without the probability of some slight loss. Moreover, the less exposed situation of New York made it as safe a storage place without treaty protection as many European countries which granted extra treaty safeguards but were in a less secure military position.

The aims of increasing the holding of gold in custody by the B. I. S. gave special significance to this protective clause. Power was expressly given to it to buy and sell gold for itself and others, and to hold it in custody. The Bank was called on to perform this service very early in its career.¹⁸ It offered certain special advantages to the countries availing themselves of the privilege. One of these was the anonymity of the holdings—that is, there was no public knowledge of where the gold was deposited, or by whom it was owned, and there was, therefore, no basis for criticizing subsequent withdrawals. This enhanced the possibility of coördinating and offsetting gold movements under normal conditions, thus protecting the exchanges from sudden pressure.¹⁹ Another advantage was the superior safety of the holdings of the Bank in certain centers. The crisis of 1931 was to bring out the advantages and disadvantages of such holdings.

A number of nice legal questions were raised with regard to gold custody. There was some doubt, for instance, if gold

¹⁸ For Greece, for Poland, for Spain, for Austria, for Esthonia, for Lithuania, and for others, see *Information Financière* (December 1, 1930).

¹⁹ See *infra*, Chapter X.

owned by Central Bank X and given to the Bank in custody, and thereafter held by the Central Bank in country Y for account of the B. I. S. were really in custody of the B. I. S. or not. The nominal interposition of the B. I. S. as bailee changed the quality of the gold in a purely formal way. It is possible that the same gold might be held in the same place and used as the basis for the same credit, but after the change it would be earmarked in the vaults of Central Bank Y for the B. I. S. instead of for X. This change might bring a special immunity and also might conceal the real ownership of the gold. The legal aspects of this procedure were clear, but the situation was unusual, and the extent to which there was a real change introduced by the second custody in the case of fungible goods and doubts as to whether it was under B. I. S. dominion might conceivably lead to a protest that the formal intervention of the B. I. S. did not alter conditions. Because of this remote possibility the matter was carefully studied by international lawyers for the Bank, and their reports left little doubt as to the legal rights involved.

There is sometimes a considerable difference between the legal aspects of the question and the practical requirements. Most of the gold would probably be centered in London or in Paris. If gold were not in one of these centers, and not in New York, it could quite easily be held in Cologne rather than in one of the nearby countries not affording an immunity. If the inviolability of the gold owned by the Bank were threatened, the whole structure of international banking as developed by the B. I. S. would be shaken. In any case gold security must rest on the intentions and desires of Central Banks rather than on the more formalistic basis of treaties, if real confidence is to be attained.

Emphasis on the legal aspects and security would tend to establish international obligations and promises that would strengthen the economic structure at various points. The privileges which would be granted the Bank for its property

might conceivably be given later to Central Banks on a similar basis. Even if this were so, the exemption of gold from seizure could never be completely assured, but would continue to be an object of international arbitration and dispute if hostilities should occur.

RELATION TO GOVERNMENTS

In addition to specified exemptions from taxation and from disabilities or interference, the Bank enjoyed no diplomatic privileges, no "extraterritorial" rights, and was not granted any peculiar status or powers. What advantages it might gain from its international character would have to grow out of an increasing competence in a field which had not yet been fully defined. The actions of the Bank in the international world might exert an indirect influence on the development of international law as applied to this type of organization. It is even possible that through future laws or practical development it might acquire a special character which it did not possess during its early years. The relation of the Bank to separate governments did not greatly affect its work or plans.

Nevertheless the relation of the Bank to Switzerland would continue to be of particular importance because its legal existence depended in part on its Charter. Although in the first instance this was to run for fifteen years only, it was provided that it should be renewed in due course, and no difficulty on this score was anticipated. In all the negotiations with Switzerland, it was assumed that the Bank would bring both prestige and business to the country where it was domiciled, and a few concessions and privileges were asked in return. There was some success with regard to taxation and legal status. If, in the beginning, there had been any difficulty about the granting of these rights and making easy the incorporation, the organizing committee might have considered another city, since many countries

were eager to become the site for the new venture of the Bank. No later shift of location was at all probable.

The United States took an official attitude which made necessary special arrangements. By a communiqué issued May 16, 1929, the State Department made it known that there could be no recognition of the Bank, nor Federal Reserve representation on its board. The government did not sign the treaties putting the Bank into operation, and would in no direct way further its development. This was a logical, but at the same time unnecessary stand. The United States could have permitted the Federal Reserve Bank to participate without signing any treaty. In fact, the action of the government in forbidding it to do so was extra-legal. Banking collaboration is in no way inconsistent with the official attitude of the government toward debts and Reparation, and cannot be prevented by law or government.

During this postwar period an attempt had been made by the State Department to control foreign loans which emphasized the desire to keep free of the complex European situation in the postwar years. By expressing their approval or disapproval of certain issues they did exercise an influence which was related to the general political stand in these matters. This was not by virtue of any legal restrictions, but rather on account of the psychological dangers of going counter to the Department's advice. There was to be a change later, not so much in the official attitude toward the debts and Reparation, as in the general attitude toward European affairs. This made possible the participation of Mr. Prentiss Gilbert, Consul in Geneva, at the League Council meeting in 1931, and the visit of two Federal Reserve representatives to Basle. Thus, as already mentioned, in 1931 Mr. Crane spent several days in Basle, and Dr. Burgess conferred with the Central Bank governors assembled there in October. And on the other hand, officers of the Bank for International Settlements paid a number of visits to the

Federal Reserve Bank of New York. Both Mr. McGarrah and Mr. Fraser had offices put at their disposal during their visits to America, and were in constant touch with those at the Federal Reserve.

In May, 1931, there was, for the first time, a policy of active participation by the Federal Reserve in the B. I. S. This was evidenced by the share which the Federal Reserve took in the credits, first to Austria and Hungary, and later, the twenty-five million dollars' participation in the Reichsbank credit arranged through Basle. Various other connections developed, and the B. I. S. in its turn had many dealings in New York. The Federal Reserve Bank of New York had been appointed the sole correspondent in America, and after the first few months, more than two-thirds of the Bank's funds in America were held at the Federal Reserve. The contacts between the two were bound to become closer as the B. I. S. extended its influence.

In 1929, however, there was no sign of this evolution of economic and political interests. Thus the organizers of the Bank were placed in the position of working out a formula. It was obvious that transactions on the New York money market were necessary to the successful operation of the Bank, either in its work of clearing Reparation and debts, or in developing Central Banking coöperation. The result was the invitation to a group of banking houses to participate in lieu of the Federal Reserve,²⁰ as well as those provisions in the Statutes which assured the Federal Reserve along with other Central Banks the right to oversee and veto transactions without assuming direct and positive responsibility. For different reasons a similar adjustment was made in the case of Japan. The Central Bank of Japan was prohibited by law from buying shares of any kind. Therefore the Industrial Bank of Japan joined in the undertaking

²⁰ These banks were: The First National Bank of New York, the First National Bank of Chicago, and J. P. Morgan & Co.

on a basis similar to that of the consortium of American banks.²¹

The significance of this limitation on the participation in the System can be estimated only with the passage of time. During the first year, the transactions were much as they would have been in case the connection had been like that of other countries. In 1930 a large majority of the funds of the Bank were held in New York because of the persistent flow in that direction.²² The fact that it enjoyed no special immunity in New York was a purely nominal difference. Also, in the United States, there was no direct guarantee of deposits²³ like that obtained in a number of countries, and there was no use of the money employed account. This special form of deposit had been developed under the gold exchange standard mainly to centralize funds left abroad with Central Banks in the countries where it was on deposit. Without this special arrangement it would have been difficult or impossible for some banks, such as the Bank of England, to have attracted these funds, since they could not pay interest on the usual deposits under their Statutes. The net effect was that the money so left was invested under the Central Bank guarantee, and the Central Bank kept a small part of the earnings to pay for the security which resulted.

Future events are bound to alter the relation of American banks to the B. I. S. If debt payments continue to be made in any volume the clearing work will lead to the holding of B. I. S. funds in New York. If, on the other hand, the Bank devotes itself more exclusively to coöperation between Central Banks, the need of close contacts with authorities in

²¹ It has been erroneously stated in some discussions of the B. I. S. that this was the Yokohama Specie Bank.

²² See *infra*, Chapter XII. This changed with the Hoover Debt Holiday in 1931.

²³ This might conceivably have affected the B. I. S. during the time of bank failures; actually it lost no money in this way.

the Federal Reserve System is of the highest importance. It would be better if the simpler relation through the Central Banking system could supersede the more complex connections with the two groups, one of which is free of public control. Daily transactions would not differ much in form, but there would be fewer deposits with private banks, perhaps, and closer personal contacts would be made. Moreover, it would increase the European understanding of American needs and policies to have men from the Federal Reserve more frequently in Basle.

On the other hand, despite the relation between the Bank in its origin and the problem of reparation payments, there was no special connection between it and the German government. The B. I. S. operated through the Reichsbank just as it did through the other Central Banks, receiving its information and communicating with banks and others through this channel. The sole responsibility which the Bank had toward the government was, in the case of the request under the Young Plan, to call the Special Advisory Committee and perform its work as outlined. In no way was the German government in special contact with the Bank, but it stood on the same plane as the six other founder countries.

In general the freedom of the Bank from government interference, provided in the Statutes, is very definite. No government officials, unless they should be presidents of Central Banks, may be directors.²⁴ The Bank may not make advances to governments or receive deposits from them. The location was chosen with a view to avoiding close contact with any parliament or diplomatic center. The emphasis on the authority and contacts of Central Banks indicates the strongest possible desire to keep the B. I. S. a private institution. The special provisions, applicable in the case of taxation, interference and disabilities, as well as the settlement of disputes, are indicative of this same aloof-

²⁴ *The Statutes*, Article 31.

ness. The Bank stood in relation to governments in much the same position as other international corporations, or as other Swiss corporations.

THE ATTITUDE OF THE LEAGUE

The League of Nations is a special case under the general question of relations to governments. Once the principle had been accepted that the Bank was to be a private institution—a principle fundamental to the Young Plan—there was no serious consideration of establishing an official link, except on the part of the League.²⁵ The matter was discussed by the League before the meetings of the Baden-Baden committee. The subject was introduced in the Assembly September 10 by M. Mowinkel of Norway. He referred to Article 24 of the Covenant, which states that all "international bureaux" shall be placed under the direction of the League if the parties concerned consent.

A draft resolution was proposed on September 14 by the delegates of Denmark, Norway and Poland. This urged that the Assembly, recognizing the importance to the Bank of independence in conducting its business, should invite the Council to take the necessary steps for establishing an appropriate relationship in view of the fact that the Bank would influence the economic life of all countries. This draft resolution was referred on September 19 to the second committee.²⁶ It was discussed in this committee on September 20, 21, and 23. It was evident that there was considerable opposition to the suggestion. Nevertheless, the delegates from Austria,²⁷ Holland,²⁸ and Bulgaria,²⁹ associated themselves with the views of those who put forward the resolution, with some reservations. The delegates of

²⁵ Extracts from the *Minutes of the Tenth Ordinary Session of the Assembly, and of the Second Committee of the Assembly, September, 1929*, League of Nations, C. 494. M. 158. 1929. II.

²⁶ *Ibid.*, p. 3.

²⁷ *League of Nations, op. cit.*, p. 9.

²⁸ *Ibid.*, p. 5.

²⁹ *Ibid.*, p. 14.

the other countries, for the most part, opposed the resolution.

The arguments for finding some basis or manner of connecting the Bank with the League were aroused partly by the fear that the new institution might pursue a policy in conflict with the efforts of the League in the economic sphere, or might exert too powerful an influence over individual states. It was further urged that the material, experience and opportunities for mutual help made it logical that the two should be closely linked together. It was asserted that:³⁰

The aim of the League of Nations in the economic field is absolutely identical with that of the Bank, that this Bank will exercise an exceptional influence upon the economic life of the world, and that it is impossible that these two institutions should work separately.

Although this assertion of identity was not echoed by the committee, a number of them agreed with the general spirit of this statement.

The majority of the committee, however, opposed the resolution which was therefore withdrawn by the three delegates. Dr. Breitscheid of Germany questioned the applicability of the Article 24 in the case of the Bank, and opposed the intervention of the League in a matter growing out of the Treaty of Versailles.³¹ He argued further that no political questions were involved in the bureaus referred to in Article 24 of the League Covenant. He questioned the willingness of the new Bank and those who were organizing it, to contemplate the presence of a representative of the Secretary General at its meetings.³² M. Loucheur spoke against the resolution for France, and for a number of other countries, including Great Britain, Italy, Japan,

³⁰ M. Gliwic, Poland; *League of Nations, op. cit.*, p. 9.

³¹ *League of Nations, op. cit.*, pp. 10-11.

³² This was a part of the arrangement prescribed under Article 24 of the Covenant.

and Belgium. He said that the exact nature of the connection had not been defined and was hard to imagine, and that he feared that the intervention of the League might discourage or interfere with a constructive economic development. Moreover, he did not consider the possibility of the Bank going counter to the League in its policies a real danger.

It came about, therefore, that instead of urging the establishment of a connection, the committee recommended that the deliberations on the matter should be transmitted to the governments, and that they in turn should make these known to their representatives at Baden-Baden. This action enabled those who framed the Statutes to act in view of these fears and suggestions, without calling for any definite exchange of opinions.

Such help given or contacts made were on a purely personal basis.³³ It is quite natural that men who had formerly been associated together in financial work should confer from time to time. It is also obvious that the Managers at the Bank should follow League publications and conferences with keen interest, just as it was inevitable that financiers passing through Basle on their way to Geneva would frequently stop for friendly interviews. Despite such informal contacts, however, it should be observed that the problems which occupied the League finance committee at this time, such as customs treaties, government-guaranteed agricultural loans, and so forth, were not the Bank's problems. The gold question had to be considered, but little action was possible in the early months.³⁴ On the other hand, the B. I. S. was more than completely occupied with the pressing problems of its daily business.

The attitude of the B. I. S. to the League of Nations was, in fact, the outgrowth of very definite circumstances to

³³ Newspaper reports that Mr. Pelt (Dutch), a very able and experienced member of the Information Service of the League, had been assigned to the Bank to help in its organization, were inaccurate.

³⁴ See *infra*, Chapter XIV.

be observed at this time. What some interpreted as an air of aloofness was rather an expression of the preoccupation of the Bank with its own immediate and urgent problems of organization and function. There was little time to consider any special contacts or the theories of relations to other organizations. Moreover, there was some feeling at the Bank that it was important to protect the new organization from a predominant influence exerted by any more powerful or older body. A third reason for preserving a high degree of independence, in this case, was that the League was a political organization, and that the International Bank should not violate the spirit of its Statutes by becoming very closely linked with the League. This policy is comparable to that of the Central Banks which try to avoid very close connections with the governments in their respective countries. There were, in the fourth place, a number of reasons why Germany, Italy, and the United States preferred to see the Bank maintain an independence from the League.

It was the policy in Basle to allow the relationships between the two organizations to develop naturally and slowly out of concrete problems. A number of events led to an association of the two organizations. Thus, in the help granted to Austria and Hungary, the League appointed the advisor to the treasury, whereas the B. I. S. nominated an expert to assist the Central Bank in its part in the financial reconstruction.

Then again, the League was responsible for the suggestion that an exchange conference be called in the autumn of 1931, since they found in their work on the commercial barriers and hindrances in Central Europe that special money and exchange problems were causing difficulties. As a result of the League's suggestion, the B. I. S. arranged the Prague meeting.³⁵ Then again, the Bank agreed to appoint directors to the International Agricultural Credit Corpora-

³⁵ See *infra*, Chapter XIV.

tion, which the League was attempting to organize in 1931. These incidents indicate that there was no distrust between the two organizations, although the relationship had not as yet become very close.

The future relation of the Bank to the League is not one easily forecast.^{**} It is probable that there will always be a friendly division of labor. Many financial questions on which political forces have a direct influence will be left outside the scope of the Bank. Other matters which are close to the slow and continuous development of banking technique may well be handled by the Bank. The League, for instance, could hardly work directly toward modifications in the gold exchange standard, even though it might discover just what those modifications should be. The work of investigation, contacts, and programs will naturally come to be divided between the two organizations in a way appropriate to the future nature of their personnel and the active and regular business undertaken. Although there may have been some feeling of distrust at the outset, evidenced in the early discussions, there was every reason to see in the events of the early months a cordial understanding on the part of both organizations.

Although the attitude of the Bank toward governments was clearly formulated in advance, the relation to other banks was not so definitely outlined. To be sure, many thought that the Statutes and Young Plan implied that most of the work of the Bank should be done through the agency of Central Banks, and pointed to the veto power as an indication of this. Nevertheless, it was distinctly stated in Article 23 of the Statutes, that all permitted transactions could be carried out with private banks. Thus, although the prohibitions indicate to a considerable extent the direction in which the B. I. S. could go, they do not define the scope of its activities narrowly. Much was left to the judg-

^{**} Sir Arthur Salter, *Recovery, the Second Effort* (New York, 1932), pp. 334-337.

ment and later experience of those who would formulate the policies of the new organization.³⁷

The veto power (discussed in Chapter III) granted the Central Banks³⁸ would have meant complex responsibility if the B. I. S. had wished to deal directly with private banks. As it was, the business was carried on through the agency of Central Banks.³⁹ This was automatically cared for by introducing funds through the Central Bank which gives its approval in executing the order. Since the efforts of the B. I. S. were aimed to strengthen the power of the Banks of Issue and their control over money markets in conformity with certain cardinal principles, no conflict arose.

In fact, the veto power was never used during 1930 or 1931. Matters of importance were subjected to careful consideration within the B. I. S. as well as within the Central Banks before action was definitely outlined, and there was no plan or desired action on the part of the B. I. S. which led to conflict between it and Central Banks. What criticism was expressed centered around *lack* of action.

Since this considerable latitude was permitted to the Bank by the Plan and the Statutes, however, even a basic decision as to policy must be regarded as temporary, and subject to later revision. This holds true of the relation to private banks as well as in other fields. It is quite possible that the proposal to accept deposits and to work with private banks in various capacities will recur again in Basle.⁴⁰

If it should happen later that the Bank did not demon-

³⁷ As a usual practice, deposits with private banks were confined to New York and Holland.

³⁸ *The Statutes*, Article 20.

³⁹ See *infra*, Chapter VII, for description of how business was carried on in the different markets, and of what dealings might be direct with private banks.

⁴⁰ It is true that Central Banks are technically *private* and not government banks, but since they are from time to time subject to various forms of pressure from their governments, and since they are organized to serve the public welfare and not mainly for the profit of their shareholders, they are usually considered to be public institutions.

strate a high degree of usefulness in the field of Central Bank coöperation, those in control would perhaps, under proper conditions, turn in other directions and take advantage of the fact that connections with other types of banks were not excluded. This was an improbable event, and, in any case, the policy during the first year was to refuse the deposits and most other kinds of direct contact with private banks. The B. I. S. left its own money in them in some cases, but did this under the general supervision of the Central Banks.

If the B. I. S. should extend its connections at a later date to include private banks, it would have to safeguard them in a few respects to conform to both letter and spirit of the Statutes. It should be noted in the first place that all the functions and permissions granted under Article 22⁴¹ with one or two minor exceptions were to be carried out for or with Central Banks. Article 23, on the other hand, states that these same functions may be exercised with other banks or financial corporations or individuals "provided that the Central Bank of that country does not object." This indicated that the Central Bank was to be the main organ and channel for the Bank's influence, but that other developments might be acceptable. Article 24 applied only to Central Banks, and it has been regarded as most important to the development of clearing and foreign exchange facilities through the Bank. On the negative side, the Bank is enjoined under the Young Plan to avoid competition, which might be construed as limiting to a certain extent its activities in this direction.

The question of the field of operations arose in practical form many times during the first year of the Bank's existence. For one thing, many large private banks wished to make deposits with the B. I. S. largely for reasons of prestige, but partly for the sake of the transfer exchange advantages, or interest to be earned. The possibility was

⁴¹ See Appendix, *infra*, *The Statutes*.

debated during the first five months, and the matter was decided tentatively in the negative in October, 1930. The reasons for this decision lay mainly in the desire to strengthen the Central Banks in their own fields rather than to work beside them, perhaps in duplication or competition.

The problem was also raised by the plans for a number of international banks during this time. The first of these was the Amsterdam International Mortgage Bank, outlined and founded in 1931. The second was the International Mortgage Bank incorporated in Basle in March, 1931. Other proposals were under discussion, such as the International Agricultural Credit Corporation approved by the League in May, 1931. Then there were the plans for the so-called Norman Bank, as well as that developed by Dr. Schacht, and also the Francqui Bank, none of which went beyond the stages of theoretical discussion.

Many were disappointed that the Bank did not take a more aggressive part in these schemes, but it was impossible that it should be the prime mover in this direction. In the first place, it could not invest large funds in long term loans, which were necessary for such ventures. In the second place it could not buy shares. In the third place, its interests in real property were limited by the letter of the Statutes as well as by policy. Moreover, these organizations were in some cases directed either by political groups or by bankers so aligned as to give some ground for anticipating political influences and aims.

Then again, the nature of these various undertakings was such as to require a spirit of adventure, a trial of new methods, an effort for considerable profits with the possibility of risk, which was alien to the spirit of Central Banking. Those who were directing the Bank took the stand that they should prepare a solid basis for the creative development which should be carried into new fields by private initiative, rather than organize such efforts in Basle,

or compete with them through active participation in such schemes.

The upshot of this was that the Bank showed itself willing to buy bonds of such organizations when they were established on a broad basis. It expressed a more than formal sympathy with sound efforts to convert short time credit into long, when properly organized.

A survey of these general characteristics and relationships shows that the Bank was assured considerable liberty of action, and freedom from government interference. It was to be controlled by Central Banks, and it was also to work primarily through them. Nevertheless, there were lasting vestiges of the political origin of the Bank, which were apparent in the agencies which exercised the ultimate control over its actions. These are seen, above all, in the composition of the Board of Directors, giving the predominance to reparation countries, and extra Directors to France and Germany.⁴²

The League had faced similar problems of representation and control in the attempt to secure a good balance on various commissions and councils, and in the question of the allegiance of employees to their own governments. The Committee of Thirteen was devoted to a study of these matters. The gradual evolution that came with the building of habit and tradition lessened rather than increased the difficulties of this kind in Geneva. There was less conflict of loyalties than some had feared, and the devotion to the interests of the League did not necessarily interfere with the interests of its workers as nationals of various states. The general trend in Basle was found to be the same, even though sharply conflicting desires regarding debts, gold holdings, and loans continued to slow the progress of its work.

Another peculiarity in the control of the Bank was the limited power of the shareholders.⁴³ Ownership of shares carried no right of representation or voting at meetings of

⁴² *The Statutes*, Article 28. ⁴³ *The Statutes*, Articles 6, 7, 8, 9, 15.

the Bank. All such rights were vested in the Central Bank or consortium of banks of the country in which shares had been sold. Such rights were in proportion to the number of shares sold in each country. Even such rights seem to be of comparatively little importance.⁴⁴ The matters on which the general meeting must pass were simply the report of the year's work, the dividend and appropriations to reserves, the election of auditors, and the act of discharging the Board from personal responsibility. Since the new Directors were elected by the existing Board or appointed by the Central Banks, and since the Board had the final word in the appointment of the managers ⁴⁵ as well as in the policies of the Bank, they could determine its actions completely and almost without check.⁴⁶

Since the significance of the Bank lies in its long run achievement, it is impossible to avoid wondering what would happen in case of world war. Such imaginings cannot lead far, since all the basic conditions would be changed if a number of countries were drawn into armed conflict. Moreover, it is necessary for those at the B. I. S. to act as if the treaties and exemptions regarding the Bank would be respected, even if there should be a break in the diplomatic relations between countries. Any other assumption would throw the plans of the Bank into confusion, and would prevent the rational development of the Bank's business.

There is no reason to suppose, however, that even war would interfere completely with the work of the Bank. Governments at war would continue to need foreign exchange and there is ground for considering funds would be

⁴⁴ *The Statutes*, Article 48.

⁴⁵ *The Statutes*, Article 41.

⁴⁶ The possibility of the general meeting rejecting the report is hardly to be contemplated. The managers had a certain advantage over the Board in that they were continuously in touch with the work of the Bank. The governments had certain ultimate rights as signatories of the treaty. The Central Bank had the power to veto within its own country; and the Statutes set limits at many points.

safer with the B. I. S. than they would be in any one center. They would enjoy certain immunities and would be to a certain extent anonymous and might therefore be less subject to seizure should any government determine on extreme measures.

It is apparent the legal nature of the Bank preserved for it a high degree of independence and freedom of action. It achieved a definite personality very different from that of a sovereign state, but commanding the respect of governments as an organization on a special plane. It was limited in some of its acts, and also protected from interference by a treaty which would be extremely difficult to change. It was given privileges and immunities, and placed outside the narrower sphere of any one money market. It was marked with the imprint of the reparation struggles, but not in such a way as to cripple its development. And, finally, the Board, although seeming to be dominated by reparation interests, as a matter of fact was composed of the men who were most influential in the larger money markets of Europe.

CHAPTER VI

THE FIRST TASKS OF THE BANK

As we have seen, it took a little over a year to draw up the chart of the Bank's future, to pass the necessary laws, ratify the treaties, and organize the personnel which would put it in operation. The stories of the Young Conference, Baden-Baden, the Hague, and the choice of the Officers and Board, were front page news in the journals of the world. There had been a series of crises and disputes. There had been resignations, referendums, manifestoes, extravagant prophecies, and violent denunciations. The truth was often distorted but the main facts stood out for all to observe. It was clear that a notable step had been taken and that future economic affairs would be profoundly influenced.

In contrast to the glare of publicity focussed on the Bank in the period of organization, there was an air of mystery surrounding it during the early months of operation. Scant information was issued from the Bank itself. Rumors abounded but they were too unreliable to carry conviction. The distressing condition of economic life in many countries tended to shift the emphasis away from Basle. One may search the newspapers in vain. A few brief notices of meetings or monthly statements are all that are to be found. The Bank was forgotten by some, while others tried to reconstruct its probable activities from a few generally known facts.

This was due, in part, to a deliberate policy of the Administration. Those who were closest to the affairs of the Bank had distrusted the extravagant hopes stimulated by imaginative writers. They knew that they must face deli-

cate political questions and venture into untried economic territory. To a considerable extent their procedure would be a matter of trial and error. If there must be error it would be wise to have this kept within the confidential circles of the Bank's Managers and Directors. Each act would involve a theory and affect money markets; too close a scrutiny might lead to unfair comparisons, hasty criticism, and jealous attacks. The Bank could not have a policy until repeated action had demonstrated practicable methods of business. It was important to avoid becoming the subject of public dispute and to develop the business of the Bank in an unspectacular manner. This was, to a certain extent, the reason for the infrequency and lack of detail in announcements as to the Bank's actions.

The silence of Bank officials did not deceive those who were in a position to judge the importance of the decisions of the first few months. The B. I. S. was faced with various types of problems. There was, first, the handling of the reparation funds, and the clearing of them against Allied debts. There was, second, the development of a deposit and investment policy which was essential to the custody of these funds as well as the others at its disposal. Further than this there were the decisions as to tasks to be undertaken in the interests of coöperation. These three types of business involved questions of theory. Each day presented some new matter to decide, new contacts to be made, and new principles evolved.

Reparation funds, which presented in immediate concrete form the problems before the new Bank, were dealt with in almost the same way as formerly by the Agent General. Here, to a certain extent, there were precedents to follow. The modification in procedure, and the detail of the receipt and clearance of funds, are described in Chapter XIII. It is obvious that although the funds originated in special legal claims, they became at once ordinary banking resources to the B. I. S., indistinguishable from money paid in for shares

and for other purposes. They opened up general problems as to the form of investment to be made and interest rates to be paid to depositors with the Bank. These matters took the Bank at once into unknown territory. The rules worked out in this early period are critical to the later development of the Bank.¹ They were subject to modification but, in general, the plans of the first months carried over, with gradual change and evolution, into the early years of the Bank's operations.

Discussion of the further tasks of the Bank began at once in Basle. Stabilization of currencies not yet on a gold standard was considered. Loans to credit-poor countries were proposed; the development of a world exchange clearing system was suggested; and the encouragement of middle term credit was one of the early projects submitted to the Board. All these matters demanded careful consideration. They were the subject of committee deliberation, and a series of memoranda within the B. I. S. The position of the Board of Directors on these matters became gradually more definite as the limits and potentialities of the Bank became more evident.

The first six months were occupied with attention to details, and the formulation of general principles. It was not until the end of the year 1930 that one can really say that the Bank had policies, knew its limitations, and could see definite tendencies in the mass of daily decisions. It was in the nature of the case that the orientation of the Bank must change somewhat with shifting events. It was subject to the alterations of the reparation situation, and open to sudden calls for help that might come to it in the name of Central Bank coöperation. There was, therefore, nothing final in the policies which developed. They were destined to change to a considerable extent. These changes indicate

¹ The details of the deposit and investment policy, the safeguards against inflation, the uniform interest rate, the effort to secure liquidity, and the attempt to attract funds are described in Chapter VII.

the desire to preserve the fundamental aims and principles rather than any shifting of purpose.

The brief communiqués issued by the Bank give an indication of the variety of the business done. When these are interpreted in the light of the more ample studies within the B. I. S. and its later stand in regard to economic principles, they become impressive indications of the speed of the development and the straight line progress made. A chronological consideration of these acts of the Bank is an interesting background for the more detailed analysis of its policies, and the theories on which its actions were based.*

Every important event in the financial world during this time had an influence on the actions of the Bank, and these actions in turn determined the policies which were to affect later action. It is difficult to keep the complex set of interrelationships in mind. In order to get the proper balance between the various general influences and the development of a policy in Basle, it is necessary in a study of the Bank to look first at the concrete tasks taken up, then at the procedures which became habitual in the process of working out the detail of these tasks and, later, at those financial events which restricted or directed the Bank's activities.

There are, thus, three angles of approach to the problems of the Bank—one through a study of process and detail of operation, another through an account of the general decisions month by month, and a third through an analysis of broad principles and aims in the light of certain economic theories.

These different ways of looking at the Bank are taken up in turn. The chronology of events and the theories devel-

* Chapter VI will give a general historical survey with brief comment on the meaning of the main decisions. Chapter VII will discuss the deposit and investment policies in some detail. Chapters VIII and IX will give the development of credit policy during the later months, and a description of the main events up to the close of the first financial year, March 31, 1931. The later history of the Bank will be given in Chapters XIV and XV, which describe the crises in the reparation question in England, and in various countries where the B. I. S. was called on for help.

oped in the first six months are discussed below before there is any consideration of the further development in the second six months. Then the policies and chronological account of this second stage are outlined before attention is turned to the second year.

This arrangement is made in order to emphasize the way in which the Bank developed in its environment, limited by a multitude of powerful forces and conditioned at every point by the circumstances in which it found itself.

The decisions and policies of the first six months grew quite naturally out of the thinking during the period when the plan was being worked out. And during that time the system of deposit procedures and general policies was gradually formulated. This is covered in Chapters VII, VIII, and IX.

The next six months are discussed in Chapters IX, X, XI, and XII.

The second year is outlined in chronological order in Chapters XIV, XV, and XVI with due consideration to basic questions of policy which were raised, while Chapter XVII looks back over the two-year period and on into the future.

FIRST BOARD MEETING

On May 12 and 13 the first regular Board Meeting of the Bank was held in Basle. It made formal the election of the Officers, selected in the April meeting before the Bank had actually come into existence.^{*} It set May 17 for the opening of the Bank. This date was chosen because, on that day, with the signing of the Trust Agreements and the closing of The Agent General's Office, the Young Plan came into effect. Since it was not convenient to open the Bank for general business on a Saturday, however, May 20 was made the day for the payment of shares and the beginning of regular operations.

^{*} See *supra*, Chapter II.

At this first Board Meeting a number of matters connected with Reparation were taken up. The signing of the Trust Agreement was authorized, the receipt of the funds in the hands of the Agent General was arranged for, the fiscal agency for the Trustees of the Dawes Loan was accepted, and the Young Loan plans were further considered. In addition to this, it was decided to offer shares to Holland, Sweden and Switzerland, as well as to the seven original participants. Further details which related to the internal organization of the Bank and its personnel were discussed.

One important matter bearing on the policy of the Bank was decided in this May meeting. After a discussion of the veto clause in the Statutes⁴ it was agreed that all transactions should be carried out through Central Banks, thus automatically giving them the power to express their disapproval if they so wished. This decision did not mean that business must be carried on exclusively *with* Central Banks but that the movement of funds is in every case executed through them as agents. Business was actually confined to Central Banks in two cases, France and England, because of the expressed desire of these Central Banks to restrict dealings to themselves. Another matter of considerable importance was the confirmation of the decision in the April meeting that all acts and functions specifically authorized in the Statutes might be carried on subject to the discretion of the President without preliminary consultation of the Board of Directors.⁵

In conformity with arrangements made on May 12 the reparation funds were actually turned over to the B. I. S. late in the evening of May 17. The transfer was effected through changes in book entries in Berlin, London, Paris, and New York.⁶ The Bank began to perform the many tasks assigned to it and opened its doors on May 20 for general business. From the beginning the hours were long

⁴ See *Statutes*, Article 20.

⁵ See *Supra*, Chapter III.

⁶ See *infra*, Chapter XII.

and the officers and staff were almost overwhelmed with the multiplicity of detail.

Between this meeting and the second, at which matters of somewhat wider interest were discussed, the Administration worked out the internal organization (described in Chapter III), and the method of daily work. In addition, it placed the funds received from the Agent General for Reparation on deposit with various Central Banks, shifting them in some cases from one currency to another. It added to these other funds received on June 15, by way of regular annuity installment from Germany. In carrying out the Trust Agreement, a portion of this annuity was put in the special Creditors' Annuity Trust Account, and the equivalent of half of this sum, or in this case, 100 million reichsmarks, was put in a similar account by Germany. Meanwhile, the Young Loan was requiring the attention of the officers of the Bank, and the flotation of the Bank's shares through ten additional Central Banks was being arranged.

THE JUNE MEETING

By the date of the June meeting, the Bank was faced with larger questions. Deposits from Central Banks "for their own account" were coming in, and the policy with regard to them was a matter of urgent importance. In addition to this, the relation of the Board of Directors to the Bank was being worked out, and the manner in which the money of the Bank was invested was given further consideration. Other matters less difficult, but still of considerable importance to the conduct of the B. I. S. were the nature of the financial statement to be published each month,⁷ and the possible extension of the Trustee functions of the Bank under Article 3, of the Statutes.

This second meeting of the Board on June 17 must have been peculiarly interesting to all those who participated. There were representatives of seven countries present. For

⁷ *The Statutes*, Article 51.

the first time in the conferences of the Bank, reparation problems were not the main topic. The matters under consideration were to a large extent banking affairs. The field was broad, the persons assembled were widely recognized as men of distinction and power. The comment of one of the eminent participants indicates a measure of disappointment, or at least reserve, as to the character of the gathering. It was roughly this, "In form this is what we hoped for; in spirit, I wonder,—it is too formal, too political, and not spontaneous enough." Events will prove whether or not this hint of disappointment was aroused by a real weakness in the nature of the Bank.

At this gathering it was arranged to offer shares to ten additional countries. These were: Austria, Bulgaria, Czechoslovakia, Denmark, Danzig, Finland, Greece, Hungary, Poland, and Rumania. The offer was actually made on June 25. This brought the total number of participants to 17.* Further business was a survey of work done in floating the Young Loan, and the Bank's functions as Trustee. The budget for the Bank's running expenses was approved, as was also the handling of funds so far. A further formality attended to was the announcement that the Bank would be legally bound by the single signature of either Mr. McGarrah or Mr. Fraser, or, on the other hand, by signatures of any of the two Managers. Although decisions concerning particular investments and deposits were left to the Board, there was, as a matter of course, some discussion of the principles involved.

One of the matters left to the discretion of the Managers had been the rates of interest to be paid. It was realized that quick changes might be necessary and that only those constantly in Basle would be in a position to determine what was wise. The policy at first tried was to classify de-

* Shares were reserved for other countries when they should have fulfilled the requisite conditions. Portugal and Yugoslavia were especially mentioned at this time.

posits held with the Bank into three groups. These were the low interest rate currencies, such as francs and dollars, intermediate currencies, and high interest currencies. A Central Bank making a deposit with the B. I. S. received interest on it in accord with the currency group into which this claim on the B. I. S. fell. Thus a country with a claim on the B. I. S. for lire would receive a return set for the group of currencies in which the lira fell. Variations were made within groups, of course, for the deposits of different terms.⁹ This policy did not prove to be successful. It raised unfortunate comparisons, and was difficult to carry out without errors in grouping. It was abandoned after a short trial, in favor of the uniform rate, or *taux unique*. This meant one rate for all currency claims, although there were various rates according to the length of time indicated.

THE FINANCIAL STATEMENT

A first financial statement was issued on July 5, showing the position as of June 30. This was examined with keen interest by financiers everywhere. There was at first some disappointment because of the indefiniteness of the statement in some respects and the lack of details given. The meaning of the accounting unit, "swiss francs at par," was not understood by some.¹⁰ The omission of any indication of the geographic distribution of investments was criticized, although this indefiniteness came to be recognized as essential in the effort to avoid political controversy and national rivalries. If the amounts placed in different countries had been declared, the subsequent increase or decrease in the sums in various markets would be taken as signs of distrust or confidence, or, perhaps, of partiality. Therefore this in-

⁹ See *infra*, Chapter VII, for deposit technique and Chapter VIII for interest rate policy.

¹⁰ *L'Information financière* (Paris, July 6, 1930) regrets that a "living unit" was not used, apparently overlooking the stipulation in the Statutes, and the *Neue Zuercher Zeitung* misunderstands this phrase as a criticism of the actual swiss franc. See also the *Frankfurter Zeitung*, July 5, 1930.

formation was carefully guarded, and only such general statements as those by President McGarrah on November 14¹¹ indicated the position on the exchanges.

Approximately 90 per cent of the June total, 1,085,720,-801.42 swiss francs at par, came directly or indirectly from reparation funds, if the share capital be considered of this nature.¹² The other 10 per cent came from Central Banks and is indicated under deposits "for their own account." The largest item, 438,198,394.45 swiss francs, consisted of undistributed proceeds of the Young Loan. This item disappeared entirely from later statements. The next largest item, twenty-five per cent of the total, was made up of the two special deposits, by the creditors and by Germany, in fulfillment of the Trust Agreement. The sum received from Germany on June 15, appears under the heading III, b. Central Banks for the account of others. This item was to occupy a conspicuous place in all the balance sheets, until the "Hoover Moratorium" stopped the piling up of treasury funds for the payment of the half yearly installments on the debts to the United States.¹³

The Capital and the Special Deposits, amounting to approximately 375 million swiss francs, or about 35 per cent of the total, constituted long time funds which gave the Bank a margin of safety in maintaining the liquidity of its assets in comparison with its deposits. The other funds were mainly at short term, although the proportions were bound to change somewhat with changing conditions. The Bank had a further resource in the fact that the capital was only a quarter paid up, and that the total authorized number of shares had not yet been issued.¹⁴ This placed in its hands the possibility of increasing the money available.

¹¹ Gates W. McGarrah, "The First Six Months of the Bank for International Settlements," *Proceedings of the Academy of Political Science* (Jan., 1931), p. 33.

¹² See *infra*, Appendix.

¹³ See *infra*, Chapter XII.

¹⁴ The last of the authorized shares was issued in May, 1932.

Later statements of liabilities change with the disappearance of the Young Loan proceeds,¹⁵ the increase in the deposits made by Central Banks, and with the division of the various categories into sight, three months and six months, and long term funds. The exact sources of deposits were not given, but could be inferred to a considerable extent from the general facts known about debt, reparation payments, and the Banks which participated in the B. I. S.

The Bank's assets were divided into two main groups at this time. The first consisted of "funds employed" which were held on short notice and amounted to 494 million swiss francs. These funds were practically equivalent to cash, being less than 15 days for the most part. This part of the Bank's assets amounted to approximately 46 per cent and was derived principally from the undistributed proceeds of the Young Loan. The investments were mainly in France, England and America.

The second large division of the Bank's assets took the form of "investments" not exceeding 90 days and amounted to 517 million swiss francs or about 48 per cent of the total assets. These funds were used to buy commercial bills and acceptances, marketable treasury bills and other short term investments.

The remainder of the Bank's assets were held in sundry investments exceeding 90 days, and a very small part in "cash." The relative proportions in these categories were to fluctuate widely with the distribution of the Young Loan proceeds and the building up and breaking down of the sums held for treasury accounts.

THE JULY MEETING

The third Directors' Meeting took place on July 14. The Board found many urgent problems awaiting them. Some of the questions discussed were:

¹⁵ See quarterly statements of trusteeship.

1. The internal organization, and, in particular, contracts and compensation of the personnel.
2. The sale of shares to ten additional Central Banks.
3. Trusteeship for the Austrian loan.
4. Stabilization of currencies not yet on gold standard.
5. The adoption of four languages for correspondence, i.e., English, French, German and Italian.
6. The handling of German payments, and clearing against Allied debts.

Moreover, there was a continuation of the conversations on methods of handling deposits and the type of investments which should be made. It was alleged in some quarters and denied at the Bank that the possibility of strengthening the pound sterling, by asking for reparation annuities in that currency, was a matter of debate.

Currency stabilization had been indicated as a proper function of the Bank both by the emphasis on Central Bank coöperation, and by the stress on the gold standard as a basis for its dealings.¹⁰ In 1930, there were a number of currencies that did not satisfy the "practical requirements of the gold or gold exchange standard." Spain and Yugoslavia, in particular, seemed to be interested in having the services of the B. I. S. in stabilizing. Both countries were discussed from this point of view in the July meeting. The result was an extensive study of the Spanish situation, interrupted in 1931 by the revolution.

In the July meeting, as in the others, formal conversations, following the agendas prepared, occupied only a part of the time spent by the Directors in Basle. The Governors of Central Banks and some of their aides arrived on the Friday or Saturday previous to the stated meeting. This was the practice adopted after the first gathering. It gave them a chance to confer on their more urgent problems, and to consider informally some of the matters which must be

¹⁰ See *The Statutes*, Articles 3 and 21.

decided in the Monday meeting. Many questions concerning exchange values, credit operations, political dangers, and the needs growing out of the depression, came under consideration. During the first six months, the gatherings occupied most of three days, and occasionally ran over into Tuesday. In view of the urgent world affairs to be considered it was hoped that the development of definite working principles would require less time in later meetings, and that there would be more opportunity for the financial leaders to confer informally.

THE SUMMER OF 1930

Three months intervened before the next meeting on October 13. The Managers of the Bank carried on the work in the light of the general principles laid down for them in the Statutes and Board Meetings. A great effort was made during the summer months to acquaint various Central Banks with the possibilities which existed in the B. I. S. and to find out from financiers in various money markets what they considered desirable. President McGarrah made various trips to Paris, Berlin, London, and other centers. The General Manager, Monsieur Quesnay, visited southern and eastern Europe to establish contacts in countries further afield. In the late summer he visited the Scandinavian capitals. Other officers of the Bank returned to their home Central Banks or cities in which they had special business to perform, with a view to making the links with the Bank closer.

Thus, the summer interval gave the Administration time to perfect the organization which they had evolved, to extend the facilities for investing the funds left with it, and to consider the theory and potentialities of the new enterprise. There was little to disturb the even tenor of affairs during July and August. From the evacuation of the Rhineland, June 30, and the dissolution of the Reichstag, July 18, until September 14, conditions were fairly good in Germany.

Many thought that the Young Plan actually afforded the final solution and the B. I. S. was generally referred to at this time as the Reparation Bank. Those who opposed the Young Plan settlement criticized it;¹⁷ others said that in any case it was a superfluous agent,¹⁸ while a few anticipated impressive new achievements in the world of international finance.¹⁹

The execution of operations from a technical point of view was made difficult by the plethora of short term funds in the high exchange markets, such as New York and Paris. From the middle of the summer, for months to come, there was an over-abundance of money in Switzerland, as well as in Paris and New York. The conditions which had prevailed in 1929, when the Bank was planned, were sharply reversed. With the sudden relaxation of tension in tight money markets, it was faced with a total lack of demand for short funds in the stable exchanges, the low earning power of liquid investments, and a demand for long term loans which it could not meet. This put the B. I. S. under considerable pressure, as to its policies, its methods, and its ability to make profits.²⁰

Although there was no acute crisis during this time, the feeling of discouragement which had prevailed in many countries since the war became intensified.²¹ Serious obstacles to trade expansion raised by the new tariff in the United States, and the obvious abnormality of the flow of gold to France and America increased a sense of the futility of effort. Political instability was everywhere. The German election campaign was disturbing, even though the forecasts did not indicate the full measure of the change to come.

¹⁷ E. Welter, *Die Reparationsbank* (Frankfurt, 1929).

¹⁸ G. Cassel, "Is the International Bank Necessary?" *The Bankers' Magazine* (Nov., 1929); J. Caillaux, *Deutsche Bergwerk Zeitung* (Aug. 9, 1929).

¹⁹ Sir C. Addis, *The Stock Exchange Gazette* (May 9, 1930).

²⁰ The results are discussed below in Chapters VI, VII and VIII.

²¹ The relation of the Bank to German problems is discussed in Chapter XI.

September 14 stunned Europe with the news of the National Socialist triumph in Germany. It was at first thought that no moderate government was possible, and in fact none would have been able to govern under ordinary parliamentary procedure.²² The rapid growth of the extreme parties was interpreted rightly as a protest against the economic and political pressure which deprived Germany of freedom of action. It sounded the knell of the Young Plan payments, and it presented the Bank for International Settlements with the first exchange crisis with which it had to deal.

There was at once a flight from the mark and a fall in German securities and exchange.²³ The B. I. S. was called on to help the Reichsbank. It was under obligation to do so on two scores; first, because it was charged with the task of easing transfers, and, second, because it was created to increase stability and the smooth working of Central Banks in their dealings with each other. Its powers were strictly limited, however. The total resources at its disposal were 1,700,419,572.01 swiss francs. Almost 10 per cent were in long term investments. About 34 per cent, treasury money for inter-Allied debts, had to be kept mainly in dollars. A considerable part of the remaining 56 per cent had to be distributed between the twenty participating countries. Less than 100,000,000 swiss francs additional money could, in these circumstances, be placed in Germany as an aid to the exchange.

The action of the B. I. S. was prompt, even though it could not be extensive. There was an immediate increase of investment in Germany through the Reichsbank. This was in addition to previous purchases in mark values, for 90 per cent of the long time investments noted in the Bank's

²² See *infra*, Chapter XI. Prime Minister Bruening governed in effect by decree during 1931.

²³ See *infra*, Chapter XII.

statement had been made with a view to increasing the funds for the use of the German economy.

Negotiations were begun, early in October, for a short term credit to Germany of 125 million dollars, arranged by Lee, Higginson and Company. This was larger than the amount which the B.I.S. could use for similar purposes. There was joint participation by Holland, Sweden and America.²⁴ Switzerland was invited to come in but refused, although large amounts of Swiss capital went into Germany through other channels at this time. It was at first hoped that the Bank in Basle could participate in the credit, both by its influence and by supplying a part of the loan. This was impossible, however, because of the prohibition on loans to governments. For various reasons the arrangement proved difficult of consummation. In fact, it seemed likely that at one time it would break down. Certainly there was tremendous relief when on October 13 the successful completion of the negotiations was announced.²⁵

The credit was a great help to the Bruening government, which began its work under extremely difficult conditions. As a protection of the exchange, the loan was of the utmost importance, even though, in some cases, banks in various money markets probably withdrew sums more than equal to credits which were granted to ease the situation. It succeeded in lessening the force of the pressure, however, and the German exchange stood the strain of the next months surprisingly well. In fact, it was not until the spring of 1931 that there was another serious threat to the value of the mark.²⁶ Without the help afforded by the B.I.S. and this private bankers' loan, it is doubtful whether Germany could

²⁴ It was said that England did not participate, as she did not wish to put pressure on the pound; France, because of political opposition; and Switzerland, because of a Rhine port disagreement.

²⁵ The loan was to run for two years at about 6.4 per cent. Arrangements for extending it were made in 1932.

²⁶ See *infra*, Chapter XII.

have supported Bruening in his efforts to improve the financial situation.

The first of a series of conferences was held at the Bank in September. This gathering of economists of the Central Banks discussed various theoretical questions relating to the Bank. The variety of opinion expressed as to the general basis of action prevented any clear-cut result. The meeting had a certain value in improving the acquaintance of men who had met infrequently or not at all, but did not contribute directly to the solution of the urgent questions regarding policies on the agenda of the October meeting. It was decided, therefore, that the next special group called to Basle would be made up of technicians who would be asked to consider concrete and somewhat detailed aspects of some of the larger questions confronting the Bank.

On October 13, 1930, the fourth meeting of the Board of Directors was held. It was preceded by the customary two days' conference of some of the Central Bank Governors. These informal conversations were to a considerable extent occupied with the German situation. Every type of aid was considered, but the only action possible to the B. I. S. took the form of credits already being extended to the limits of the Bank's capacity, and attempts to further, indirectly, the Lee, Higginson Credits. The B. I. S. endeavored in particular, though with little success, to encourage the participation of other countries in this credit, but rumors in many quarters that the Bank itself would furnish a part of the credit were denied from Basle.

Various matters of form and principle were before the Board at this time. The announcement given out mentioned some eight items of business from the agenda. These were:

1. The participation of the Bank of Esthonia.
2. The postponement of the election of additional Directors.
3. Report on the distribution of Young Loan receipts.
4. Decision to publish regular statements on work as trustee of loans.

5. Approval of the monthly balance sheet and business of the previous months.
6. A discussion of the deposit policy of the Bank.
7. Consideration of further steps in developing international clearing facilities.
8. Coöperation between Central Banks, particularly in regard to foreign exchange.

The result of these deliberations was to assign various problems to committees which should take up in more detail some of the questions raised.

There were, indeed, many unsettled problems before the Bank. For instance, it had not been definitely decided in October whether or not to accept deposits from private banks. The practice had been to take them from Central Banks only, but the matter was still debated within the Bank at this time. There were many requests from private banks in various countries, and there is no doubt that the resources could have been greatly increased if deposits from these additional sources had been allowed. It was wisely considered, however, that the Management of the Bank was in no position to appraise the thousands of private banks making these requests, and that if it began such a procedure it would have to accept almost all the deposits thus offered to it.²⁷ For this reason dealings with private banks were exceedingly limited and one-sided, consisting of deposits made with a few of them always through the agency of the Central Bank in the country concerned.

Other matters which were discussed in the frequent conferences among the officers of the Bank were, in the first place, whether the B. I. S. should buy and sell gold, or hold it in custody, and in the second place, whether it should grant intermediate credits, or encourage such credits indirectly. This was the subject of a special study, carried on by a committee that met in Basle on November 25. It involved the whole subject of the liquidity of the Bank. Then,

²⁷ See Chapters VII and VIII for fuller discussion of this decision.

in the third place, the extension of clearing facilities was being urged by many, and came to the forefront in connection with various types of transactions. Other topics, such as the improvement of bill markets, stabilization of currency, the relation to the League of Nations, the type of research suited to the Bank, the kind of publicity desired, and how to carry out some of the more general charges in the Young Plan, were all considered.

Thus it is clear that the emphasis shifted very quickly from the fulfillment of the reparation tasks to the more strictly banking problems which called for wider choice of action. The receipt of monthly annuity payments, the execution of deliveries in kind, the functions as trustee for loans, were matters of adjustment of detail. Consideration of questions of credit and exchange, of interest rates, and bill markets, on the other hand, brought the Bank face to face with the problems which were to deliver a terrific blow to the gold standard in 1931. The forces which led England to suspend the payment of gold in September were already manifesting themselves in 1930 in the piling up of the precious metal in a few centers, in the discrepancy between long and short term credits in most countries, and in the lack of confidence which was already serious. Those who directed the affairs of the B. I. S. searched for means to combat these dangers, and found their resources and methods pitifully inadequate in these first months of its existence.

During all this time two conflicting views worked like a ferment within the Bank. There were those who contended that it must learn by slow experience, wait for the growth of resources, and look forward to an aggressive policy in the distant future. The other group urged that the security of the existing economic system depended on daring leadership—that the Bank must accept the dangers and work for the immediate readjustment of the gold standard. Resources were small, they admitted, but it was possible to increase them. Experience was limited, but the best brains of the

financial world would be available if the Bank determined to lend freely, to reorganize the gold standard, and to stimulate the expansion of credit which would be sufficient to prevent further deflation. This view was a challenge to action, but the more conservative policy prevailed. Unfortunately, it will never be possible to know whether an aggressive policy in the first few months would have been effective or not. The only fact which emerges clearly is that the Bank survived the difficulties of its first year with increased strength.

From the very beginning the work of the Bank was made more difficult by the way it was interrupted or diverted by financial and political events over which it had no control. This is notably the case in respect to the work done to prepare for the stabilization of the Spanish peseta.** From July, 1930 until the spring of 1931, officers of the Bank spent considerable time and effort on this problem. As early as November, Monsieur Quesnay presented a report to the Spanish Central Bank in which he declared that it was feasible for Spain to enter at once on the first stage of stabilization, limiting within a broad range of the existing value the fluctuations which might occur from day to day. It seemed likely that economic conditions would permit of a successful steadying of the rate as the necessary first step toward pegging it at the chosen point of stabilization.

Negotiations to this end continued until the arrangements were completed for a loan to aid in stabilization.** The plans were broken off sharply, however, by the revolution in April. Two loans were arranged in the course of these negotiations. One was the credit opened up with the B. I. S.

** See confidential report of November 15, 1930.

** President McGarrah went with Governor Bas of the Bank of Spain to London and Paris. Monsieur Quesnay and others made a number of visits to Madrid in the course of these negotiations. Professor Charles Rist had made plans for Spanish stabilization during the previous year, at the request of the Bank of Spain. The criticism of the borrowing against gold was due to the fact that Spain had the fourth largest accumulation of the metal in a Central Bank at this time.

when it took Spanish gold into custody in December, 1930. The second, arranged but not taken up, was a 50-million-dollar loan to be granted by Morgan and Company, of New York. The granting of credits from Basle was somewhat criticized at the time, since it was thought in London and elsewhere that the Bank of Spain might better have sold its gold and held exchange as an aid to later stabilization. It became evident to the Management of the B. I. S., however, that this was not politically possible and they, therefore, agreed to open this deposit. The gold which was sent to London was one of the first transactions in the metal which the B. I. S. handled.

There is no doubt that work for currency stabilization, such as that undertaken in Spain, was a proper function of the Bank, and was considered both by the Board and by the Management to be one of its primary duties in the early period of its existence.³⁰ Circumstances, however, prevented it from carrying through a single project of this nature. Portugal and Yugoslavia stabilized without direct aid from the Bank; other countries were not appropriate fields of action, and the departure of England from the gold standard in the following year put an end to such plans for an indefinite period.

In addition to currency stabilization one of the tasks suggested for the Bank was the furnishing of a clearing system for international payments. Of course, the handling of the reparation and debt payments was a type of clearing operation, but many at the B. I. S. looked forward to an extension of such services. Various methods were proposed and reasons given for advancing in this direction. The transfer of the payments that ultimately went to the United States treasury was smoothly and efficiently carried out. The Bank furnished a real aid to this work. It is probable that the number of foreign exchange transactions was reduced

³⁰ See *infra*, Chapter XV, on Central Bank Coöperation.

and the resultant pressure less than would have been the case if the funds had been handled by a larger number of intermediaries. Many argued that the step from this to a world clearing was simple and obvious. Others contended that the desirability of new clearing systems was not yet demonstrated.

There was in fact a sharp division of opinion on basic principles. There are those who have always considered it an aid to economic adjustments for many exchange transactions to come into the open market and influence, even if for a very short time, the rates which prevail. Others have thought that a better result would be obtained if a large number of such transactions should cancel each other, and a very few come into the market to affect rates. The difference lies in part in the different views regarding the influence of the balance of payments on economic affairs, and conflicting estimates of the efficiency of the speculative forces in the foreign exchange markets.

The B. I. S. had so far avoided any active influence in the foreign exchange markets by accepting the rates prevailing in each center at a given time. It did not take the initiative with offers or bids. Moreover, the practice with regard to gold had not been decided. It took small sums from Spain, from Lithuania, and from Poland. In addition to this a small amount of gold was bought from Canada and held for a very short time. None of this was brought to Basle, but was held under earmark in Central Banks, mainly in London. It is obvious that the Bank was approaching the question slowly.

In fact, it was clearly realized in Basle that a development of clearing beyond the reparation transactions would constitute a new and revolutionary measure. The war debt payments reached figures which could be known in advance. Moreover, since payments were not subject to the free play of economic forces, but were inelastic, the Bank had no

responsibility, and no choice of action. A further extension of clearing opportunities would open up the entire question of how uncovered balances should be met.⁸¹

The approach to this problem was made through a consideration of the technical differences in handling exchange and gold transactions in various countries. A committee was appointed for this purpose in the November meeting, and met for the first session on November 25. The chairman of the group was Dr. Fuchs, the exchange expert of the Reichsbank. Among those who attended were representatives from the Banks of France, Switzerland, England, Belgium and Italy. They considered the detail of the operations in the exchange market and reached the conclusion that some advance could be made toward smoother transfers if the conditions for buying and selling gold could be made more similar, resulting in a slight narrowing of the gold points. It was found that the deliberate delay in crediting gold, and the conditions under which it was acceptable, increased the speculative gap between the buying and selling rates of foreign exchange.

The exchange experts did not make a definitive report at this time, but presented it early in 1931. Their conferences tended to stress the manifold complications and differences in the European markets. It became increasingly obvious that careful preparation would be necessary before a comprehensive clearing system could be contemplated. Meanwhile the recommendations of the committee led the Managers to see what could be done in the way of increasing uniformity of procedure. This was dependent in some cases on minor adjustments, in some cases on a modification of policies, and in some on a change of laws which governed exchange and gold dealings. Interest in the general idea continued to preoccupy the bankers in Basle, and there was considerable discussion elsewhere as to the advantages and

⁸¹ See *infra*, Chapter XI, on Clearing.

disadvantages of an inclusive system of transfer and cancellation.

Another main concern was the problem of developing intermediate credit through the B. I. S. This subject was raised first in the autumn of 1930 when a committee was appointed to meet on November 8. There was a growing demand for longer term credits to bridge the gap between the short time money, of which there was an excess in many markets, and the bond issues, which were out of the question until confidence could be restored. It was at first hoped by some that the B. I. S. could itself furnish credits of from two to five years. This general idea was one of the reasons behind the committee's studies. The other was the specific desire of certain of the participating countries to be able to sell to the Bank bills which ran for more than the usual period.⁸²

The principles behind this study must be considered in connection with the credit policies of the Bank.⁸³ They are closely related to the two contradictory views that influenced the founding of the Bank. There was always a group of financiers who wished to have the Bank extend credit for the benefit of commerce, even if it meant a mild form of inflation. This group included Monsieur Francqui, Dr. Schacht, and Sir Josiah Stamp among others. The other group favored confining the activities of the Bank to the more definitely monetary field as opposed to credit transactions. There was no complete solution of the problem, and no definite action was taken as the result of these committee studies. Nevertheless, the Management of the Bank hoped by the purchase of a few bills of odd dates which it was known to hold, that it would encourage a more liberal view. It was not itself in a position to buy any large quan-

⁸² See *infra*, Chapter VII or VIII. See *L'Information financière* (Nov. 11, 12, 1930) and *The Financial News* (Nov. 12, 1930), "Lombard Street."

⁸³ See *infra*, Chapter IX.

tities of such paper. In fact, the November meeting was disturbed by criticism of some of the investments already made or projected. Consequently, it was agreed at that time that the Bank must increase its liquidity.

This problem was widely commented upon when newspapers reported a sharp disagreement in the Board Meeting of November 10.³⁴ These reports exaggerated the actual situation. Differences of views had occurred in the course of the many decisions of the Board, but those which took place in the November meeting did not indicate any sharp divergence of opinion. Certain projects were undoubtedly rejected as unsound for the Bank, but these had not gone far toward completion before they came up for discussion, and there was no serious breach in the coöperative efforts of those guiding the Bank. Reasons for objecting to the alleged credit to Yugoslavia mentioned in *The Financial News*, were that the currency in question was not on a gold basis, that the transaction was in direct competition with other organizations, that the funds were not liquid enough for the Bank's purpose, and that there was a possibility of political complication. There is little doubt that the future dealings of the B. I. S. were influenced by this incident and the increase in liquidity in later months was in part attributable to views expressed at this time.

The shift of interest becoming evident at this time makes it apparent that there are a number of reasons for considering November the end of the first period of development. The objective fact may be observed in respect to both resources and membership. In the second place, by this time the reparation work of the B. I. S. had been reduced to routine, and the Bank was considering further tasks such as stabilization, credit measures, and clearing facilities. In the third place, it is possible to observe a number of more or less definite policies at this time. For six months the acts had been tentative and experimental. After that period

³⁴ See *The Financial News* (Nov. 11, 1930).

had elapsed the further work of the organization was on a more solid basis; contacts, customs, deposit procedure and principles regarding investment and interest rates were clearly formulated.

It was forced by the pressure of its own business to ignore, or at least to postpone, some of the general business and inclusive problems which were concerning other groups of financiers. The gold problem was being much discussed, both in connection with the imminent shortage in many places, and more particularly in connection with the withdrawal of gold from London to Paris. The proposal for granting agricultural credits to the east of Europe was much talked of in Geneva, but the suggestion that the B. I. S. join in these plans was entirely unfeasible. Tariffs, balance of payments, political and economic controversies of various kinds were disturbing the world as the depression deepened. The Bank was forced to ignore a large part of them. Its own tasks, the handling of Reparation and deposits, the building up of Central Bank contacts, the investigation of its credit and clearing potentialities occupied it fully at this time. All these things pointed to an eventual contribution in the solution of these larger problems, even though the active part played at this time was small.

CHAPTER VII

DEPOSIT METHODS

THE conferences and discussions which took place during the first six months of the Bank's existence resulted in the gradual clarification of the deposit and investment procedure. One or two main purposes can be traced in the action taken in the meetings just described, and these purposes came to have concrete manifestation in the carefully planned machinery for handling funds consigned to the Bank. It is important to make a careful analysis and appraisal of this procedure which serves as good indication of the stage of development by the end of 1930. It is even more essential to understand it as a preliminary to a discussion of its later period of active participation in world affairs.

The intricate parts of the financial mechanism were quickly fitted into each other, for it was important that there should be no gap or delay. The relation between the Bank and the various money markets was carefully defined. The conditions under which credits were to be granted or received were outlined; the significance of exchange fluctuation, the spread between interest rates, and the future trend of values were carefully considered.

This process meant the scrutiny of past banking experience, the investigation of existing desires, and the formulation of new theories not outlined previously. The need had not been apparent. No new constructive work could be undertaken by the Bank until all the steps in the process of opening accounts and using funds had been made definite. This work was inconspicuous and was taken for granted

in many quarters. It was, nevertheless, the most important technical accomplishment of the Bank and held untold potentialities for the future of the financial world.

The analysis of the work of the Bank requires the extension of existing theories in new directions, the pushing further of accepted ideas, and the readjustment of old concepts. It is not possible to see the ultimate meaning of some of the processes instituted. They must be appraised, not so much in the light of immediate accomplishments—these may be considered disappointing by some—but rather with a view to future possibilities: for example the eventual influence of an international bank or international banks on the expansion of credit, the modulation of business cycles, the thawing out of frozen assets, and the steadying of exchange rates.

A theoretical discussion of potential credit creation by the Bank might be called the "theory of the multiple expansion of international credit." A thorough analysis of this problem cannot be undertaken here and the lines which it would follow can be indicated only in a general way,¹ as a commentary on the later possibilities of the Bank. Such an analysis entails also a consideration of the gold exchange standard, its possibilities in the expansion of credit, and the factors which were to restrict its use. It is closely connected with the question of clearing, since the increase of international credit is similar to, or dependent on, the holding over of balances which might temporarily remain unpaid between countries. These matters raise difficult abstract problems, many of which cannot be treated here. Nevertheless, it is appropriate at the present time to use the new material available, and to attempt to construct a theory which may be altered, and carried further as experience and science make the way plain.

Before any generalizations can be made, however, it is essential to understand the usual procedures at the B. I. S.

¹ See *infra*, this Chapter.

in granting or receiving deposits. There were certain dangers which had to be avoided, and special aims which had to be fostered. The result was the formulation of a number of rules and methods. Some of the acts performed should be taken as exceptional, notably the granting of a few credits to support weaker banks. The bulk of the business done established the usual procedure, whereas the exceptional acts indicated broader possibilities of future development.

In carrying out both the usual and the exceptional acts various pitfalls had to be avoided. The Bank had to prevent the wholesale creation of credit either as the result of or as a preliminary to a deposit credited on its own books. It tried to avoid any modification of the gold exchange standard which would bring about unlimited inflation. It considered that it must prevent any wide discrepancy between assets and liabilities in currencies which might involve unwarranted exchange risks. Further than this, it tried to see that the terms which it granted to those making deposits would permit a net profit arising from the operation—that is, a differential between interest paid and interest earned. Thus, by the very conditions under which it granted deposits, it protected itself partially from incurring undue risks. It had to make it impossible for participating countries to use it as an instrument of unsound policies. These are but a few of the many problems faced, and difficult though they were, they were met by devices which freed the Bank from a large share of the risks and acted as semi-automatic protections.

Despite the importance of this aspect of the Bank's activity, few people realized exactly how deposits were made or employed. The processes of commercial banks were well known, but it was not realized that they offered no precedents for the World Bank. For instance, the very nature of the enterprise prevented a close link of assets and liabilities with any particular monetary system. This limitation

resulted from the continual exchange risks which the Bank encountered and the need for diversity of assets. Any tendency to pile up holdings in one exchange would have brought a decline in the mobility of the Bank's assets and defeated its main purpose of stabilizing and equalizing currency conditions.

Obviously this situation was quite different from that prevailing in ordinary commercial banking, where the near and familiar enterprises were often the ones which offered the most profitable and secure investment opportunities. For political reasons there could be no distinction between clients, except on grounds of principle, even though the opportunities offered the Bank in different countries varied widely. No such complicated conditions faced the typical business bank. In fact, in familiar types of banking, the undertaking of an investment—that is, the granting of a productive loan—is simultaneous with the opening of a deposit on the books of the bank. One might even say the deposit is the investment. In the case of the B. I. S. the deposit was granted in exchange for certain assets, much as if it were bought by those assets. The investment problem of the Bank came after this in most cases; in fact the process was often divided into two stages. This same separation of processes was comparable to the problem which occurred with savings banks, whereas there was only one stage in the deposit-investment act of commercial banks.

In the case of the B. I. S., as in other banking, deposits differ, from an economic point of view, in respect to their origin. They are frequently divided into two classes. One kind is called a *created* or *granted* deposit and the other kind a *received* deposit. This phraseology is not entirely accurate since the deposits are, in themselves, indistinguishable. It is rather the acts which precede them which differ and which give rise to important economic results. In the case of so-called "created deposits" a loan is the first step and the funds are subsequently left on deposit with the

bank making the loan. In the case of "received deposits" funds are paid into a bank and an equivalent deposit is granted. This claim permits the depositor to draw out these same funds again. Such are, for instance, the deposits of a savings bank. Most of the deposits on the books of the B. I. S. originated in this second manner.³ Legally, the claim is identical in either case and once a deposit is opened it is indistinguishable from the others. Economically there is a significant difference according to the causes which bring the deposit into existence and the uses to which it is put.

The characteristic origin of the deposits with the B. I. S. limited it to the possibility of gaining the spread between the yield on the credit it gave and that on the investment it made. It could not create credit freely. In general, the ratio of credits given and received was one to one and it could not secure more income earning assets than its liabilities, allowance being made for funds accruing from its capital, reserves, and Special Deposits. During the first two years, it did not attempt to take advantage of the cancellation of credit transactions or dormant sums to create additional credit in the manner of commercial banks. Every sight liability had to be matched franc for franc with quick assets. If these limitations are borne in mind, in addition to the wide territory of operations, variety of currencies involved, varying interest rates and potential exchangerisks, the difficulties of procedure seem almost overwhelming.

These principles were not worked out all at once but most of them were quite definite by the end of the summer of 1930. For instance, the first tentative method of paying different interest rates was relinquished in favor of the uniform rate.⁴ The ways in which deposits could be opened in the name of Central Banks, at first strictly limited (see below, type A), were broadened somewhat to permit the

³ The special credits granted in the summer of 1931 fall into the category of "granted" deposits; see *infra*, Chapter XIII.

⁴ See *supra*, Chapter VI and *infra*, Chapter IX.

opening of seasonal credits to put foreign exchange at the disposal of countries with a temporary shortage (see types B, C, and D). Investments were made more liquid and efforts to get a high yield lessened as the Management saw more clearly the rôle which the Bank must play as a bulwark for certain Central Banks. Thus, although evolution and change characterize this procedure, the surprising thing is that the methods of the next few years were well formulated in the first two or three months and a settled procedure was recognized before the end of the year.

Such a rapid development was necessary, because idle money is sheer waste; no vacuum must arise in the shifting of funds. Moreover, the steady growth of resources would have been impossible if there had been hesitation or uncertainty in dealings with various money markets. The success of these methods was indicated by the growth both of participation, and amounts of money turned over to the Bank. Criticisms of details of its actions were confined to the Board meetings and the small group of men closely associated with its business in the twenty-six participating countries. In general, the public did not question these acts and policies nor realize that a totally new system had been put into operation.

Even though the Bank was handling deposits according to a well-ordered routine by autumn, some questions which concerned general principles were left open for later modification. In fact, the Board did not deliberately crystallize and define its policy but repeated acts tended to mark out the course of later transactions. In any case, the machinery was moving; there was no hitch or stoppage. Reparation payments had acted as the priming fluid but the later motive force came from Central Banks. An indication that money was received and invested with satisfactory results is found in the profits earned and increased participation during the first year.

The technique of these operations was decided by the

Management.⁴ They followed a conservative course and relied on the assistance of Central Banks at many points. The investments in so many markets would have presented serious difficulties if they had not been arranged through the agency of officials of the Banks of Issue and with the coöperation of the large commercial banks. The task was not easy, in any case, under the conditions of plentiful short term money in 1930. The conditions imposed were mainly to guard against unlimited inflation and the more patent abuses of the gold exchange standard. They were also planned to prevent exchange risks which would endanger the position of the Bank.

The striking characteristic of the early months of the Bank is the steady growth of short time deposits. This growth is interesting historically, because of the light which it throws on the attitude to the B.I.S. and its part in a time of abnormal conditions in the money markets of the world. It is interesting from the point of view of theory, because of the policies, partly concealed, and partly revealed, in the shifting amounts under different headings in the financial statement. It is evident that the Bank was quite fashionable among Central Banks, and attracted to itself really considerable deposits almost irrespective of an immediate monetary gain accruing from these deposits.⁵ Then again it appears that the very easy condition of the short term money markets made a drift of funds to the Bank very much more marked than it would have been a year or two previous. Both of these points are worthy of further consideration.

A definite and detailed description of how these deposits were built up, and the specific needs from which they arose, gives a vivid picture of the Bank's limits and possibilities. In fact, such a description is a necessary basis for comment or criticism on the policy of the Bank, or for a forecast of its further work.

⁴ See *supra*, Chapter IV.

⁵ See *infra*, interest rate policy.

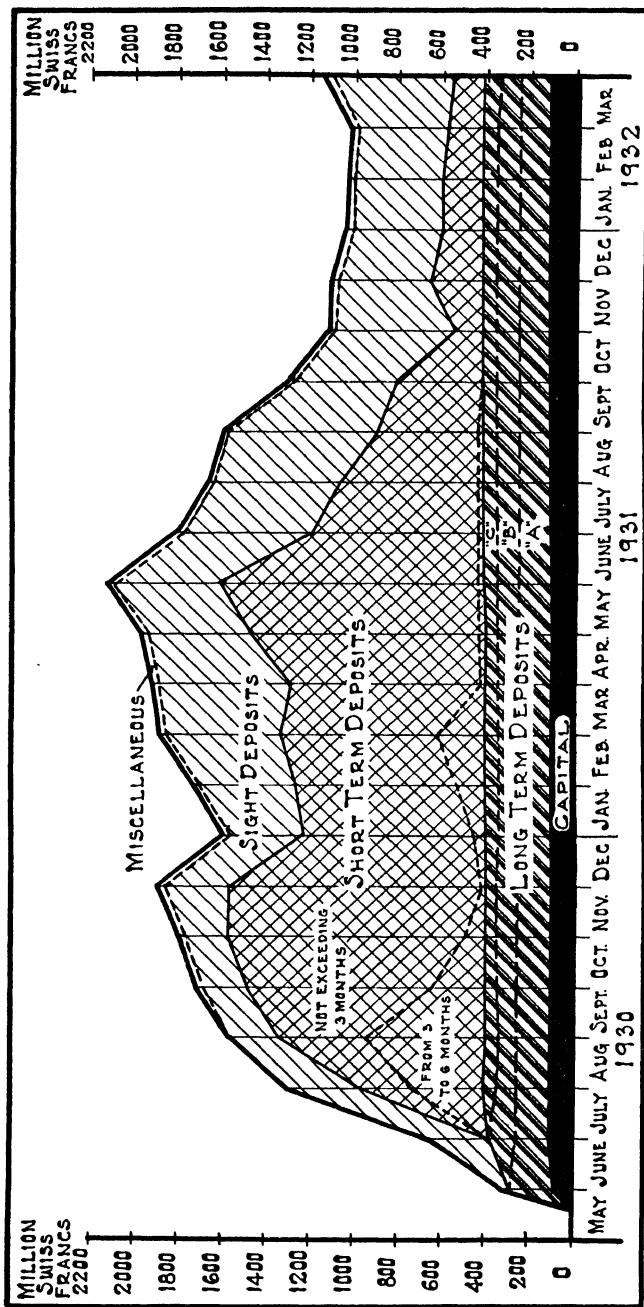


CHART II *

LIABILITIES OF THE B.I.S. CLASSIFIED ACCORDING TO MATURITIES

* See monthly financial statements published in the Appendix, the difference between Chart II and Charts I and III is accounted for by the deduction of the proceeds of the Young Loan in June, 1930. A is the French Guarantee Fund, B the German Deposit, C the Trust Account.

There were several definite rules laid down for depositors. These were mainly five. *First*, deposits were received thus far from Central Banks alone; in fact, for the first years deposits of private banks were refused, although there were numerous requests coming from such banks. *Second*, deposits opened in the name of a Central Bank were not accepted in the currency of that Central Bank—that is, the claim of the Central Bank was for repayment in some currency other than its “home currency.”⁶ For reasons growing out of the War Debt situation the Federal Reserve was an exception to this second rule. Its deposits with the B. I. S. were made and repaid in dollars,⁷ since there was no possible way in which this would cause harmful inflation. In fact, this arrangement tended to redistribute capital according to legitimate needs.

A *third* rule was laid down in regard to the payment of interest on all deposits held by the Bank. This was uniform, irrespective of the currency in which claims were denominated.⁸ In the *fourth* place, the investment of these assets by the Bank for International Settlements was made through the Central Bank of the country in which the investment was located. A *fifth* rule prescribed that the retirement of investments from one money market to a different money market should be made through the Central Bank, even in the case of the United States and Japan.

These five conditions were of a general nature, and could be applied almost without exception. They were in line with the policy of sound and conservative banking which characterized this entire period. The steps involved in the receipt and use of short term deposits were difficult, and brought into the foreground most of the significant problems of banking policy. In order to make clear the pro-

⁶ See *infra*, p. 16: most exceptions to this rule took the form of “deposit B.”

⁷ See Chapter XIV.

⁸ See *supra*, Chapter VI, for earlier policy and *infra*, for classification of types of deposits.

cedure involved, it is well to divide the process of making deposits into four types. In the first place there is the procedure which may be called A and which was concerned with received deposits. This included most of the liabilities in the early years of the Bank. The steps involved in type A can be outlined briefly here; B, C, and D are discussed later.

I. A Central Bank of a country—we will say, for example, Sweden—wishes to make a deposit in the Bank for International Settlements. It communicates with the Bank by letter as to the general business involved, and then later, probably by telegram, it informs the B. I. S. that it has placed at its disposal, through the agency of the Federal Reserve, dollar funds held in New York.* Normally, the foregoing would represent merely a transfer by a Central Bank of dollar assets from one depository (the Federal Reserve) to another (the B. I. S.) and would effect no appreciable change in the position of the depositing bank. The results are that (a) the Swedish Bank owns the same dollars as before, but holds them on the books of the B. I. S. instead of on the books of the Federal; (b) the Federal owes the same dollars as before but to the B. I. S. instead of to the Swedish Bank; and (c) the B. I. S. owns dollars in New York which it did not own before, but owes dollars to Stockholm which it had not previously owed. As to why the Swedish Bank might have gone to this apparently needless trouble there are several explanations.

The motives which will be referred to below are mainly three. First, the Swedish Bank might, as a manifestation of Central Bank coöperation, desire to put at the disposal of the B. I. S. dollar funds not immediately needed for the meeting of Swedish commitments in New York. Then again, it might feel there was prestige to be had in a B. I. S. deposit, that is, by joining the "Central Bankers club." Finally, it might find it would be paid by the B. I. S. a

* These funds might be similarly handled for Sweden in any *non-Swedish* gold standard money market.

higher rate than it could earn with the same dollars in the New York market—the Federal Reserve itself paying no interest on deposits with it. Other motives will be mentioned later in connection with clearing and the exchanges.

II. The Bank for International Settlements immediately adds the dollar credit to the asset side of its balance sheet, and a similar amount to the liability side of the balance sheet in the form of a deposit on which Sweden draws in dollars. It will be seen at once that this operation involves absolutely no foreign exchange transaction. Both the assets and liabilities are in dollars. It does involve certain questions of interest rates, since the Bank of Sweden receives a rate in Basle which may be more or less than the B. I. S. can earn on the dollar assets put at its disposal in New York.

III. It is helpful to trace still further what happens after the shifting of the titles to these various amounts. It is usual for the Central Banks to use these funds to pay foreign commitments.¹⁰ Indirectly the deposit may prevent the deflation which might otherwise have occurred on account of an exodus of gold or a loss of foreign exchange reserves, but the deposit with the B. I. S. cannot be considered a basis for the note circulation, except in rare cases.

IV. Meanwhile, the B. I. S. will take one of two courses. It may leave the funds in the form in which they are acquired, or it may change them through the agency of the Federal Reserve Bank.¹¹ If the funds are put to work they are handled in various ways—they are transferred to private banks as deposits bearing interest or are used to buy commercial bills or acceptances or short dated government securities. It is possible to consider that these various oper-

¹⁰ The laws with respect to the condition under which foreign claims can be used as "reserves" against note circulation differ from country to country. It is improbable that the Bank opening the deposit will use its deposit with the Bank for International Settlements as part of the legal reserve behind notes.

¹¹ See *infra*. The "Money employed account" was not used in the United States. Balances with the Federal Reserve Bank were, in fact, small.

ations constitute a cycle beginning with the establishment of a claim by Bank X on the B. I. S. and by the B. I. S. on some other Bank Y and ending when the B. I. S. has been paid by Y and has paid X. Actually the movement of funds through these channels constitutes a flow not suddenly terminated but widening and narrowing as new claims are opened or liquidated. The cycle is incomplete until the deposit at the disposal of Bank X has been either withdrawn from the B. I. S. or renewed, and until the investments of the B. I. S. in money market Y have been replaced or withdrawn. This final stage is so merged with the beginning of new operations, and the funds are so intermingled with other funds, investments moving in and out of the various money markets, that it is perhaps unwise, and certainly difficult to seek to find a terminal point for the processes which have been set in motion.

It is possible to distinguish four types of deposits, the first of which has been described above.

- A. Types entailing dealings in one currency.
- B. Deposits opened to give support to certain currencies on the foreign exchanges.
- C. "Granted" deposits or loans by the B. I. S. not leading to an immediate investment in any money market, except insofar as the claim on the Bank receiving the loan is an investment.
- D. The proposed exchange transfer types of deposits.

Both the banker and the lawyer are apt to insist that the distinction between the four types of deposits, though of use to the theoretical economist, is misleading to the practical man. It is true that the assets and liabilities of the Bank are not distinguishable in the normal course of events as differing according to the forces which bring the deposits into existence. The funds are, in effect, pooled, but in certain cases risks and responsibilities have been assumed by the Bank which differ widely in their economic implications.

The question as to the motive behind deposits with the

B. I. S. made spontaneously at the request of the Central Bank of the country concerned has already been raised.¹² Of course it is possible in some cases to gain an interest differential between the rate paid by the B. I. S. and the rate the Central Bank would receive elsewhere. This cannot be the case, however, always or even usually. If it were, the Bank for International Settlements would find its work extremely unprofitable. The motive is frequently the desire to form a business connection with the International Bank. It is clear, for instance, that if a Central Bank should wish later to have a loan, special advice, or exchange assistance, it would profit by having maintained a connection with the B. I. S., so it could turn to the Bank in a sudden emergency. In most cases, however, the desire to share in Central Bank collaboration is a major factor.

In some instances, in fact, there is a delay in depositing with the B. I. S., because of the fear that such a deposit which gave the depositor a claim on a "gold currency" could not count as legal reserve behind the note circulation. This was the case with the Bank of Greece. The Statutes provided that only deposits with Central Banks could count as reserve. The matter was referred to the Finance Committee of the League of Nations and an opinion obtained that deposits with the B. I. S. came within the spirit and intention of the Statutes in regard to reserves. Immediately thereafter the Bank of Greece opened a deposit with the Bank for International Settlements. In most cases, however, any gold exchange counted as reserve for the purpose of note circulation so that there was, therefore, no special advantage in holding such reserves with the B. I. S.

The second method of opening deposits with the B. I. S., type B, is less usual. It involves transactions in two currencies and a probable long position for the B. I. S. in one currency corresponding to a short position in another. This fact means inevitably that the exchange rate between two

¹² See further discussion in Chapter VIII.

centers, at the time when the deposit is made, must be taken into account, and it means also that the probable direction of exchange fluctuations in the future must be kept in mind. For the B. I. S. may wish to shift its position from one market to another, if at any time the increase in its liabilities in one currency is out of proportion to its business in other currencies.

This type of transaction, however, has so far¹³ been effected in such a way that the Bank does not come into the open market to alter existing rates of exchange, but exerts only a retarding or negative influence. Moreover, the funds shifted are so small in volume that the influence can, for the present, be ignored. The nature of the Bank's rôle in the exchange markets is based on a fine distinction, but it can make considerable difference in the effectiveness, or lack of effectiveness, of the operations of the Bank. It will be considered later to what extent and by what means the B. I. S. influences the rates of exchange and the rates of interest in the different markets.¹⁴ However this may be, the Bank does not take an aggressive part¹⁵ in altering such rates, and its aim is to increase and never to upset stability. It was essential that the B. I. S. should handle these matters in this conservative manner at the beginning.

The steps involved in making deposits according to procedure B, a type midway between "created" and "received" deposits, are quite simple in character. In the first place, it is understood that a Central Bank wishes for one reason or another to increase its assets in a certain currency. This means that it must turn over to the B. I. S. holdings in some currency other than that which it is trying to accumulate. Preliminary conversations with the Bank are instituted, and

¹³ That is, up to June 1, 1932.

¹⁴ See *infra*, this Chapter.

¹⁵ It is, of course, true that the Bank occasionally makes it understood that credits will not be opened in a money market unless rates are increased, but this is only in case of the weaker currencies and usually in the case of appeals for help rather than the more normal operation in the well-developed centers.

the reasons for the request are carefully scrutinized because the transaction involves—potentially at least—an exchange risk for the Bank for International Settlements, even though it may be dealing in currencies which are at the time on a gold basis.

One of the simpler cases under procedure B occurs when the B. I. S. acts to meet the need for credit arising from a seasonal increase in the demand for foreign exchange. If, for instance, the Bank of Italy wishes to have at its disposal dollar credits at a particular time, and if it is known that Italy will be exporting commodities in the near future, and that therefore the balance of trade will turn in her favor, it is reasonable to expect that the B. I. S. can accumulate dollar credits by buying them with lire at some later date without incurring any exchange loss. There may even be an exchange profit. If the Management considers an exchange loss unlikely, and if it feels that the money market in Italy is well adapted to the investment of some of its funds, it will grant the Bank of Italy a dollar credit in exchange for lire at the rate of exchange on the day when the transactions are consummated. This is tantamount to a sale of dollars against lire.

The net result of this transaction is, first, to the Bank of Italy—an increase of dollar deposits with the Bank in Basle. It is probable that it has acquired these deposits because of an actual or threatened diminution of its dollar portfolio. If this potential decrease of foreign exchange assets materialized it might be necessary for the Bank of Italy to envisage a reduction of its note circulation. It is possible to imagine conditions in which such a reduction of note circulation would be unfortunate, notably in the case of seasonal swings, or unjustified temporary outflows of capital, aroused perhaps by political fears or some abnormal interference with the balance of payments. It is, of course, possible that the credits accumulated would be used immediately by the Central Banks to make payments abroad, but

this is not the usual procedure. The deposits often remain with the World Bank for considerable periods.

The result of transaction B is, in the second place, that the liabilities in dollars of the B. I. S. have been increased and its assets in lire have grown to a corresponding extent. These assets in lire are invested through the Central Bank of Italy in the Italian money market. The placement of these funds is similar to that which occurs in case A. From this point forward the two procedures are the same. That is, the investments made in the Italian market as the outcome of a purchase of dollars by Italy—transaction B—and the investment in the Italian money market which might result from the turning over of lira assets directly to the B. I. S. in return for a deposit in lire (made by any except the Bank of Italy)^{1*}—that is, transaction A—are executed in the same way. The B. I. S. pays interest on the deposit opened, in this example in dollars, and earns interest on the assets acquired, in this case lire, as long as the accounts remain open.

It is possible to distinguish a number of different steps in this process, although the sums involved lose their identity in the various pools of funds once the accounts are established.

1. The B. I. S. opens a dollar account for the Central Bank of Italy.
2. The Central Bank of Italy opens a lira account for the B. I. S.
3. The Central Bank invests this lira account at the request of The B. I. S. perhaps in bills or acceptances.
4. Italy uses the dollars to make certain payments in the U. S. A., gradually liquidating this account.
5. If the lire are invested by the B. I. S. in bills, when the bills mature the B. I. S. must determine whether (a) it will re-invest in bills, (b) allow its lire to lie in a deposit account in Italy, or (c) use them to buy dollars or any other currency.

Although there is no difference in the method of handling

^{1*} See *supra*, this chapter.

the investments resulting from the two types of transactions there is a new problem introduced from the point of view of the B. I. S. This problem is not difficult of solution unless in the first place, transaction B becomes quantitatively large, and in the second place, the direction of the flow of funds is persistently toward certain currencies and away from others. This situation is one against which the Bank can guard itself partially by a careful scrutiny of the motives and causes behind such transactions, and further by careful balancing of assets and liabilities which are held in different monetary units. Moreover, in addition to the precautionary methods which the Bank can use, there is, in the very fact that the Bank is in a central position acting as a kind of balance wheel between different currencies, an element which lessens slightly the risks of a temporary short position.

Nevertheless the occurrence of operations of type B makes necessary a scrutiny of the causes of exchange fluctuations. Some are found to be caused by fairly regular and discountable factors of a seasonal nature, others by slightly temporary disequilibriums which might be ascribed to the chance play of random forces. These are conditions with which the Bank may be able to deal, at least in the case of small markets, as its power grows. Its effectiveness would depend on the extensiveness of its operations, wide contacts, and the variety of resources at its disposal. There are, however, other deeper causes of exchange fluctuation which require a different policy in exchange transactions. A striking instance is, of course, in the forces leading to the abandonment of the gold standard by England and the resulting rapid fall of the pound affecting many currencies. These crises come sometimes with business cycles, and sometimes with catastrophic and occasional events such as wars, crop failures, or abnormal and inelastic demands for "out-payments" by way of indemnities.

Requests for deposits by countries disturbed by exchange

risks, falling under type B, were considered in the light of the possibilities of limiting this risk. Reliable methods of protection are not evident at the present time. It is obvious, however, that the Bank must be sure of certain things.¹⁷ In the first place, it must see that all measures are taken in the country desiring a foreign exchange deposit to assure a stable exchange value. In the second place, the sums so invested cannot be large in comparison with other business. In the third place, the Bank must make reasonably sure that there is active support, or at least that there is likely to be no danger of aggressive interference on the part of the more important money centers of the world. In short, the questions involved are those of good banking policy, comparable to those of any bank going into a foreign field, but rendered more complex because of the wider extent of business, and because the Bank must give adequate consideration to the wishes of many Central Banks. Such transactions involve difficulties not present in those of type A, but they offer compensations and render special help which may be highly significant.

Thus, in the main, the motives of the B. I. S. are two. For one thing, it hopes to perform one of those equalizing functions which is definitely assigned to it in the Young Plan. In addition, in practically all cases of this kind, the Bank is acquiring investments in a high interest rate market. As long as the yield on these investments is greater than the yield on those in other centers, and higher than the interest paid by the World Bank, there is a clear business advantage in granting such deposits. Where this spread between yield on investments of the Bank and the interest paid is considerable, it is evident that the Central Bank concerned is losing in respect to interest for the sake of some special advantage in securing exchange or the facilities which the B. I. S. offers.

This advantage may take the form of a favorable action

¹⁷ See *infra* for an analysis of the exchange position of the Bank.

of speculative forces in the exchange market. Thus, if the Central Bank had to bid openly, there might be greater pressure on values for the same amounts exchanged. There is a considerable difference between carrying out the transaction at the existing rate of exchange, with no publicity and with a comprehensive knowledge of other contemporaneous exchange investments, and the more conspicuous attempts of the Central Bank to build up credits. Moreover, the very fact that the funds are received through the intermediary of the Bank for International Settlements, which has a clear mandate to keep in touch with capital flow between countries, gives grounds for confidence, even though a country may happen to need to increase foreign assets for some special reason. In other words, the B. I. S., while not usually creating new credits, and not adding directly to the circulation either within a country or between countries, is increasing the usefulness of funds already in existence. Moreover, while taking advantage of higher rates of interest in particular centers, it is at the same time preventing such high rates from rising still further.

A different procedure of opening deposits is in operation in the case of special credits granted against collateral to Central Banks in distress. This is a created deposit and has been referred to as type C. Here the B. I. S. gives the right to draw on Basle in certain currencies and receives interest on the sum advanced. The assets of the borrowing Bank, if turned over to the B. I. S. constitute a pledge rather than a sale of collateral, and the final repayment is to be in the currency which has been lent. The whole transaction is usually protected against exchange risks by special guarantees and gold clauses. The credits opened by and through the B. I. S. in 1931 are described in Chapter XIV.

This third type of deposit was not opened until the experience of the Bank with the other two methods was well crystallized. The quantitative importance of these "created"

deposits depends, in the first instance, on the funds available to the B. I. S., but even more on the attitude of the powerful Central Banks which are in a position to put large sums, or comprehensive guarantees, at the disposal of the B. I. S. in order to extend its capacity in this direction.

The fourth type of deposit, here referred to as D, is interesting in connection with the clearing possibilities of the Bank and its foreign exchange business, but is of no practical consequence at the present time since it has not been used. These are the deposits which are withdrawable in a number of currencies. The relation of the facilities offered in this connection with other clearing possibilities have been discussed in Chapters X and XI. It is sufficient to indicate here that this method of handling funds, set up on paper in April, 1931, came under the heading of "received" and not of "created" deposits.

THE EXCHANGE POSITION OF THE BANK

Early in the history of the Bank the exchange problem presented itself in an urgent way.¹⁸ The first funds left with the B. I. S. for later payment to the United States led to the accumulation of large dollar assets in New York. The later funds called for a wider distribution throughout Europe. The request for deposits of type B and the desire on the part of the Bank to counter exaggerated movements away from certain European currencies raised the question as to whether or not the Bank could be short of any exchange. It was obvious that if it could rightly anticipate the long run movement of exchange rates, and if it could appraise accurately the fundamental values obtaining, it could perform a great service in the name of stability, by holding some uncovered positions. The early decision of the Management was that a short position was not in itself to

¹⁸ Some further aspects of the Bank's exchange operations will be discussed in Chapter XI, Clearings.

be condemned, but the claims on it in various currencies which might be uncovered should be kept to a small percentage of the total business.

It is true that various theoretical protections are available to the Bank in respect to exchange operations. Some of these are of no immediate practical consequence and some are in constant use, but all have a certain bearing on the future development of business. The first is the policy not to be short. The second is to offset exchange losses by profits. The third is the development of forward operations. There are a number of other theoretical possibilities.

Hypothetical methods of eliminating or offsetting the exchange risk vary greatly in their effectiveness and in their availability to the Bank. Some of these possible methods of limiting losses are summarized below:

1. Matching assets with liabilities in each currency.
2. Offsetting the exchange risk by high investment yield in less stable currencies.
3. Forward exchange dealings, hedging risks.
4. Special rediscount arrangements permitting ready purchase and sale of exchange.
5. Pegging the exchanges to prevent fluctuations.
6. Diversification of holdings to offset exchange gains and losses.
7. Restriction of dealings to gold standard currencies.
8. Correct anticipation of future exchange trends.
9. Quick communication and technical facilities, permitting rapid change of position when fluctuations occur.
10. Facilitating the flow of capital by information, increase of confidence, and technical means, so that the spread between interest rates is less, and exchanges steadier.
11. Narrowing the gold points by developing clearing facilities, so the region of fluctuation is smaller.
12. Accumulation of gold by the Bank so that liabilities can be paid in gold rather than in a currency which has appreciated on the exchanges.

The methods of Central Banks are comparable to those open to the B. I. S., but differ in their importance. The

Central Banks had to have most assets in their own currency, and were in a way always "long" on the domestic exchange and "short" in foreign exchange, but they had a number of effective instruments at their command. The second protection, the offsetting of risks with profits, and a proper diversity of holdings, is entirely comparable. Then again, the third possibility, forward operations, was fully available to Central Banks, but is not used except in abnormal times. The fourth method, however, special rediscounting arrangements, might not prove to be as useful a resource as in the case of the B. I. S. Central Banks are in a much stronger position than the Bank in Basle, however, in respect to maintaining the value of the currency in which they are long; that is, the domestic currency.

Instruments at the disposal of Central Banks for the protection of their currencies on the exchanges have been, generally, the control of volume, the raising of the discount rate, and the sale of gold. The first could be exerted partly through rate control and partly through open market operations. Such efforts were successful, according to the proportion of the volume of the internal purchasing power to the external commitments of the country. It was generally considered that the raising of the discount rate was the quickest means of raising the exchange value of a currency by attracting foreign funds. The third and frequently employed method of strengthening the home currency was the export of gold. This lessened the sale of the domestic currency for foreign accounts, and raised its value in almost direct proportion to the amounts sold. In contrast to the Central Banks the B. I. S. could not control the volume of any currency, could set no effective discount rate, and could not counter exchange movements by gold sales.

Unfortunately, postwar conditions made the risks greater than they had been and, at the same time, weakened the ability of Central Banks to protect their own currencies. For instance, the large amounts of foreign obligations and

the increased uncertainty of the international values of many currencies multiplied the difficulties. The collapse of sterling in 1931 furnished a dramatic example of the kind of troubles facing Central Banks. The basic cause of these difficulties was the tremendous increase of one-sided indebtedness in various quarters and the consequent uneven distribution of gold.¹⁹ The attempt to make the B. I. S. a bulwark of currency values was doomed to complete disappointment. Nevertheless, the potentialities of the Bank must be kept in the foreground since, if it is by nature a good instrument, there is need for long effort and temporary sacrifices in order to enhance its power.

The development of this side of the Bank's functions was made more complex, because the maintenance of a safe exchange position was practically excluded by the ends which it was designed to serve. The avoidance of risk would have meant a passive existence and a refusal to face the responsibilities laid upon it. For instance, it was proper for the B. I. S. to be long in marks at such times as October, 1930.²⁰ Moreover, a long position in dollars was frequently indicated by the definite need of funds to discharge war debt liabilities in that currency. Temporary short positions in the stronger currencies made it possible to help smaller Central Banks during technical or seasonal shortages of those currencies.²¹ Caution was observed in keeping the volume of such operations to a small proportion of the total business, but as the capital and reserves increased it was logical to expect the B. I. S. to extend its exchange risks in the interest of stabilizing currencies or supporting Central Banks.

The second way of limiting foreign exchange risks—diversity and balance of profits against possible loss—was one which was an essential part of the Bank's program. In

¹⁹ See *supra*, Chapter I.

²⁰ See *supra*, Chapter VI.

²¹ This is type B operation, described above.

fact it was such a natural aspect of its work that it can hardly be looked upon as a deliberate method of meeting the exchange risk. It is obvious, nevertheless, that the large number of exchange transactions brought a kind of protection which might not be enjoyed by a Central Bank with restricted connections. The history of the first 18 months shows that there were a few exchange losses, but that these were in part balanced by profits on high yield placements in some of the capital-starved countries.²² In fact, in the fall of 1931 when the largest and the first considerable loss was incurred, the Bank was earning high returns on its credits in Central Europe.

A third safeguard mentioned above is the development of forward exchange operations by the B. I. S. Much is to be said for this method. It offers the most complete exchange protection and minimizes the risks of temporary short positions. It is especially useful in the granting of seasonal aid to depressed currencies. John Maynard Keynes has urged the wider adoption of this protection.²³ His proposals have met with some objection, but it is probable that the hesitation is due largely to unfamiliarity and to the fact that the troubled times have made it difficult in recent years to extend and perfect financial institutions.

In any case the B. I. S. found that forward operations would call for a modification of one of its early principles. It was thought that in order to execute forward orders the Bank for International Settlements would have to develop closer relations with private banks which carried out most of this business. Another alternative was to encourage the development of forward exchange business through the Cen-

²² See the profit and loss statement in the annual reports of the B. I. S. The depreciation of certain currencies after the suspension of the gold standard in England brought some serious losses in the latter half of the second year, but these were offset in the main by gains resulting from short positions in sterling.

²³ J. M. Keynes, *Monetary Reform* (New York, 1924), and other works.

tral Banks, but opinions differed as to the advisability of this. In any case it was not easy for the Bank to take an aggressive stand until the different possibilities were clearly understood.

There were other more fundamental reasons which led the Management to postpone forward exchange operations, although it was known that there was no complete unanimity on this question, and no certainty that the attitude in the first months would hold for a later period. Nevertheless, there was a fairly strong feeling in Basle that it would be unwise for the B. I. S. to take on this type of transaction. The main reason urged was that the Bank in going into any market did so partly to stabilize the exchange. It was argued that if a purchase of currency were an influence to increase the value of money in this market, a sale of this currency forward might have a depressing effect. Moreover, some considered that it would be unfortunate if it were broadcast that the International Bank was selling the exchange in question, even though the nature of the operation was well known. It is possible, of course, that such sales would be misconstrued if the counter-balancing purchase were not equally well known. It is not clear, on the other hand, that such sales, if well handled, would actually depress the currency involved. This whole question is open to further study and analysis, since forward exchange business is comparatively little understood and no comprehensive theoretical analysis of its significance has been made. Another mechanism to lessen exchange risks was devised at the B. I. S. in the early months. This was an arrangement for the rediscounting of the assets of the Bank under certain conditions and to certain amounts with the Central Banks of a number of countries. The agreement was calculated to make possible at some time a further type of deposit which we shall call type D. Although it was not actually in operation in the first two years, some hoped that

it might become a valuable means of easing exchange transfers.²⁴

Even though the exchange transfer plan did not materialize at this time the rediscounting arrangements relieved the Bank of the danger of being suddenly caught without exchange to cover its commitments. The usefulness of this privilege was limited, however, since the acceptance by bank A of assets in money market B for rediscount, and the consequent granting of a credit to the B. I. S. by bank A, would always have to be made on terms which took into account prevailing rates of exchange. It lessened the danger of the Bank in Basle being seriously embarrassed by some sudden speculative crisis, but it did not eliminate the exchange risk entirely. For although in the interests of coöperation Central Banks would probably give the B. I. S. a rate between the gold export and gold import points, many questioned whether any such guarantee as the "gold clause" would be valid in times of great stress.²⁵ These arrangements, therefore, were calculated to limit losses, and increase facilities, but could not solve the exchange problem.

A fifth possible method of preventing exchange loss in the placing of deposits and incurring liabilities was more comprehensive and at the same time more difficult to carry out. It consisted in the support of currencies and the narrowing of the field of fluctuations on the exchanges. This had been done in certain cases by Central Banks through pegging and was likely to be one of the lines of the development of the B. I. S. in the distant future. It is true that theory differs both as to the significance and the results of exchange fluctuations. Nevertheless, it is generally admitted that some seasonal fluctuations and most speculative crises are essentially bad. On the other hand, at the two

²⁴ This arrangement was proposed to Central Banks in the spring of 1931.

²⁵ See *infra*, Chapters XV and XVII.

extremes, long run trends and minor movements of value should, it is generally assumed, be allowed to exert an influence. These questions concern not only the handling of deposits but also the possible clearing functions of the Bank.²⁰

In short, the inevitable conclusion is that the B. I. S. has no adequate instruments for steadying the exchanges. It must, therefore, distribute assets and open deposits in a conservative manner. It cannot control volume, set money rates to govern the flow of capital, nor use gold in an effective way. Future development along these lines is not impossible but the immediate present has to reckon without them. Tendencies may be observed in the setting of the interest rate on deposits at levels which would attract funds from some markets and not from others. An increase in the rate paid by the B. I. S. might in some situations cut into the earnings of the Bank on deposits and at the same time lessen the possible loss on exchange operations. It would rarely be possible, however, for the Bank to set its rate above that prevailing in any market where funds were scarce and the currency weak on the exchanges. The flow of capital, in most cases, would be in the opposite direction to the movement of Bank funds.

The following brief comments on the remaining seven methods of limiting exchange risks make it evident that very few of those here listed were of immediate practical consequence. Thus it was found in 1931 that (6) the restriction of dealings to gold standard countries would not in itself constitute a protection, since it was possible for any one of these countries at a moment's notice to suspend convertibility. Then (7), diversity of holdings offered a certain protection in the case of minor fluctuations, since the very nature of relationships made compensating differences, but in the case of wider fluctuations permitted large losses if a short position should be taken.

²⁰ See *infra*, Chapter XI.

Furthermore (8), (9), (10), (11), the improvement of forecasting, communication and capital movement would increase the safety of the Bank's investments and lessen the exchange risks, but only over long periods of time and as the result of the gradual development of facilities. Likewise, the narrowing of the gold points is likely to occur in the long run, but is of no immediate importance to the Bank. And finally (12), the Bank could not protect itself from exchange risks by holding gold, unless some new conditions were put in force to make such holding a profitable operation. This survey of possible exchange protections in the placing of deposits leads to the conclusion that the Bank must avail itself of those other expedients, such as the forward exchanges and special arrangements with Central Banks, in order to meet the very real present-day risks.

In addition to natural limits set to the activity of the Bank in the exchange markets, there was definite opposition to its extending its efforts in this direction. This came from two general sources. There was, for one thing, a fear of competition expressed in those centers which had long played a dominating rôle in foreign exchange, notably London. This fear received concrete expression in the Young Plan. In the second place, reinforcement was given to this view by the theoretical objections to the Bank's taking on this function. These were based partly on the principle that it was better to allow the natural swings of exchange value to be obvious and untrammelled. Then, in addition to this, many considered it wise, on general principles, for more money markets to develop their exchange technique, encourage dealers, and gain familiarity with these important financial practices.

In any case the handling of deposits was consistent with both the theoretical and practical objections to an aggressive exchange policy. Although it was necessary for the B. I. S. to transfer funds from one currency to another, this was done through agencies already existing and at rates

set by the play of various forces in the market. Moreover, there was no large scale buying and selling of gold and no interference with practices already obtaining. It is true that the exchange committee²⁷ appointed by the B. I. S. did consider the methods of buying and selling gold, and put forward certain recommendations, but this was done by and through Central Banks and did not alter the situation to a great extent. Moreover, the clearing question was raised²⁸ but was not brought to any revolutionary conclusion. Proposals for later extension of activity were studied, but the early influence in the exchange market was limited to the assistance of the mark and other currencies during brief periods, and to abstract discussions.

One such system has been referred to above as "Deposits, type D." It was announced in a circular letter in April, 1931, but was not actually used at this time.²⁹ It offered the privilege of exchange transfer deposits. This permitted a bank to make a deposit in any one of ten currencies with the right to withdraw funds in any one of these ten without going through the open exchange markets. The rates at which one currency would be valued in another were to be set between the gold points. The B. I. S. was in a position to offer this facility as a result of rediscount arrangements in ten centers. The plan was devised (1) to lessen the steps required for exchange of currencies, (2) to decrease the volume of transactions coming into the open market, (3) to lessen sudden pressure on the exchanges by lessening the likelihood of an unexpected shortage, and (4) to make possible more cancellations of transactions in opposite directions. It was to be an experiment with a clearing system of a limited kind. It was to be carried on within the limit of Central Bank influence and through existing agencies, but under slightly new conditions.

Some objected that there was no need for such special

²⁷ See *supra*, Chapter VI.

²⁸ See *infra*, Chapter XI.

²⁹ See *infra*, Chapter IX.

facilities or to have exchange transactions pass through Basle when direct two-sided dealings were entirely adequate. Some even suggested that they would prefer to have their purchases carried out in the open market rather than to receive an artificial rate as under this scheme. Nevertheless, the plan served at least to indicate that there was no immediate demand for such facilities, and there were difficulties in the way of the special arrangements offered. It is an indication of how the Bank can extend its efforts cautiously and inconspicuously without committing itself for a long period. For this reason criticisms should be looked on as the proper and valuable result of such suggestions, rather than as condemnation of the Bank's desire to expand or diversify its business.

In fact, it was evident that, although the handling of deposits led to the purchase of many currencies, neither in the gold markets nor in exchange dealings did the Bank exert any noticeable influence. Its power, insofar as it was evident, was mainly psychological and indirect. It was busy strengthening its own machinery and finding out the path of future progress. Many exchange policy discussions in Board Meetings had repercussions on the exchange markets, but the evolution of its own technique was carried out quietly under the protection of existing institutions. During the first two years the exchange transfers were not large in volume and a considerable proportion of the deposits were received and discharged in one currency. The general problem could not be avoided, but it was kept within narrow limits during the first six months.

MOTIVES FOR OPENING DEPOSITS WITH THE B. I. S.

As has been suggested already, varied motives led to depositing funds with the B. I. S. Certainly the exchange facilities were not the main factor. In fact, from a chronological point of view the first funds left with the B. I. S. were those which came from the Agent General for Reparation,

The next came from share capital and from the undivided receipts under the Young Loan, the Special Deposits, and from the German Annuity payment of June 15, 1930. These annuities, insofar as they were not withdrawn at once, were shifted instantaneously in accord with standing orders to the special type of deposit account in the name of Central Banks held for treasury account. Immediately thereafter, other deposits began to flow to the Bank and presented much more interesting problems than those which arose directly out of reparation and debt payments. The growth of the "foreign exchange reserves" held by Central Banks in Basle in 1930-1931 was rapid.³⁰

A summary of the main motives which led Central Banks to build up credits with the B. I. S. indicates at least five. These were (1) interest earned, (2) clearing facilities, (3) exchange advantages, (4) prestige, and (5) the desire to further coöperation. It is probable that the fifth reason influenced the stronger Central Banks to a notable degree in 1930,³¹ whereas the advantages offered, through exchange assistance and interest earned, influenced the weaker countries to a greater extent. Certainly the effectiveness of the Bank as a clearing instrument was of most importance to those with large debts to the United States. All of these motives, however, were effective to a considerable extent and worked sometimes together, sometimes separately, to attract funds.

The development of deposit policy was dependent on the volume of resources, and the gradual piling up of experience. The resources themselves were dependent partly on the technical methods used to attract them to the Bank, and partly on the vigor of leadership which would make participation seem worth while. Some methods of commercial banks were not available to the B. I. S. For instance, it was

³⁰ See Chart I, p. 40.

³¹ For instance, the first deposit of the Federal Reserve System was made to help in credits granted to eastern Europe at a time of crisis.

contrary to the dignity and influence of the B. I. S. to bid for large funds by high interest rates, even if it could afford to pay them.³² Moreover, the requirements of liquidity often made it impossible in all cases to earn large yields. In general, it had to place its funds safely and at short term. At some later time when short term money might be at a premium, the Bank could benefit by the very services which it would render. In 1930 and 1931, however, there was a plethora of liquid funds, and the tide was running against it.

It remains to be seen whether the Bank will be able to attract deposits when there is a widespread demand for liquid funds. It is conceivable that the activity of speculative centers might be so great, at times such as those prevailing in 1929 in the United States, as to suck away the resources at the disposal of the B. I. S. Moreover, it will be several decades before long run liabilities and assets, that is, the capital, special deposits, and undivided surplus of the Bank will greatly increase the resources available. The answer to the question lies in the attitude of Central Banks, which can and probably will increase the funds on deposit with the Bank when the time for constructive action seems to them opportune. There exists, however, a very real theoretical difficulty, even though it is possible that wise management and a spirit of coöperation can reduce it to a minimum.

The contrary case, that is, that the Bank be given more money as deposits than it can use profitably, would never occur. There are two reasons for this. First, on short notice the Bank can reduce its interest rate to zero if necessary; and, second, it can, and already has, redistributed the funds received from markets where there is a plethora, and invested them where there is a scarcity. It is true that the Bank might find a need for a change in policy in case of a

³² The criticism was occasionally heard that the Bank paid too high rates during 1930.

sudden shortage of credit, or very plentiful money, but the need of flexibility was fully realized in Basle and the various contingencies foreseen.

Changing events indicated that some of the motives for building up deposits were subject to considerable development, while others were more or less narrowly circumscribed. Thus, the importance to Central Banks of clearing changed very much in 1931, with the "Hoover Debt Holiday." Then again, emergency help afforded might lead to an increase of funds from the stronger Central Banks, but in general this is not apt to occur on a large scale. Moreover, it is not possible to predict whether or not this type of assistance will develop into an important phase of the Bank's activities in the future.

On the other hand, a desire to have the prestige value of participating in the work of the B. I. S. was of real importance in increasing the number of depositors without greatly adding to the volume of money held with it. In fact, a very small deposit which could be increased at any moment would serve the purpose. The extension of Central Bank coöperation, however, would call for more aggressive support, for it would not be possible for the new institution to spread its interests far and wide unless it could count on large deposits, left more or less permanently with it, by the stronger banks. It could not help in emergencies, unless various centers would supply it with funds, quickly, and in large amounts, so that it could give assistance where needed.

The interest rate motive for enlarging deposits with the B. I. S. is the one which offers most difficulties and yet in some ways is the most obvious manageable instrument. It might seem at first glance, that by paying an intermediate interest rate, the Bank would attract funds from low interest countries, and would invest them in the higher paying centers. Assets in these high rate money markets would not tend to flow into the Bank except for special reasons.

That is, in theory, Germany would not make large deposits in the B. I. S., since the rates paid in Basle were much lower than those obtainable in the German market. The situation was not, however, as simple as it appears, because of the complicated relation between money rates and exchange risks. Thus, the Bank was obliged to invest large parts of its holdings in New York in 1930 and 1931 to meet imminent claims for payment in that center, even though money rates were only one or two per cent.

Even so, experience during the first year showed that it was possible for the B. I. S. to pay a rate above that in New York, Switzerland, and the more liquid centers, and still make a good profit on its business.³³ This policy did not escape criticism. There was a feeling in some quarters that the Bank held investments which were not good enough for its portfolio, although not a penny was lost in the first year. Certainly there were instances when the holdings caused considerable worry to the Management, and one case where the Bank had a narrow escape.³⁴ Moreover, some of its investments in Germany might not have been justified except on the grounds of coöperation. In any case, the International Bank was of service in its efforts to direct money toward countries suffering from sudden panicky flights of capital. The yields on such investments in Germany and elsewhere were high, but the amounts so invested were small.

Because of low yields on money in France and the United States, on the other hand, uniform interest paid on deposits of the different countries led to a swelling of the dollar and franc holdings of the Bank. Those who turned over assets in these and other low interest centers made a net gain in the differential between the B. I. S. rate and the lower rate. On the other hand, there were smaller funds coming from high rate countries. This difference was in accord

³³ See *Annual Report* (Basle, May 19, 1931), p. 2.

³⁴ This occurred in December, 1930.

with the aims of the Bank to equalize somewhat the flow of capital, even though the impression on money markets made by its operations was almost negligible because of the restricted volume. This very tendency, however, made the exchange position more difficult, for in order to earn the interest paid on low yield capital the Bank had to move away from the stronger exchanges toward the weaker currencies of capital scarce countries. The arguments for and against this policy will be considered in Chapter IX. The outstanding fact to observe in connection with deposit procedures is that they functioned smoothly and profitably.

Some expected that an additional motive would lead Central Banks on the gold exchange standard to hold credits with the Bank for International Settlements. These banks could, in many cases, consider the claims on the Bank as a part of the legal reserve against their currency. Some of the countries who could not do this immediately advocated laws to make it possible. This arrangement increased the flexibility of the gold exchange standard, for it was still possible to hold earning assets instead of gold, and there was in addition the protection of anonymity, treaty safeguards, and various other facilities which the B. I. S. offered. Moreover, the exchange reserves held in Basle would strengthen Central Banks and aid in coöperative policies. These factors certainly influenced some of the smaller Central Banks. In any case, the B. I. S. favored some degree of concentration of the gold exchange reserves in their hands, hoping to decrease the anarchy and sudden withdrawals of capital which had been one of the bad features of the gold exchange standard since the war.

These considerations led to the conclusion in many instances in 1930 that deposits with the B. I. S. were more usable than gold, or than deposits with other banks. The legal conditions governing currency reserves were responsible in some cases; the clearing and exchange facilities, actual and potential, were effective in others. The increased

prestige of the Bank made funds with it particularly good assets to hold. Closer examination will show that the net effect of the Bank's part in the holding of foreign exchange reserves, while quantitatively small, had a tendency to increase the velocity of circulation of purchasing power in the countries concerned.

In this connection an example can be outlined to show the possible effect of deposits with the B. I. S. If the Bank of Greece holds commercial paper denominated in lire, it cannot use this as a backing for its note issues, but it can apply to the B. I. S. for a dollar deposit and, if the B. I. S. approves the transaction, increase its dollar exchange assets by surrendering its lire. This deposit becomes immediately effective for supporting the notes in circulation in Greece, even though the total assets of the Bank of Greece are in no way altered. It may come about indirectly that the knowledge in Greece that there is no immediate danger of deflation will lead to greater business activity, and thus cause eventually some increase in notes or bills. It would be inaccurate to say that the Bank created credit by its acceptance of deposits, for the phrase would imply something rather different from what the Bank actually does, but it would be a mistake to underestimate the significance of the operation. The Bank examines the conditions, and when these come within the principles laid down, it gives its stamp of approval to deposits which then serve many new purposes, and become enhanced in value even though the number of units is unchanged.

Since many deposits and transfers are made for motives not at first evident, it is well to distinguish between those operations which are purely legal, and those which are economic in their significance. For instance, the turning over to the B. I. S. of funds in a given country in return for a deposit labeled in the same currency is in the first instance merely a change of title (type A). It is quite possible for the B. I. S. to replace these funds which have been

turned over to it in exactly the same form and with the same institutions as they were before the transaction. Thus, a dollar deposit with J. P. Morgan & Co., which was the property of Italy, may be liquidated in order to leave funds in the Federal Reserve at the disposal of the B. I. S. and later be redeposited with Morgan & Co. However, if the Bank wishes to change the form of investment and buy bills, it is doing something which has economic significance and may influence the demand for some form of investment. Whenever it chooses to transform its assets, it is going beyond the merely legal stages of the procedure. This further stage is the investment process.

CHAPTER VIII

THE USE OF FUNDS

FUNDAMENTALLY the economic changes are of much more importance than the legal adjustments, although the receipt of funds and the use made of them were two complementary aspects of a unified deposit policy. In any case investment raised problems quite as delicate as did the receipt. In the eyes of its Managers the Bank was a business undertaking which would lose its power and meaning if it could not earn a reasonable return and conduct its business so as to contribute directly and indirectly to the world's wealth. Thus, although profits were not a main motive¹ and although large profits would indicate that the B. I. S. was emphasizing narrow aims to the detriment of its broader functions, nevertheless the ability to earn a fair return would be considered one of the signs of the wisdom and soundness of its transactions.

For two reasons reparation payments created an investment problem for the Bank. In the first place, it was expected to place a considerable share of its funds in Germany in order to furnish some slight counter flow to balance out-payments. In the second place, if it was to clear reparation annuities in the simplest way, it would have to pay interest and find a profitable employment so that the treasuries

¹ Some who had worked on the plans for the Bank considered it important for the B. I. S. to earn large profits. This is indicated by Article 53 of *The Statutes*, which was taken directly from the Plan. Others looked on this as a minor matter and insisted rather on liquidity and the forbidding of competition, and the close collaboration with Central Banks. These motives were, in many respects, conflicting.

would allow the funds to remain with the Bank, rather than shift them immediately.²

In fact all the foreign exchange business of the Bank was an investment matter. The currencies held were all "foreign" to the Bank, so that even when attention was focussed on soundness and liquidity the exchange problem had to be kept in the foreground. Even the more general matters such as the extent of participation, and the influence which the Bank should try to exert in the credit markets were bound up with the question of where money should be employed. All these matters had been considered in a general way by the first sub-committee formed in the June 1930, Directors' meetings. At this time Governors Luther, Moreau, Beneduce, Norman and President McGarrah³ went into the question of the use of funds, and laid the groundwork for later actions which were carried out in much the same way throughout the first two years.

Thus, every investment is considered from three different angles. There is, first, the geographic distribution of funds. This is for most purposes the question of the exchanges, but cannot be separated from consideration of interest rates, security, and other more general matters. Then, second, is the question of distribution in time, that is, the length of the bill, and to a certain extent the form and way in which it is liquidated. The third is the question of soundness and risk which is closely associated with the selection of the investment, and the guarantees or general conditions which surround the transaction.

It was sometimes said in Basle during the early months of its activity, that the Bank had no credit risk to face, but

² The suggestion was made to the U. S. Treasury by one who had much authority in these matters, that they should revise the settlements, so that the sums would be received monthly, rather than semi-annually. This would have lessened the importance of the B.I.S. "clearing" work but would also have diminished the strains. Nothing of the sort was done, however.

³ R. Deschièrè, *Les Réparations, protection des obligataires, la Banque des Règlements Internationaux* (Paris, 1931), p. 177.

that it did have to incur a continual exchange risk. The statement, although it is only partly true, indicates the line of approach to placement policy, and some of the influences which bore upon it. In general it may be said that through its connections with the Central Banks, and through the conservative policy which the Bank pursued in taking almost exclusively the most liquid forms of investment and through special guarantees, the credit risk was cut to a minimum.⁴ On the other hand, because the B. I. S. had "no home currency," it could not avoid the exchange risk, unless it kept its funds always in the same centers as its liabilities, a practice which would mean avoiding one of its main functions, that is, the more even distribution of credit over space.⁵

The exchange risk has been considered elsewhere but it is well to refer again to the fact that the Bank did incur an exchange risk, and was short certain currencies, and that this exchange risk was not technically covered by any form of hedging, or forward operations.

Some protections were evolved which limited the chance of risk and the steady inflow of reparation money in 1930 gave the Bank a degree of flexibility of movement since it could ask any desired exchange distribution.⁶

The handling of the investments with regard to geographic distribution was not definitely settled at an early date, there was, moreover, a consistent policy of secrecy.⁷ Even though the exact distribution of assets was not revealed it is possible to judge the approximate situation by analyzing the credit conditions at any time in relation to the specific aims which the Bank was trying to accomplish.⁸

⁴ See *infra*, Chapter IX.

⁵ See *supra*, Chapter IV.

⁶ *The Trust Agreement*, Cmd. 3484.

⁷ Gates W. McGarrah, "The First Six Months of the B.I.S." *Proceedings of the Academy of Political Science* (Jan., 1931), pp. 32, 33.

⁸ Gates W. McGarrah, "Bank for International Settlements," address before The American Club of Paris (Feb. 12, 1931; printed by The Guaranty Trust Company of New York), p. 5. "While I cannot discuss our

Thus it is clear that in connection with its function as a clearing house for reparation and debt payments it had to keep a large part of its funds in New York, in fact about 80 per cent at certain times. This situation changed after the "Hoover Debt Holiday." Similarly in the effort to stabilize currency relations it placed a considerable part of the remaining funds in Germany. Of the rest small portions were invested in the various participating countries. The Bank followed the prevailing practice of keeping non-interest bearing deposits with its correspondent Central Banks, as a partial compensation for the services rendered to it on various occasions.

One of the few definite statements issued by the Bank on the subject of the distribution of assets is to be found in the First Annual Report:^{*}

Out of the total of our short term deposits on March 31st, 71% had been effected in dollars, 11% in Reichsmarks, 9% in pounds sterling, 3% in French francs, 3% in Dutch florins, 2% in Swiss francs, and the remainder scattering. Necessarily the currency originally deposited has a relationship to the repartition of our own investments. Nevertheless, thanks to arrangements which it has been possible to make with a number of Central Banks providing for the immediate conversion of one currency into another without passing through the open market, we have been able, with security, to redistribute deposits received and to effect a considerable geographic distribution of our investments on 25 different markets. The amount held in Germany represents, for example, 21% of our assets. Of the funds invested, 41% were invested with Central Banks, 20% with banking institutions selected by Central Banks, and the remainder with or through institutions selected by us with the knowledge of the interested Central Banks. . . . In this last category, as in the case of the first two, all our investments are made through the intermediary

investments in detail, I can say that they are very widespread and that, contrary to some current reports, only a small fraction is placed in the Balkan States, and nothing in countries whose currencies are not yet stabilized."

^{*} *First Annual Report*, for the business year ended March 31, 1931 (Basle, May 19, 1931), p. 5.

of the Central Banks concerned, which are thus aware of all operations in their markets.

This general comment gives an idea of the main currents of B. I. S. funds.

The very short terms of the Bank's investments meant that the matter was constantly reconsidered. Moreover, public opinion, criticism of the Bank, and the suggestion that it coöperate in various international and national enterprises, were constantly bringing new possibilities into the foreground. The other two problems, liquidity, and soundness, were more familiar. The Bank was not placed in a unique position in respect to them as it was in many of its policies. They were freely discussed, and the main facts were available to those concerned or could be inferred to a considerable extent from a careful study of the balance sheet.

The manner of making the investment, and the protection against credit risk will be taken up in conjunction with the type of investment which the Bank chose to make. The general nature of such investments can be seen on the assets side of the balance sheet; the short term funds were much larger than the long term. A comparison between the assets and liabilities indicates that during the first months the investments were directly influenced by the shifting of funds to meet Reparation, war debts and fixed obligations, although as time went on, with the increasing funds of the Bank, and the growing experience with the pace of withdrawals, this link was sure to become less close irrespective of probable modifications in these payments. The gradual crystallization of these methods and policies proved them to be workable and led to the maintenance of a more independent and at the same time increasingly liquid position.

With regard to maturities, investments may be divided into short time, intermediate, and long time, made through the Central Banks acting as correspondents. They were all arranged with a view to exchange risk and earnings and also

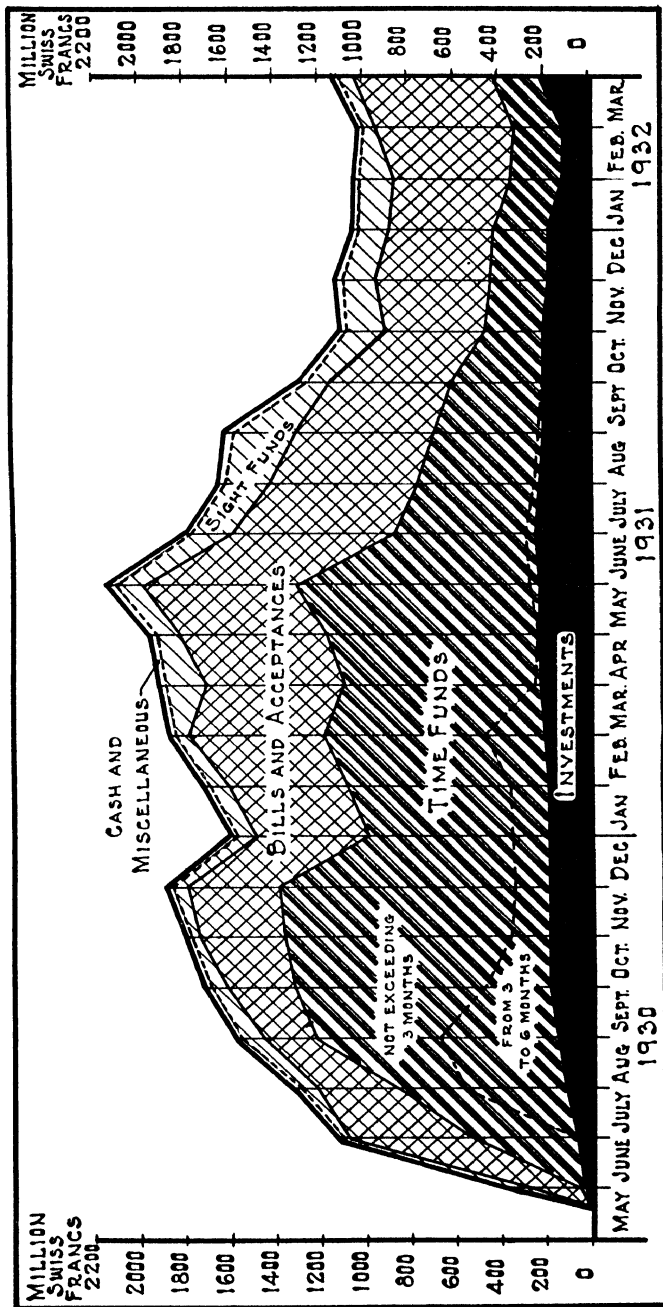


CHART III *

ASSETS OF THE B.I.S. CLASSIFIED ACCORDING TO MATURITY

* See monthly financial statements published in the Appendix.

to establish principles and methods which would preclude the stimulation of any rapid and uncontrollable expansion of currency. The cardinal principle of such investments was that the Bank should carry them through so as to increase the power of the Central Bank, and not swell the resources which would be outside its control. While there was no reason for restraining the expansion of credit, the Bank had no right and no desire to usurp the privilege of initiating any movement in the direction of increased purchasing power.

The short term investments of the Bank consisted of demand and time deposits, commercial bills, acceptances, and treasury bills. These ran from three to six months, although in certain cases there were odd dates. If the bills had already run for a short while, the deposits were not necessarily withdrawn at the end of the short period indicated. In fact there was usually a standing order for the renewal of the investments when they matured. The selection of bills and acceptances was made by the Central Banks, a list sometimes being sent to Basle.

It was found that commercial bills were the most attractive form of investment for the Bank. These were self-liquidating and were based on genuine commercial transactions. Further than this, the Central Bank which selected the bills, usually guaranteed them against credit loss. For these reasons a very large part of the Bank's holdings took the form of commercial bills. Those who looked to the breaking down of foreign exchange barriers between countries hoped that through the extension of rediscount agreements, and through the building up of technical experience along this line, the flow of capital over space could be made as even as basic economic conditions permitted. Others at the Bank, less hopeful of the realization of such ambitious achievement, considered the bills sound business.

Under the Statutes the B. I. S. was not permitted to ac-

cept bills ¹⁰ but it could, of course, buy acceptances, and did so in just the same way that it bought other bills. They were a particularly sound investment, and since they represented in the main the export and import of goods, were peculiarly appropriate to the aims and functions of the new Bank. In most instances the financial assistance given to Germany in the course of normal business took this form. Such transactions were far from offering any serious competition such as was at first suggested, but rather facilitated and encouraged the business of acceptance houses to the extent that the Bank could deal in this form of paper.

These arrangements were facilitated by the Central Banks which guaranteed the soundness of commercial bills and bankers' acceptances bought by the B. I. S. in many cases. Even where a direct guarantee was not obtainable, it was possible often to secure a special arrangement equivalent to a guarantee. For instance, in the United States, the Federal Reserve agreed to buy back bills held by the B. I. S. at any time before their maturity. This repurchase agreement offered to all Central Banks made it possible to recover funds at sight. It is obvious that the B. I. S. obtained the highest possible degree of security by this agreement. The purchase of bills was made through the Central Bank; in fact the Managers in Basle did not follow the details of the selection closely, since they were not in a position to judge this commercial paper from first-hand knowledge. Such knowledge was, of course, in the possession of the Central Bank concerned. Thus, although the Central Banks did not, in certain cases, take a direct responsibility, their assistance was at the disposal of the B. I. S. and the part they played greatly increased the security of the investments.

Short-dated government securities, the second form of short-term investments, were not, of course, so guaranteed, since it was considered unnecessary and inappropriate for

¹⁰ *The Statutes*, Article 25.

the Central Banks to put a seal of approval on government promises to pay. These bills were bought on many occasions by the Bank. The procedure involved was simple and requires no special analysis. The bills were mostly three, six, and nine months' bills. In England, treasury bills were bid in at auction according to the regular procedure. Very few were held outside the United States and Great Britain. The purchase of British Treasury bills in August, 1930, was commented upon in the press, since it was interpreted as an effort to strengthen the pound on the foreign exchanges. Although it did act in this direction, it can hardly be called an exchange support. The purchase of the bills was good business from the point of view of yield, and seemed at the time to be a sound exchange risk. In fact, the treasury bills in the Bank's portfolio yielded a nice margin over and above the interest rate which the B. I. S. paid on deposits left with it by the treasuries of Central Banks.

In this connection the Directors of the Bank had to bear in mind the express prohibition of lending to Governments.¹¹ The question was raised both in Basle and elsewhere as to just what was implied. The Management even went so far as to consult various lawyers on this matter.¹² The decision was reached that the intention was to prevent governments from issuing new or larger loans because of possible support from the B. I. S. If the securities were already issued,¹³ the Bank, in buying the bills, put additional funds into the market, but did not directly increase the money in the hands of the government. It is true, of course, that by supporting the value of the bills through an increased demand, it might indirectly encourage further

¹¹ *The Statutes*, Article 25.

¹² This was done in respect to the proposed purchase of Russian bills in 1931.

¹³ The British case does not quite correspond to this specification, since bids were made for bills about to be issued. The Bank did not make this a deterrent, and from a purely economic point of view there is no clear distinction.

issues. In any case its influence was quantitatively small, and the effect was simply one of many forces which might influence governments in their policies.

Although many bills and acceptances were bought, a considerable portion of the Bank's investments took the form of deposit accounts. These fell under three separate headings. There was: (1) the traditional and permanent non-interest-bearing account which the B. I. S. kept with every participating Central Bank; (2) the so-called money employed accounts through Central Banks, which earned interest; and (3) deposits made directly with private banks with the knowledge and approval of the Central Banks. This type of investment was not connected directly with a specific business transaction as were the bills or acceptances. Moreover, they were not always guaranteed, and therefore, not quite as free from risk.

The non-interest-bearing deposits with the Central Banks were made in order to give the Banks working funds from which they could derive a net gain to compensate them for the services which they rendered the B. I. S.—that is expert advice, communication facilities, payments, collection, and custody of gold and securities, and various other services. It is customary for Central Banks to leave such deposits with each other if they have frequent business dealings although the gain is more illusory than real. In the case of the B. I. S. the Central Banks forego in profits a part of what they gain in interest. This deposit is not in any case very large and differs in a general way from bank to bank according to the amount of business done through each.

The second form of deposit was the "money employed" account with and through Central Banks, on which interest was paid. This form of investment was not possible with every Central Bank. Among those which did not use this procedure were the Federal Reserve, Italy, and Japan. The special type of deposit was an outgrowth of the gold ex-

change system as it developed after the war. Central Banks as a general rule do not grant interest on deposits. For this reason it was found that countries holding large foreign reserves left these funds with private banks and in some cases the Banks of Issue lost control of the money market because they could not influence these deposits. In connection with the difficulties which Central Banks experience if large funds are left with private banks, it is interesting to note that Dr. Schacht found it impossible to make any discount change effective in Germany because an effort to contract internal currency merely served to attract more foreign funds which were put at the disposal of private banks. This trouble was even more patent in the case of some of the smaller countries. To prevent this abuse the Central Banks developed the "money employed account." They accepted deposits placed in their market, and gave to the Central Bank making the deposit a return based on the use made of the money, minus commissions for guaranteeing the investment.

Despite these arrangements during the first few months of the Bank's existence a considerable part of its funds were invested with private banks. In one country, for instance, at one time almost seventy per cent of its funds on deposit were left with private banks. In the second year this situation changed and approximately seventy-five per cent of its funds on deposit were left with the Central Bank. There were a number of considerations which influenced this policy; these were the costs and commissions, the interest rate, guarantees, and the general policies. The most important of these was, of course, the regard for the interests of the Central Banks and the general policies of the B. I. S.¹⁴

¹⁴ One of the managers of the Bank said: "It is a definite policy of the B. I. S. to accept funds from Central Banks alone, and to invest these funds only with or through the Central Banks." The partial exception to this policy arose from the fact that it is not always possible or financially advantageous to withdraw money from other investments at the precise date when the funds are to be paid over, through the intermediary of Central Banks to the United States Treasury.

At first the theory was not clear on this point but later opinion emphasized the functions of the Bank as intermediary between Central Banks. This policy was undoubtedly influenced by Montagu Norman's ideas as to the need of "exclusive relations." In the beginning, when the voluntary deposits were small in comparison with the special deposits and capital, there was a tendency to separate the resources of the Bank into two parts. One of these, Central Bank accounts, was left mainly with Central Banks. The other, long term deposits, were invested more freely since they were not derived from Central Bank sources. In the later months, however, the responsibilities to Central Banks predominated over other ideas and led to a very high concentration of B. I. S. funds with these institutions. In addition to this as the absolute sums at the disposal of the B. I. S. became smaller, the proportion with Central Banks became greater.

It is possible that, in certain instances, particularly toward the beginning, the B. I. S. was influenced in its investments by the question of commissions or other costs in buying or selling bills or acceptances. This was certainly less true in the later months; even interest rates were not considered of prime importance unless the higher interest obtainable by the B. I. S. coincided with the policy of strengthening the position of the Central Bank. In general it may be said that when the B. I. S. knew the exact period during which it would hold the deposit in question, it asked for commercial bills. Because it was sometimes hard to match maturities to the time interval, deposits with private banks were occasionally made. As time went on, however, the choice was more definitely between commercial bills, with their higher yield, on the one hand, and Central Bank deposits, including "money employed accounts," on the other. This was especially wise in view of the insecure position of private banks in a number of countries during the years of depression.

CONCRETE PROBLEMS TOOK PRECEDENCE

These variations in principle and method which are found in the receiving of deposits, the exchange position, the motives appealed to, and the use of funds, all point to a diversity of aims within the Bank and of conditions outside. These were harmonized and made consistent by the desire to serve Central Banks within their own markets and to renounce short run advantages in favor of slow and safe development. The general questions which were raised by economists in connection with the founding of the Bank, such as inflation, the distribution of gold, and price stability, were all of necessity considered in connection with the daily handling of funds. In general, however, the Management turned away from the more ambitious plans and bold theories, to devote themselves to the meticulous regulation of the business immediately in hand.

It is possible, now, to summarize the more important concrete questions which have to be taken up in regard to the receipt and investment of deposits. There was the need to consider, in the first place, the nature of the body making the deposit; second, the currency in which the deposit was received; and third, the currency into which it was converted if changed; then fourth, the length of time for which the deposit is left with the B. I. S.; and fifth, the interest, at present a uniform rate, paid on such deposits. The sixth and the last was the nature of any conditions or recommendations which the Bank might wish to make at the time of opening the account.¹⁸

Then as regards the investment of the deposits, the Bank must consider first the condition of the money market in which funds are to be invested, second, the rates of interest which can be earned, and third, the probable value of the currency in terms of foreign exchange at the time when the investment matures. In the fourth place it must keep in

¹⁸ In some cases the later exchange problem would be implied in the opening of the deposit.

mind the bank policies of the center in which it is leaving funds and the probable terms of reinvesting these funds when that becomes desirable. These considerations can generally be weighed in the light of past banking experience. As a result of the accumulation of daily decisions, there originated new policies and untried banking procedures. The Bank must blaze a new trail even in carrying out its routine business.

Thus, despite the limits set by small funds, deposit methods led to a more even spread of credit over space. This in turn tended to bring about a slightly better distribution of funds over time. Nevertheless, the Bank could not deal adequately with the problem of the present versus the future, that is, of short time credit versus long time credit. A particular situation existed in 1929; there was a wide spread of interest rates between countries, and a great demand for short term credits. In 1930, however, there was plenty of short term capital, and the more urgent need was to transform it into long term credits. Thus, it came about that it was not so much the geographic equalization that was necessary, as an adjustment in time. Agencies were already in existence which were in some measure calculated to spread capital through space. The B.I.S. could use the help of other banks. Arbitrage operations, seasonal credits, and the more orderly forms of speculation, all helped in this field. The easing of day-to-day and of seasonal fluctuations was mainly a matter of further technical development, and the Bank formed in this case a further link in a fairly well-developed chain of agencies. The means of acquiring and using deposits here described are mainly aimed at the more even geographic diffusion of funds. Meanwhile conditions demanded that the Bank go beyond these procedures and try new methods to ease the cyclical and long time difficulties with which the world was struggling.

INFLATION AND THE BANK

Certainly early fears of inflation became irrelevant in the face of the unparalleled deflation in depressed countries everywhere.¹⁶ The precautions against uncontrollable expansion of purchasing power were nevertheless important.¹⁷ The Management did everything in its power to prevent the use of deposits as an unsound basis for note or credit expansion. In the absence of a decisive experience to prove the matter one way or another, only a tentative judgment to the effect that these inflationary possibilities were checked is warranted. This is as it should be for whatever one may think of inflation, the Bank was not a proper instrument at this time. It would be impossible for it to bring about or to check a world-wide inflation, and it would be unjust for it to encourage a purely local expansion.

The Bank could not, under existing conditions, create deposits. Thus there would be no direct inflation.¹⁸ In fact, it would not open deposits in return for any created by Central Banks in anticipation of its support. This principle prevented most forms of indirect inflation. In exceptional cases it accepted for deposit funds which had been bought through exchange transactions in foreign markets. This permitted inflation of a very indirect kind, but one which would have been available usually, in one form or another, without the help of the B. I. S. A further factor which can hardly be called inflation, but which worked in that general direction, was the improved quality of investments held by the B. I. S. That is, a Central Bank might

¹⁶ Albert Hahn, Alfred Lansburgh, Wilhelm Lautenbach, Hans Neisser, Melchior Palyi, Walter Sulzbach, and Erich Welter, *Die Reparationsbank* (Frankfurt, 1929). See various articles. These writers agree that the Bank had no power to inflate or to influence the situation aggressively.

¹⁷ Melvin A. Traylor, *Speech* (April 28, 1930), *Bank for International Settlements, Documents* (Chicago, 1930).

¹⁸ By inflation is meant here an increase of purchasing power accompanied by rising prices. This definition needs further modification for more precise uses.

hold deposits or bills in a certain center which would not be so safe, nor so readily marketable, as the same kind of investment if held by the B. I. S. There would be no change of quantities in this case but a change in effectiveness. The Central Bank might find it had more quick assets when it "bought" the deposit in Basle in exchange for holdings elsewhere.

Much has been said of the possibility of inflation through the B. I. S. There were, in fact, many hopes and fears in this respect in 1929. A number of those who wrote about the Bank, and Dr. Paul Einzig in particular,¹⁹ indicated the possibilities of a vast expansion of purchasing power. There is a real need for a careful consideration of these potentialities. The theory which has been suggested here but not fully developed has been referred to as the "theory of the multiple expansion of international credit."²⁰

The practical answer to the question posed by this theory is twofold. On the one hand the Statutes, by direct and indirect statements of what the Bank may do, excluded the easier and more profitable methods of inflation. On the other hand, the Management and Board, by the policies which they developed, made any expansion of purchasing power through the Bank unlikely. Professor Salin takes a position which is quite contrary to that of Dr. Einzig in that he emphasizes the passive nature of the Bank and the difficulty it would have in retaining deposits if either political or economic factors should start an adverse movement.²¹ There is little doubt that his argument is sound if his premise is granted, for the Bank is indeed helpless unless it has the real support of Central Banks. This support must be based on an enlightened self-interest that can be expected to stand severe shocks.

¹⁹ Paul Einzig, *The Bank for International Settlements* (Macmillan, London, 1930).

²⁰ See *supra*, p. 125.

²¹ Professor Edgar Salin, "Die Bank fuer internationalen Zahlungsausgleich," *Weltwirtschaft und Seeverkehr* (Oct., 1930).

Nevertheless such possibilities remained and deserve examination. From a mechanical point of view there could be a pyramiding of credit through the B. I. S.²² The following situation might occur although the motives for bringing it about are lacking. For instance, the B. I. S. could give the Central Bank of Italy a deposit of one million dollars and receive a deposit of one million dollars worth of lire. This might lead to a pyramiding of credits at a ratio of approximately $2\frac{1}{2}$ to 1, on the basis of the original exchange of assets. That is, if Italy secured a dollar deposit with the B. I. S. it might expand its credits in lire with these dollar funds as a reserve. These funds could, if the B. I. S. approved, be accepted in return for more dollar claims, which Italy could use for further expansion. Since the Bank of Italy needed a reserve of only 40 per cent of gold exchange behind its notes the expansion could proceed very fast if it were facilitated by the B. I. S.

There is nothing particularly new in this situation. This kind of process has always been possible between private banks and between Central Banks. The check which prevents its happening in most cases is the fact that there is usually no motive for creating this purchasing power unless it is to be used. Obviously, if it is used, the depletion of the deposit drawn out prevents creation of the later deposit. The pyramiding is, therefore, quickly halted. In any case, if the money is created and not used it makes little difference whether or not it is brought into existence.

A theory of multiple expansion of credit would become of importance, therefore, only in case there was a concerted desire to expand credit. If this were not the case, the natural correctives would halt the movement. That is, in the case of the B. I. S. a depletion of its assets in certain currencies would prevent its opening credits on its books in

²² This is true even though the policy of the B. I. S. excluded the granting of loans against security, except under unusual conditions. Thus the tremendous volume of inflationary credit which *Einzig* indicates was not a real danger. Paul *Einzig*, *op. cit.*

those currencies. In the case of Central Banks, a decline in gold or exchange reserves would lead to caution. This restraint would be effective unless credit were being created at an almost uniform rate in the larger money markets, so that withdrawals and new deposits would balance on the average.

Professor Whale in his interesting article, "The Creation of Credit through the B. I. S." suggests "two extreme hypotheses." The first case which he outlines would exist if all Central Banks were willing to consider their deposits with the B. I. S. equivalent to gold. If this should come to pass, he argues, the credit possibilities are almost unlimited. In contrast to such a situation he outlines a second case, which would hold if no Central Bank considers its B. I. S. balances a substitute for gold. In the latter circumstance he maintains the Bank could not increase credit but could only influence its distribution.²³

It is probable that he underestimates the restraints which would prevail even under case one, since the veto power of the Central Bank as well as the fear of an unwise expansion would limit the Bank before it could go very far. On the other hand, he minimizes the possibility of a joint inflation of credit through the Bank even though such credits were not a direct substitute for gold. In other words it is apparent the forces which would prevent or stimulate credit creation through the B. I. S. lie in the Central Banks themselves rather than in the statutory limits or in the resources immediately available to the B. I. S. An intermediate case indicated by Professor Whale comes nearer to the situation actually envisaged at the Bank. In this instance he assumes the use of B. I. S. deposits as a substitute for a part of the foreign exchange reserves of Central Banks. In one important respect, however, he departs from the immediate prospects in that he assumes that the B. I. S. would find a gold

²³ P. Barrett Whale, "Notes on the International Bank and the Creation of Credit." *Economica* (London, June, 1930) pp. 130-136.

reserve necessary. In so doing he limits unnecessarily the theoretical possibilities of expanding credit. His outline of these three cases offers an interesting commentary on the urgent question under consideration at Basle. This was the problem as to how deposits could be made equivalent to gold in order to lessen the pressure on available supplies and assure their value in all circumstances.²⁴

As the matter was looked at in Basle, the concern of the B. I. S. for its own security would prevent its exercising an inflationary influence. On the one hand, it could have no influence in the larger markets because of its comparatively small resources. On the other hand, the risk of participating in inflation in one of the smaller money markets would be very great. It would lead to the depreciation of the Bank's assets and a loss which would be the greater as inflation went further, since the Bank must estimate its holdings in a given country in relation to their value on the exchanges of other countries in which it is involved. There is, then, little to fear from the B. I. S. in this respect, nor is there any new hope for those who wish for a ready expansion of credit. There are great possibilities of international expansion but the concerted action called for is a condition not likely to become actual in the near future, particularly as the whole tradition of Central Banking runs counter to it.

Recent events have demonstrated that opinions differ sharply as to the effects of inflation, and the importance of preventing deflation. Some had hoped that the Bank would catch up prices and purchasing power and bear them along on a slowly ascending wave. In 1929 the Statutes served to dash these hopes. In 1930 the practices of the Bank put them beyond the immediate limits of probability. Future tendencies might, of course, swing the B. I. S. in a different direction but early safeguards were rigid. Potential means for increasing purchasing power might develop later through a clearing system. But the view of the Directors and Man-

²⁴ See *infra*, Chapters XV and XVII.

agement was that no such facilities should be created since they would tend to postpone international adjustments to real values. No considerable inflation could be brought about, therefore, unless it was world-wide, and this had always been possible even without the B. I. S.

Methods influence theories, as well as theories, methods. Thus, the early months of the Bank, though devoted to the perfection of manifold relations and the profitable handling of business, left an impression on the policies which would govern it over longer periods. Some were bound to be disappointed at the modest rôle assumed, others to criticize operations only vaguely understood. Both attitudes were natural. Time alone can give the correct verdict. Theories call for a more aggressive action but circumstances set the speed with which it can be attained. It is unwise to criticize the rate of progress so long as progress continues to be made.

CHAPTER IX

THE DEVELOPMENT OF POLICIES

THE year 1931 brought the climax of those forces which had been disturbing the economic world since 1914. The peace of 1919 had given Europe no real economic respite. After ten years, the destructive force of war became evident again in the disturbance in the flow of capital, and in the building up of national barriers. These and other related forces brought about a succession of crises in Austria, in Germany, and finally in England. The Bank was forced to consolidate its position, take cognizance of its policies, and look to the larger rôle which it must ultimately play. The consideration of those policies takes us into the heart of the monetary conflict and the credit difficulties of this period. Before the troubles became acute, however, there was a brief interval between the first months of constructive effort in 1930,¹ and the serious disturbance that was to follow in 1931.

During this time of relative calm, the principles on which the Bank operated became much more definite, but the Directors, very naturally, postponed the public announcement of methods and plans. In so doing they were following the example of Central Banks whose declared policies are few. Certainly there could be no advantage in committing the Bank to a rigidly defined line of conduct. Indeed, much was to be gained by leaving different possibilities open.² A

¹ These efforts have been described in Chapters VI and VII. The chronological story of events is resumed in Chapter X after the summary of policies before 1931 is discussed.

² *The Young Plan*, Cmd. 3343, p. 11. The Experts in Paris recognized this fact. They said, "It is obviously desirable . . . not to limit unduly the functions of the new institution."

succession of acts and choices would inevitably result in a policy more flexible and better adapted to the possibilities of the Bank than a deliberately formulated program. In fact, the conditions which limited the handling of deposits and investments automatically constituted a coherent, workable system, well suited to economic requirements.

This body of procedure was not widely known, nor did the Managers of the Bank consider that it constituted unchangeable precedents. Indeed, everything was done to emphasize the tentative character of the work undertaken, even though there was some danger that the B. I. S. would be criticized for inaction.

Even in 1930, however, the Bank had developed three general types of principles which may be referred to as policies. There are, first, general concepts as to the nature and functions of the B. I. S. and its place in the economic system which influence all its actions. Such a general concept is the idea of a Super-Central Bank. Those who guided the B. I. S. considered that it must serve as an aid in maintaining the soundness of the currencies of its participating banks. Then, second, there are certain theories and aims which the Bank desires to further. These appear to be abstract, but they have, nevertheless, a definite effect on all the specific actions of the Bank. In the third place, there are the general methods and procedures which form a system of economic actions—the banking practices taken into account in the case of every investment, exchange operation, or other business done. Connected with these latter are various rules and arrangements which, once made customary, determine the conditions of business carried on at the Bank, the functions of different divisions and departments, and the way in which new plans are made.

Thus, it was not long before the Bank was applying a well-coördinated system of rules to each specific piece of business. In other words, the policies of a more concrete

nature were already partially defined. These policies and methods were known to the collaborating Central Banks. Others who might be interested in financial development were in a position to infer the general rules which governed transactions but could not reconstruct the entire system of operations. This situation was in part the result of the decision to limit publicity to a minimum, a decision which may have helped to prevent hasty criticism but which led also to misunderstanding in some quarters. Moreover, it is probable that the Bank could have increased confidence if it had declared its position on some monetary questions.

Even more uncertainty concealed the general economic theories on which the Bank was run. There were no direct statements to indicate what they might be. They could be inferred in part from acts performed, from the ideas occasionally expressed by Managers or Directors in a private capacity, and from a knowledge of the aims of Central Banks. Nevertheless, it is clear that there were a number of economic assumptions behind the separate acts of the Bank. What was done, and what was left undone, tended to strengthen the hands of a group of monetary theorists. Economists might ignore the influence of the Bank for a while, but they recognized after a time that the Bank had accepted or rejected certain general ideas. Those who grouped themselves in opposing camps in the controversy over money, prices, and exchanges, came to look on the Bank as an enemy or an ally.

This was all the more true because the general nature of the Bank had been indicated in broad outlines in the Plan and the Statutes. There could be no doubt as to the ruling principle which would guide all its discretionary acts. It was to work for coöperation among the twenty-six participating Central Banks. A closer examination, however, led to some doubt as to just what the nature of the collaboration was to be, and just how harmony could be evolved

where so many varied aims and theories existed. Even so, the attempt to bring about this adjustment was to be the major task of the B. I. S.

Great variety is found in the way all these different policies developed. Most of the rules and regulations were determined by the Management in daily meetings. The economic theories which were implicit in the other phases of policy were kept in the background of the discussions. There was some fear, perhaps, that an organization created artificially and not gradually evolved might be looked on as theoretical and unsuited to practical exigencies. Consequently, those in authority directed their efforts to organizing a *bank* in the first place, and to avoiding the form and appearance of a research committee or academy of theoreticians.

Certainly no other bank had ever developed so directly from abstract theories, and yet these theories were to be challenged and modified before the B. I. S. was two years old. The monetary doctrines which hedged about the gold standard, and the policy of *laissez faire* were shaken to their foundation by the chaos of 1931. The Bank had been founded in part to regulate the gold exchange standard and support the Central Banks in the traditions which they had copied from England. Before there had been any significant progress toward these goals, however, the experience and theory of Central Banking was challenged, and English banking turned in a new direction.*

Events of such importance as the suspension of the gold standard in England were bound to alter policies; it is impossible to speak as if a static system with definite rules governed the B. I. S. The ebb and flow of theoretical opinion was sometimes very rapid, but beneath the frequent changes was a strong current flowing definitely in one direction. The Bank was instituted in part to execute international payments, and as such, it was dependent on some international

* See *infra*, Chapter XIV.

instrument for discharging debts. Despite the interruptions, limits, and evil effects of the gold standard, therefore, it was bound to continue its business on this basis.* It could not possibly function as a bank without a commonly accepted means of payment. No substitute foundation was furnished, so it was bound to work for the strengthening of the gold standard.

Although the relation of the Bank to the gold standard question called for deliberate policies, the execution of services in connection with reparation payments was clearly prescribed beforehand in the Plan and Statutes. There was no room for choice or uncertainty; there were few tasks which touched the larger aims and hopes. The main significance of these payments to the larger task came through their influence on the workings of the gold standard and coöperation, and because Reparation interfered with Central Bank coöperation and world credit conditions, thus contributing toward the difficulties of England, Germany, and other countries in maintaining the gold value of their currency. Certainly payments to the United States and France called for an unnatural and unbalanced flow of credit and gold. Coöperation called for an easing of credit strains and an equalization of gold distribution. Here was a fundamental conflict which the Bank was powerless to resolve, even though it had a part to play in carrying out the contradictory economic purposes.

In the narrower task, as Executor of reparation agreements, the Bank was a political agent. In its larger work, it was concerned with economic factors to the virtual exclusion of political. Insofar as it entered the fields of investment for profit, it was comparable to commercial banks, and inasmuch as it worked for the ends of Central Banks and under direct guidance, it was a new link in the system of semi-public institutions for monetary control. An American

* The Balance Sheet was drawn up in terms of gold, that is, the amount in the swiss franc at par.

financier, with the problem of United States participation in mind, once said that there was a choice between three possibilities. The B. I. S. could become an agent for governments, a commercial bank on a large scale, or an agent for Central Banks. The accumulation of decisions and plans soon made it clear that the first two of these possibilities were eliminated. The Statutes had pointed to those aims which were in fact emphasized, but they had not completely excluded the other two possibilities. By the end of 1930, however, the Bank had committed itself to the last rôle of intermediary and agent of Central Banks.

In fact, the end of this first formative period was marked by this choice. It was difficult to arrive at because economic sentiment fluctuated between dark depression and ill-founded optimism. December 1930, and January 1931, were times of general gloom. A great weariness oppressed even the more hopeful political and economic leaders at the turn of the year. This feeling sometimes led the bankers associated with the B. I. S. to belittle the progress which had been made, and to criticize the early policies as inconclusive.

This pessimism was the result of two major causes and influenced every decision. The causes were first, the political condition in Germany leading to an insecurity of its exchange position, and second, the drain of gold from England. Both matters were talked over in Board meetings as well as in smaller committees and conferences. In neither case, however, could the B. I. S. take an aggressive stand. The possibilities of action give a good indication of the position of the Bank in other times of crises. It could do a few things for Germany; it could invest a small amount of capital, and it gave various indications of confidence in the country's economic future. All the time, however, it was powerless to remove the causes of the trouble, since they were imbedded in the political instability of Germany, on the one hand, and in the political requirements of the Allies, on the other.

Similarly in the case of England, the Bank could do little to relieve the strain. The execution of policies so far formulated permitted it to buy British treasury bills on the open market, to call a committee for the study of gold purchase methods, and to spread the exchange demands growing out of reparation payments as evenly as possible. These and other actions may have helped very slightly, but the transactions were so small that the result was practically negligible. For instance, the Bank encouraged discussions on those gold problems which were further taken up by British and French treasury officials in Paris in January, 1931. It did not claim credit for whatever progress was made, even though preliminary discussions in Basle saved some time and effort. This was an instance of coöperation, but it did not lead to conspicuous results, since the causes of England's trouble were too deep-rooted to be disposed of by minor adjustments.

Many thought that the familiar economic system was crumbling in 1931. Despite earnest efforts for stability, long standing traditions were overthrown and strength became weakness in many places. The Bank was a laboratory in which principles were being tested, but was not a power plant which could supply the weakened system with energy. It was a meeting place for financial experts, but it was not a council room in which treaties and tariffs could be redrafted. It was primarily a vantage point from which the crisis in various countries could be observed and quick information and advice sent to points of danger.

THE PLACE OF THE BANK IN THE ECONOMIC WORLD

Despite these recognized facts, an imaginary picture of a tremendous bank, towering above the classic building on Threadneedle Street, and the impressive structure of the Bank of France, was sometimes suggested in the early months by those who tried to make vivid the position of the Bank. This corresponded to the ideas of those who

spoke of a Super-Central Bank in Basle. The actual economic functions of the Bank in the first years, however, are more comparable with the modest building in which it began its work. It could not at once take on the dignity and power which had come to the larger Central Banks through decades of experience. Its claims were modest, but the significance of its acts was greater than was at first apparent. A careful scrutiny of the policies which lay behind makes this obvious.

The first step in the analysis of policies is the definition of the character of the Bank and a correct idea of its place in the economic system. Some observers were disappointed to see the modest position actually assumed in the first years. The possible relationships of the Bank linked it with three kinds of organizations—with governments, with commercial banks, and with Central Banks.* It had dealings with all three groups, but it had to choose quite definitely between them, in certain respects.

In fact, the determination of the nature of business to be done involved the consideration of such matters as its adjustment to varying Central Bank policies, and the avoidance of competition with existing organizations. The B. I. S. had to take cognizance of the part it could play in the industrial crisis and of the manifold and conflicting desires of financiers. It had to concern itself with many general economic matters, distinguish different types of industrial fluctuations, the factors involved in the gold question, and decide upon the optimum pace of its own development.

An outline of the Bank which might be drawn at this time would show it functioning as a central reservoir for international payments. Into it flowed funds from Germany; out of it led channels toward the United States and other creditor countries, and the terminals of this system are those government bodies which paid or received this money. At various points along the channels treasury officials determined the volume of the flow. Thus the con-

* See *supra*, pp. 50, 87, 91.

nections led through the Bank, but the controlling intervention of governments was completely outside. Only at a few points would there be lines of communication from the conference rooms of the B. I. S. to the government offices in Berlin, or to the foreign offices of the other governments. These lines of communication served to transmit information or advice, but the Bank could exert no dynamic pressure on the flow of such funds passing through its hands.

In fact a diagram of the Bank's relationships would show that the B. I. S. was placed in the center of government agencies. A few rare suggestions of enterprises in which the Bank might participate came indirectly from them, but as time went on these connections and communications were less used, although there was occasional collaboration with the League of Nations.* From the first, the policies with regard to these suggestions were easily formulated as its detachment from governments was recognized. The Bank could not make loans to governments; it could not coöperate with any joint government undertaking; nor could it associate itself with any group working through political channels. Some of these things it was forbidden to do, and others it preferred to avoid.

Thus if a chart were drawn the conspicuous feature would be broad lines indicating communication with the Central Banks in both directions, connections similar to those between the Banks of Issue themselves. The business of the B. I. S. with any two Central Banks would usually be carried out on a triangular basis. The several arrangements would be made by the B. I. S. and the two Central Banks, but any exchange transaction involved was carried out directly in the money markets of the separate countries. These and other connections between the Central Banks and the B. I. S. were encouraged by deliberate policies, through constant communication, visits, and specific investment and exchange transactions.

* See *supra*, Chapter V.

Although the B. I. S. was the central figure in such a diagram, it was considerably smaller than ten or twelve of the participating Central Banks.⁷ In fact, the Banks of Issue had resources which were large enough to extend or limit the form of the Bank. Everything might depend on the amount of credit left on deposit with the B. I. S. The Bank could not possibly become a dangerous rival. On the contrary, if a bad breakdown of the system of Central Banking should occur, it would tear the Bank for International Settlements from its foundations.⁸

One further element should be added to the picture of the Bank's relative position. In the field surrounding the central figure, there are a multitude of commercial banks. These are connected with the B. I. S. by weaker links, to indicate that there were personal connections, and communications, even though there was little direct business relationship, such as was the case with Central Banks. The commercial banks are, rather, connected with the B. I. S. through the Central Banks for business purposes. Funds flowing into the center pass out again through well-worn channels to the participating Banks of Issue and from them, in some cases, to the private banks of different countries. The connection then is neither close nor uniform.

No such chart as the one suggested above could have been drawn up in the early weeks of the Bank's work, but by the end of 1930 an observer who knew the nature of the Bank's activities could block in the main parts, and add the connecting links in a fairly accurate way. Having done so, he would see the Bank in a pivotal position. A new organization had, indeed, grown up to close the gap which existed between Central Banks; the tracing of these relationships would show vividly the dependence of the new

⁷ See table in Chapter III, p. 38.

⁸ Edgar Salin, "La Banque des Règlements Internationaux et la crise mondiale." *Société Belge d'Etudes et d'Expansions*, Bulletin Periodique, No. 82 (October, 1931), pp. 421-423.

body on those Central Banks in different countries from which it drew its power.

At the beginning there was necessarily some quick adjustment to economic realities followed by a more gradual formulation of aims. Even coöperation was a vague concept and monetary stability a general hope. No one could say exactly what the terms meant. The equalization of the distribution of gold and capital was more definite in its implications, but these ends were relative to tradition, habits, and commercial development in different countries. Such purposes were recognized in the general program of the Bank, but the first steps had to be taken slowly. There is no doubt that this constituted an important general policy of the B. I. S. It influenced the subjects introduced at Directors' Meetings, the attitude toward various financial conferences, as well as the reticence and avoidance of publicity which characterized these months.

Some difference of views on this policy existed. In fact, a number of those connected with the Bank felt, as successive crises and deepening depression increased distress in many countries, that there was much to gain and little to lose if they should assume a position of leadership. They argued that if the Bank took a strong stand, it would draw to itself the ability, experience, and resources which were to be found in many countries. This view was in the minority in the early months for two general reasons. The first was a feeling that the short experience and limited resources made aggressive action extremely dangerous to the future of the Bank. The second was that the Central Banks on which the B. I. S. relied to a notable extent, for technical services, information and general guidance, differed among themselves. It was natural that they did not wish to see the Bank for International Settlements advance too rapidly on any course which would strengthen one or another of the contrary hypotheses which lay before them.

Despite such hesitations, however, the accumulation of decisions gradually indicated the precise position of the Bank in time and in place. It was a central institution influenced by a change in any one of the surrounding Central Banks. These exerted considerable leverage on the Bank because of their greater size and independence of action. Nevertheless, the activity of the B.I.S. increased much faster than the size of its assets alone warranted. It was considered useful to have information acquired in Basle passed on to other banks. This phase of the Bank's work kept its personnel occupied with many studies, reports, and answers to questions.

There were disadvantages as well as advantages in this central position, however. The Bank could not disassociate itself completely from any crisis. It was sensitive to all monetary disturbances, and in the beginning it could not modify these events. Then, again, its place in time was clear. Its first months were but a short segment of the long life which was hoped for and prophesied. It was a growing organism, to be seen against a background of long years of changing economic traditions and methods. A picture of the Bank in this perspective draws one's gaze down long avenues of economic progress, and through the mists of intervening time to distant goals which, though shadowy in outline, are highly exciting to the imagination.

BUSINESS INEVITABLY DEPENDENT ON GENERAL THEORIES

Further development in the general aims of the Bank was dependent on the formulation of basic economic principles. This was necessarily difficult and slow. Economic theory, as has been the case in other periods of readjustment after wars, was divided into several antagonistic camps. Central Banks varied greatly in their monetary positions, and held different views, while the lack of consistency among economic experts in general made the acceptance of any body of doctrines extremely difficult. As far as the

B. I. S. was concerned, it is important to distinguish between the theories implicit in its action and those consciously adopted as working hypotheses. The B. I. S. did choose between conflicting principles, but this choice was often the outgrowth of the immediate desire to place money soundly rather than a deliberate acceptance of any theory.

This was the case in regard to the Bank's part in the bitter struggle between the two main groups of monetary theorists. It is natural that the Managers of the Bank should refrain from expressing their views on particular controversies, even though their actions might indicate exactly where they stood. Occasionally a communiqué from Basle advocated a freer granting of loans or a better distribution of funds.

It was natural, also, that a variety of monetary doctrines should be held within the Bank, but no one of these was definitively made the basis of policy. The views frequently discussed were various. At one extreme were those who favored a gold standard functioning according to classical English analysis, with a large measure of *laissez faire*. At the other extreme were the advocates of a controlled money system in a controlled economy. This latter condition would bring as a possible accompaniment, in some people's opinion, an international means of payment supplied by the Bank. These and other ideas were frequently discussed and as time went on they were modified in view of the practical possibilities of the Bank.

As this modification of theories progresses further, it is inevitable that it will bring advantages and disadvantages. It will lead to a more active influence through certain Central Banks and affect all programs of monetary policy. On the other hand, it will tend to decrease the stimulating discussion and restless search for principles which characterized the early months. Those who sympathized with the dominant views will come to be in closer contact than those who disagreed, whereas at first, almost every view was

represented and discussion covered a very wide field. It is probable that the Directors and Managers would have preferred to keep the Bank clear of abstract economic controversies but this was not always possible.

The indications of the basic assumptions found in the daily acts of the Bank are less conclusive because the choice of action was often limited by circumstances. Despite this, its attitude in 1931 toward the main economic dilemma was evident—that is, the choice between inflation and deflation. It was a time of general deflation and during these early years, there was no consistent effort in Basle to halt the downward movement. It is true that it had not sufficient resources to stimulate inflation even in the smaller countries. Nevertheless, it is conceivable that during the early part of 1931 it could have made some efforts to act as intermediary or to develop a program to halt deflation. This it did not do. It followed closely the course of those conservative Central Banks which believed in the restoration of equilibrium without deliberate monetary intervention. In fact, the B. I. S. did practically nothing to increase purchasing power either directly or indirectly.⁹

Those who favored aggressive efforts by Central Banks to counter deflation with conscious inflation contended that the B. I. S., by influence or example, could have modified world banking programs even in its early years. There may have been some truth in this view. The fact was, however, that the B. I. S. worked mainly through and with those Central Banks which accept most of the classical doctrine, and which depart from it only under the irresistible pressure of necessity. Some of those who hoped for a different stand expressed their disappointment in no uncertain terms, ignoring reasons such as those just given.¹⁰

The matter had been partially decided in the Statutes, inasmuch as they made the Bank a part of the supporting system of the gold standard. For one thing, Article 21

⁹ See *supra*, Chapter VII.

¹⁰ Dr. Schacht expressed his criticism emphatically in 1931.

prescribed that its business should be limited to gold standard countries. For another, the nature of its transactions meant that it could deal only in currencies which were internationally acceptable. Any other course would have meant grave risks. Moreover, it could not rely on any one political system, and inconvertible money becomes closely linked with the fiscal policy of governments. For, even if inflation does not occur, it is always potential, as long as nothing but laws, or the votes of parliament determine the volume of money. Opinion in Basle tended to favor the quick reactions and adjustments called for by the free working of the gold standard. As the investigation of exchange and clearing problems progressed it was decided, as a basic principle, that interference with the adjustment of the balance of payments to economic conditions should be exerted only in rare instances.

This problem recurred many times in the discussion of the possibility of clearing through the Bank.¹¹ One result of these deliberations was a distinction between necessary and avoidable fluctuations in value. There was no desire to organize a system which would delay adjustments called for by underlying economic conditions. An adverse exchange rate based on a large trade deficit should not be interfered with by B. I. S. action. The plans sketched out tentatively were consistent with this idea and indicated the advisability of delay in organizing a clearing system. It was important that the balance of payments of each economic system be adjusted to its relative position among nations as to labor costs, wealth, and monetary security. Thus, the B. I. S. could not work for stability in a blind and indiscriminating way, but must seek the more subtle methods of lessening fluctuations in value.

Postwar crises made this caution inevitable. Most of the men at the Bank had been in the thick of the struggle, and were able to combine facts and relations, to reconstruct their own theories of the gold standard, of the relation of money

¹¹ See *infra*, Chapter XI.

to prices, and of both to the exchanges. The acceptance of classical theories, insofar as they were accepted, did not solve many of the problems of the Bank. There were many points at which they were not applicable, either because of new conditions, or because they took account only of the more concrete elements in the monetary system. In fact, the necessary modifications and amplifications were beginning to emerge just when the departure of England from the gold standard turned attention with violent suddenness to the possibility of a radical change in familiar relationships.

One act, such as this, could not alter the basic monetary principles, but it could change actual values and practical requirements. It was obvious during this time, that not economic relations, but political desires, were altering the interaction of money, credit, gold, interest rates, and exchanges. Democracy was influencing economic law in unexpected ways. The B. I. S. is essentially a practical organization. It had, first of all, to carry out particular operations, in a sound way. It could not, therefore, ignore changes in government policy, even though theory may have indicated that such policies could not last for long periods of time. It had to anticipate the breakdown of any false system, but it could not act on principles which were being disregarded by many powerful forces in the financial world.

Thus it came about that the expression of basic principles, through the B. I. S., had to wait on the evolution of practical policy in the monetary world. Although there was real progress in Basle in the adaptation of classical reasoning to the new circumstances which postwar emergencies brought about, no consistent and comprehensive doctrine could be announced. Furthermore, although the Bank had a theory and acted on it, the attempt was made in Basle to discount the influence of abstract ideas on special policies. This point of view, justified by the prevalent misunderstanding of the meaning of monetary theory, did not minimize the importance of these basic ideas. It was clear that

the Bank had to prove its strength through experience before it could afford to be involved in the acrimonious debates which characterized these years.

In any case the theories which lay behind the actions of the B. I. S. dealt with many elements. A few such were the relation of quantity of money to prices, of credit to gold reserves, of interest to credit, of bank policy to stability, and of psychological factors to velocity of circulation. The first acts performed were based on those few assumptions which had stood the test of time. Later plans and ultimate aims had to wait for the adjustment of these simpler analyses to complicated modern conditions.

Meanwhile, in each one of the major branches of the Bank's activities, a code, and a tradition was built up. This held for deposit procedure, the investment of resources, interest policy, credit conditions, gold dealings, the attitude toward money market practices, and exchange dealings.

One part of these working principles has already been described. This was the system for handling deposits and investments.¹² It made definite conditions as to the currency and exchange operations, and limited inflationary possibilities as well as the general relations of the Bank to outside institutions. A part of the exchange policy has been described above and is further discussed in connection with Clearings, in Chapter XI. Other principles such as the insistence on liquidity and diversity of investment have been commented upon in earlier chapters. Then again, the policy of the Bank in the gold question is a large problem which must be considered separately.¹³ Some further analysis of the stand taken on interest, credit, and money market practices is essential to make possible an understanding of developments in the year 1931, which we are about to describe.¹⁴

¹² See *supra*, Chapter VII.

¹³ See *infra*, Chapter XV.

¹⁴ See *infra*, Chapters X and XIV.

INTEREST RATE POLICY

Interest rates paid by the Bank were governed by three general considerations. There was, first, the desire to earn a reasonable return, which meant paying less on the average than the Bank could gain on its own investments. There was the attempt to attract considerable deposits. This depended on paying as much or more than the Central Banks could obtain for high grade deposits elsewhere. And there was the more ambitious desire to move funds from countries with plenty of capital to those that lacked funds. All these factors had to be considered in conjunction with prime needs for liquidity and security. Moreover, every act had to be consistent with the dignity and coöperative aims of the Bank. It was not always easy to reconcile these diverse elements.

Not all the intricacies of the situation were immediately apparent. It was not anticipated in 1929 and 1930 that credit conditions would be abnormal for so long a period. The first method, carried out for a very short time in 1930, was to classify deposits in three groups and pay three different rates of interest.¹⁵ These variations were in addition to the differences in rates which applied to deposits of varying terms. The grouping was not determined by the Central Bank in whose name the deposit was entered, but rather depended on the money market in which the funds were received from these Banks, and the currency in which the deposit was denominated.¹⁶ That is, at this time, the Central Banks of Poland and England, making deposits with the B. I. S. in dollars, would get the same rate of interest, while England might receive different rates if it held deposits in two different currencies with the B. I. S.

This threefold division proved to be unworkable. It was one of those attempts to make a delicate adjustment to

¹⁵ See *supra*, Chapter VI.

¹⁶ The use of the swiss franc at par as an accounting device was, of course, only for the monthly and yearly balance sheets.

different conditions which broke down because of its complexity. It raised comparisons and distinctions which were politically difficult, and prevented the automatic working of a simple and generally understood procedure. For this reason it was abandoned in about two months. It was followed by the much discussed "uniform rate" or *taux unique*. Different rates were paid on funds according to the term of the deposit, but this practice was not subject to any misunderstandings as it was normal procedure. In general, the interest rate policy was in line with a basic aim of the Bank—that is, the more even distribution of credit.

The rate of interest on deposits was changed infrequently—that is, about every three months during the first year. Since the rate was above London and New York there was little reason for increasing it and there was no need for reducing it, as the resources could be invested on favorable terms. In the second year the readjustments were more frequent to keep the rates in conformity with the markets; in fact, they were changed three times in November 1931.

The schedule of rates paid is interesting chiefly because it indicates the desire to encourage liquidity on the part of the member banks.¹⁷ There was clearly no direct monetary advantage in placing the money for one or three months, unless the rates were expected to fall rapidly. A hypothetical schedule would be as follows:

Deposits at sight	2¼ per cent.
Deposits at 10 days' notice	2⅜ per cent.
Deposits at 30 days' notice	2⅝ per cent.
Fixed term deposits	
(a) one month	2½ per cent.
(b) three months or more	2¾ per cent.

Many have questioned the advisability of the uniform rate. It meant that the Bank could not profitably hold

¹⁷ W. W. Riefler, *Money Rates and Money Markets in the United States* (New York, 1930), pp. 37-61. This book throws interesting light on the differences in rates in the United States.

deposits without incurring some exchange risks. That is, it could not attract deposits held in New York without paying an interest comparable to that given by the best banks there. In order to do this and still earn its costs, commissions, and other expenses, it had to shift some of the funds corresponding to its dollar liabilities into the higher interest markets for investment, or else into less liquid forms of investment in America. If the Bank did actually move funds away from New York, it would be encouraging the flow of capital from the center where there was a plethora of short time funds, and to this extent, ease the tension in some money market starving for credit. The Bank was intended to exert just this kind of influence, insofar as was consistent with safety, but the exchange risk led to some caution in the shifting of funds.

Even though this was true in principle there was no expectation on the part of those controlling the Bank that they could influence interest levels generally, or establish anything comparable to a world rate. Moreover, the Bank's position, detached from the productive and fiscal influences of the separate countries, would have made such an influence a questionable expedient, even had it been possible. The setting of an average and uniform rate did, however, suggest that some such result might be attained at a far distant time. Even the most optimistic admit that the possibility is so remote that it does not deserve consideration at this time.

Nevertheless, an influence on the rates in a few of the smaller countries could be exerted by the B. I. S. The Bank was occasionally a marginal lender in larger markets.¹⁸ Moreover, it was frequently in a position to flood the smaller markets with funds, if this had been consistent with its aims. It was quite possible for it to prevent a seasonal increase of rates in a country like Poland or Finland. The knowledge

¹⁸ This was true, for instance, in November, 1931. On one day its funds could not be placed freely either in New York or Paris.

that exchange credits would be available for temporary use would relieve pressure which might have driven up the cost of money quite out of proportion to the volumes required. Then again, indirectly, the Bank could step into some sudden crisis leading to a flight of capital, and by its moral influence, combined with the promise of promoting joint credits from Central Banks, keep rates within bounds. There were such instances in the summer of 1931. It is true that the temporary calm was disturbed by later crises, but the Bank undoubtedly made possible a quick return to fairly normal monetary conditions in Germany and Austria.

Despite this constructive work the interest rate policy has been criticized. Some have said that rates were too high in the early months. Others have suggested that the rates were not changed frequently enough. Still others have said that the uniform rate was a mistake, and that it led among other things to a "scramble for profitable investments." There may be some justification for these criticisms, but partial answers are not far to seek. For the first, it can be said that the early policy of the B. I. S. was modified and the rates lowered after a few months, although perhaps not so far as some critics would have urged. For the second, it can be asserted that the Bank wished to simplify its relationships as far as possible, and that little was to be gained by following every important change, at a time when stability was the prime desideratum. As for the uniform rate, time alone will tell, but the early experience of the Bank seems to have proved that any other policy is unworkable.¹⁰

Even though this was true the uniform rate presented real difficulties. The Bank had to strike an average acceptable to its depositors, and yet permitting it to earn a reasonable return. This was not easy, and involved risks. Possibly some later system may be evolved which will avoid the disadvantages of the early threefold division and yet not bring

¹⁰ See *infra*, Chapter XVII, Conclusions.

the dangers that came with the uniform rate. For instance, fixed differentials in comparison with Central Bank rates might be adopted. This would prevent the accusation of discrimination and bring about a fair degree of flexibility. Or it is possible that differentials could be set, as suggested, but varied under certain typical conditions. The issue is not closed in any case and it is important enough to warrant further study. The tentative conclusion justified by the first two years is that the uniform rate was sound in principle and practice.

COMPLEXITY OF CREDIT POLICY

Some have raised the question as to whether the Bank actually had a *credit policy*. Although the term is too vague in itself to receive a clear-cut answer, the position is best revealed by one or two statements and acts which show the tendencies developed. For instance, the Bank favored the extension of long term loans to eastern Europe, the development of mortgage banks, and the conversion of short term credits into middle or long term. It indicated this approval in several ways. It issued a communiqué on March 9, 1931,²⁰ stating its hope that the measures initiated during the early months of the year would be successful. It formed a committee which considered various aspects of the matter in repeated sessions. It bought a few bonds issued by newly organized international mortgage banks when they had demonstrated their impartial, non-political nature.

More important than this, however, was the policy indicated in the interest rates which the Bank offered on deposits. This showed more plainly than any communiqués the desire that Central Banks should keep their funds liquid. It can be seen that the differentials between sight, ten days, one month, and three months were so arranged that there was a definite incentive to keep the money at

²⁰ For confirmation of various decisions made consult the B.I.S. *Communiqués*.

sight or on short notice; there was, in fact, little to be gained by leaving the money for a longer time. This situation is particularly striking since it might run counter to the short run advantage of the B. I. S. The explanation is of course that the Management wished to have the money quickly available to each Central Bank in case it should be needed to strengthen the domestic position. In addition to this policy of encouraging liquidity the Bank recognized the necessity of remaining flexible and ready to coöperate in policies which Central Banks might develop to meet sudden changes of circumstances.

The decision in all such matters was definitely influenced by the two schools of thought which had existed since the origin of the Bank.²¹ One represented by the Germans and Belgians urged the creation of credit, the development of backward countries, and stimulus to export trade; the other, represented by the French and Americans, urged that the Bank was not equipped for such work, and that it would be going counter to sound finance if it moved in this direction. The Italians were against such a development, while the English were divided in their views.

The question was not completely settled during these months. The difference which recurred in the discussions of specific business matters was rooted far back in this original division of opinion. It did not occasion a sharp conflict but, rather, varying degrees of emphasis on the possible tasks to be performed. More specifically, some were eager to develop the lending side of the Bank's potentialities, and others its rescue work, advisory functions, and technical studies.

It was in pursuance of both views that the B. I. S. sometimes bought commercial papers of odd dates and intermediate terms. The Management desired to break down the too rigid insistence on the customary three, six, and nine months' credit. Moreover, the Bank made definite

²¹ See Chapter I.

efforts by conferences, and offers of investment and advice to stimulate the development of bill markets in a number of countries. It wished by so doing to broaden the markets and to encourage the ready sale of commercial paper, a process most important to the easy flow of funds from one center to another. In the interest of the Central Banks it made an effort to attract funds. It desired to indicate by its methods that there was a great difference in the way of investing abroad. Many usages which had grown up under the gold exchange standard were unsound. The piling up of funds of one Central Bank in the private banks of some other country made the control of credit in that other country extremely difficult. Such practices the B. I. S. tried to discourage both by rule and example.

The general principle involved in these separate acts was the strengthening of the power of the Central Bank in each country to control credit. This would result, not only from the improvement of the gold exchange standard just mentioned, but also from the relief of money conditions insofar as this was possible. Similarly, assistance to Central Banks would follow from the granting of credits to needy countries, and from all the advice, suggestions, and the attempts to reconcile different views. Such coöperation between Central Banks and an attempt to increase their power in their respective systems would come naturally with a freer flow of credit, steadier exchanges, and a broader knowledge of world conditions.

It was consistent with these general policies that the B. I. S. made no effort to expand credit.²² It is true that it could have done very little with the 1931 resources against the general trend. Nevertheless it did not do even those things within its power. Such questions were left to the Central Banks; the B. I. S. acting as intermediary was passive in this connection. Its work was to increase the availability of credit here and there, and to lessen artificial bar-

²² See *supra*, Chapter VII.

riers which dammed up money in some countries. If it could succeed, it would make the development of concerted action by Central Banks many times easier.

Various other deliberate plans were made to increase the facilities, and raise the standards of the less developed money markets. It is possible to say that there are only one or two highly developed money markets, since many countries lack the tradition, agencies, and funds to discount and accept bills freely. There was a distinct need for an improvement in both knowledge and instruments.

Ultimately the Bank might do much to help develop broader money markets. Its later performance would depend on the stability of the deposits at its disposal, as well as on its true comprehension of the potentialities in the financial centers which differed so widely. There was a real need for uniformity and better mutual acquaintance. In some quarters there was insufficient discrimination between high and low grade investments. The flow of funds was irregular; misunderstandings often led to unnecessary tying up of capital, and also increased speculative forces which change values in arbitrary ways. The Bank was in a position to further both mechanical and psychological improvements. Its work was in part education and in part the supply of funds for legitimate enterprises not adequately financed through other banks.

THE BANK AND PROFITS

In the course of such work the question of profits and expenses emerged. It was clear from the beginning that the Bank would not strive for large gains.²² Certain kinds of business which might have been highly profitable, such as accepting bills or buying shares were eliminated by the Statutes. Then again, the most fruitful source of banking profits, the creation of credit was almost impossible to the B. I. S.

²² *The Young Plan*, Cmd. 3343, p. 14.

The Statutes established 6 per cent as the normal cumulative dividend after a payment to the reserve. Profits in excess of this were to be used to strengthen the Bank's reserves or to be distributed according to complex conditions to the participating Central Banks.²⁴ There were several reasons why the Managers should wish to earn this dividend, as well as substantial sums for reserves. It was important to demonstrate the business nature of the Bank as contrasted with a possible political agent or the research committee which some had anticipated. Then again, the accumulation of reserves would tend to strengthen the financial foundations of the Bank. The result of the policy in regard to profits is seen in the earnings of the first year. The balance sheet of March 1931, as well as that of 1932, showed a net profit of almost 12 per cent on its capital.²⁵ This was criticized by some, as being excessive in a time of depression and banking distress, but was greeted by many as a welcome indication of its practical business success.

PASSIVE RÔLE

Many other matters came up for consideration, and built up little by little a consistent body of policy. For instance, in the field of exchange rates and gold purchases the Bank took a passive position in the early period of its existence. This was not because it had no aims which it could further by more aggressive action, but because no action on its part could be lasting or successful unless it was approved by a majority of its member Central Banks. If any particular policy were being urged by a majority of these Banks, the Bank would gladly assume a more active rôle in executing the business which would grow out of this policy. It could help to spread and strengthen the influence of Central Banks. Then again, its quiet and inconspicuous influence in helping these Central Banks to formulate policies is one which it is impossible to measure or appraise.

²⁵ See exact figures, Chapter IX.

²⁴ *Statutes*, Article 53.

Its work in other directions was certain to develop over a period of years. It was unlikely that there would be an early extension of clearing facilities. It would require a further formulation of the foreign exchange theories and aims of the Bank, a definition of the meaning of "stability" and a working program for achieving sound money conditions. The problems involved are considered separately in Chapter XI. Similarly, another large question was the gold policy of the Bank. This was destined to become more important in 1932 than it had been at first. The early steps in this development are described in Chapter XV. The Bank had to deal with a number of practical matters growing out of the general problem, pending the time when it would have formulated a definite program.

Underlying all the policies was the concept of *coöperation*. During the first years great patience was required. There were times when it looked as if one or two Central Banks were upsetting the best possible adjustment of credit to world needs. The B. I. S. might have tried to play the interests of one group against another, but this would have plunged it at once into political intrigue of the worst kind. Any such idea was ruled out from the start. All the Central Banks were essentially free to pursue the monetary policies which they preferred, and the B. I. S. naturally respected their rights to independence. Certainly if common agreement could not come as the result of common interests, it could not be achieved by force. The path which had been marked out was unquestionably long and difficult, but there was no short cut.

In the very beginning it was decided that good will was more important than technical improvements. The prime requisite was a real, sympathetic understanding which would go beyond the mere willingness to compromise when necessary. Such a spirit could be achieved more readily with a clear understanding of three main differences. First, there are sharply conflicting national interests which must

be separated so far as is possible from monetary policy. Second, there are different economic theories prevailing in each country. Third, there is great variety in standards and practices in various money markets. Some of these differences arise from the fact that the money markets are not at the same stage of development, while others are due to national traits, or chance factors. Whatever the cause of these variations, it was the business of the International Bank to mitigate them in the interests of a broad collaboration.

This was made the more difficult because some Central Banks were much more powerful than others. Moreover, some had a long body of experience behind them while others were only a few years old. Tradition had strengthened the control of each Central Bank President in his own realm, so that he was not used to finding himself subject to criticism or in a minority among a group of Bank Presidents. The situation at B. I. S. Board meetings required delicate handling. It called for gradual diffusion of common ideas, frank discussion of monetary standards and methods, and the free consideration of conflicting interests. The possibility of making progress through conference grew as the officers and staff of the Bank came to know the representatives of the different Central Banks, and as an early tendency to distrust and uncertainty gave way to easy conversation between men who knew each other well. In fact, many of the Bank Presidents on the Board came to know each other for the first time in Basle, and the meetings themselves were unique.²⁶

The special committees carried further the aim to increase international financial understanding. It was discovered as the result of experience that conferences on specific problems sometimes produced more results than those which handled the more general theories. The inevitable comparison of the varying elements in the economic life of

²⁶ See Chapter XVI, *Central Bank Cooperation*, for comment on earlier meetings between Central Bank Governors.

each country shows great diversity, whereas general theories were often based on a presumption of similarity. Moreover, it was often possible to recommend a modification of method which was of a specific nature, whereas a broad resolution to work for distant ends was looked on with suspicion because all the implications were not at once evident. The Management made no attempt to have Basle supplant other centers for discussion. Nevertheless there was a growing tendency for monetary and banking affairs to be referred to Basle.

Thus it became increasingly natural for the Central Banks to find out what was happening in other countries in times of crises. Inquiries by telephone could give them information as to gold movements and exchange rates in a large number of countries. They could sometimes get the most direct news from New York through Basle. Moreover, they could have their own representative at the B. I. S. to keep them in touch with the shaping of plans and theories, if they wished to do so. In respect to all these things, the Bank was both hospitable and impartial. Moreover, the right to membership was broadly defined and not based on geographic or political facts.

The entire policy of the Bank had to be kept in harmony with the real facts of economic life. It had to be adjusted also to the financial leadership in the most highly developed centers. The main facts, as has been indicated, were briefly the economic depression, on the one hand, and the reparation duties and available resources of the Bank, on the other. These influenced all credit and money conditions. Then again, the aims of the Directors and Staff and other financial leaders were determined by economic theories, the desire to develop a friendly understanding between financial centers as well as by the special interests of each country. These six groups of factors were not the only elements to be kept constantly in mind, but they were highly important in guiding the shifting complex of the Bank's work.

The first stage in the development of the Bank's functions ended with the early period of rapid growth in November, 1930. It was at this time the policies here discussed began to be evident. The second stage, characterized as *Expanding Interests*^{**} carries further certain experiments and investigations. This ended in May 1931. The third phase was the adaptation to the crises in money, foreign exchange, and Reparation, which lasted through the rest of the year. In many respects the turning point in the policy of the Bank came toward the end of 1931. It was then that it was clearly demonstrated to the financial world that an agency for coöperation was absolutely essential. The temporary loss of prestige of the pound, and the changed position of the Bank of England made the need for a meeting place for Central Bankers all the more evident. Then in addition to this, the crisis forced on financiers the necessity of regulating gold, and the gold exchange standard. An international body was necessary, and the B. I. S. was in a position to use its machinery to plan a return to stability.

The policies developed during this third stage of the Bank's history can best be considered in connection with the general question, *Coöperation*, discussed in Chapter XVI,^{**} after the various catastrophic events in 1931 have been outlined. Even before this period, however, a general body of working principles had already formed a solid basis for the more elaborate structure which was to come. The ground plan did not seem ambitious to those who viewed it superficially, but close examination showed that it included all the essentials for a far-reaching revision of the banking system of the world. Economic life was not yet ready for these changes in 1930. Many varied troubles had to be experienced, including the collapse in 1931, before widespread effort was turned toward financial reconstruction.

^{**} See Chapter X.

^{**} Chapter X discusses events in the early part of 1930, leading up to the later crises.

CHAPTER X

EXPANDING INTERESTS—A SECOND STAGE OF DEVELOPMENT

MUCH was undoubtedly accomplished in the first six months, but even more interesting and difficult problems were to come. In fact, one may look at the questions which came into prominence in the fall of 1930 as a prelude and a sign,¹ but one cannot compare them in gravity with the difficulties faced a year later. Threatening events in Germany, England, and Central Europe had troubled the exchanges, and unsettled governments, but it still seemed possible to patch things up. This was a time of economic hesitation, frequent conference, and varied political efforts. The signs of improvement in January and February of 1931 were to prove deceptive. Subsequent events began to pile up in pyramid fashion, each more distressing than the one before it, until the situation in the autumn of the year impelled decisive action in the realm of Reparation and the gold standard.

By that time, fortunately, the Bank had reached a point where it could serve as a center for the gold standard discussions. If an inventory had been taken of its equipment and abilities at the end of the first six months, certain definite gains could have been claimed for it. It had built up an effective organization, gathered funds to the amount of twice or three times the reparation money, and developed a technique for handling them. It had certain well-established relationships, contacts, and a legal and economic position which was generally recognized. Moreover, it had

¹ These are outlined in Chapters VI, VII and VIII.

a body of working principles and policies which reduced some of its business to routine, and had definite aims which would determine later decisions and programs.

This work was to be disturbed by forces which were partly political and partly economic. The public began to see these forces more clearly and to urge upon responsible leaders the action which they would eventually take. In general, attention was directed into two main channels: there was, first, the urgent consideration of political questions reacting on economic life, such as tariffs, and international debt conditions. The second was the problem of gold distribution and its effect on price levels and production. The first group of forces were to come to a climax in the Austro-German customs pact, and the "Hoover Debt Holiday." The second group, more strictly monetary, exerted a growing force, until the abandonment of the gold standard by various countries in September revealed the desperate credit situation of the world. Opinion differed as to the relative importance of these political and economic factors, but no responsible thinkers separated the two completely.

Even in 1930 warnings of the coming storm were evident. Economists were led to the anxious consideration of ways to safety, bankers prepared plans, but politicians were not yet ready for the necessary sacrifices. Attention was focussed for a time on Spain and Germany.² The financial relations of England and France were scrutinized. Tariffs and loans were discussed. Some thinkers hoped for help from Geneva, from the United States of Europe Committee, or from the League financial studies. International mortgage banks were planned and actually put into operation. Bankers hoped for special credit agreements, and business men for customs adjustments. Meanwhile, the B. I. S. was constantly called on for advice and participation in various schemes, and experts within the Bank drafted tentative

² William Martin, *Journal de Genève* (December 9, 1931), "Un Lueur d'espoir."

programs designed to extend its influence. The first financial year ended March 31, 1931, on a cheerful note. The General Meeting in May gave evidence of a spirit of coöperation and the financial aspects of the situation such as high profits, and increasing deposits were encouraging.

There were, in fact, various indications in this period from November 1930 to May 1931, that the Bank was facing squarely its larger responsibilities. It formulated more definitely its credit program and ways of extending clearing facilities; it experimented with foreign exchange arrangements which might be attractive to depositors, and considered what it could do to ease the difficulties arising from gold concentration. A large amount of information was gathered, not only on economic conditions, but also on the willingness of bankers and politicians to participate in various plans of action.

It was only vaguely understood at first that the Bank had turned from its internal problems, which were partially solved, to the more general needs of the economic world. Work along these lines had been begun before, of course, but the balance of emphasis shifted in 1931 and the Bank for International Settlements became, in some respects what it was frequently called in American newspapers, the World Bank.

This second stage in the Bank's development covers the months from the end of November until the General Meeting in May. This division into stages is not purely arbitrary. It is warranted by certain specific acts, though the sequence of the work of the Bank appeared to be an uninterrupted, gradual development. Events in November which made it a point of transition have been described in Chapter VI. Moreover, at this time the policies regarding credit, liquidity, the participation of private banks, and similar matters were subjects of general agreement. Then again, by the November statement the curve of the total resources ended its rapid rise. Furthermore, it was evident by this

time that the nature of the studies undertaken by the staff had begun to change, partly because attention was no longer required to establish the detail of the routine business.

This stage of its development, which began in December 1930, ended in May 1931. Although the financial year ended March 31, May was a more significant dividing line because during this month the Bank was appealed to for the first of a series of rescue credits and special missions when the *Credit Anstalt* difficulties reached a crisis.³ The end of a period can be set at the time of the General Meeting on May 19, a date which is notable because of the election of additional directors as well as for the various events which shattered the temporary period of calm. It was the beginning of widespread monetary collapse, and was made dramatic by the threatened downfall of several governments and Central Banks.

It is evident, then, that the Bank had a few months of fairly normal business operation following the period of organization and just preceding the crisis. Deposits were stable during this time, subject to the rhythm of reparation-debt payments. In December 1930 the total resources of the Bank passed the two billion mark as calculated in swiss francs. This was the first time that they had reached such a high figure, and they were to touch this level only once again the first two years—that is, in May 1931.

This high point did not show in the monthly balance sheet, because on the fifteenth of the month large payments were made to the account of the fiscal agents of the various treasuries who, in turn, made payments to the treasuries. These transfers reduced the sums held as deposits of "Central Banks for the account of others," before the month-end balance sheet was printed. The reason for this gradual rise and sudden decline in assets was that the payments on reparation annuities came in monthly, and were to a large

³ Bank for International Settlements, "Second Annual Report, April 1, 1931 to March 31, 1932" (Basle, May 10, 1932), p. 5.

extent left with the B. I. S. for later debt payments. These, in their turn, were made every six months. The Bank was subject, therefore, to a short cycle of accumulations and withdrawals during the first fourteen months which ended with the "Hoover Debt Holiday" in July 1931.

These changes in the amount of money at the disposal of the Bank were of great importance in influencing its actions. The maximum reached at this time circumscribed its business and set limits to the possibility of participation in long term credits or wider distribution of funds. It was evident that the Bank could not expect to increase its resources for some time, and that the long term investments had reached the maximum figure consistent with its need for liquidity. The Bank must always be able to help in an emergency. The increase of short term deposits, due in part to the piling up of treasury funds, was accentuated by the desire of Central Banks to have the general advantages offered them by the B. I. S. These advantages had not been widely understood until close contact between the officers of the B. I. S. and Central Bankers led to an appreciation of the facilities available. In fact, there had been, in 1930, a definite effort to attract deposits; an effort which bore some fruit but which reached its limit fairly quickly.

Later plans were outlined to offer special exchange conditions and to make deposits with the B. I. S. especially attractive, but little could be done until the functions of the Bank should be enlarged or until renewed prosperity should alter credit conditions. The two main cycles in the fluctuation of deposits were from June to December, 1930, and from December, 1930 to June, 1931. Reparation payments dominated but other factors influenced the change in the volume of deposits. The second rise, toward the peak of accumulation for June transfers to the United States, was similar to the first, but not so rapid. This was because the stimulus to new deposits by Central Banks had reached the point of "diminishing returns." Then, later, after the cessa-

tion of the Bank's functions as a clearing house for reparation and debt payments in July 1931, there was a rapid decline for four months followed by a period of comparatively little change. Deposits then began to increase again.

In any case, the funds at the disposal of the Bank restricted its participation in the credit proposals of this period. For example, the Bank could not play an active rôle in the mortgage banks suggested by various financiers. Its approval was evidenced by the purchase of bonds, and in a communiqué,⁴ and when in 1931 the League International Agriculture Mortgage Credit Company was being outlined, the hope was expressed in Geneva that the Bank would assist in this work. It could not do so for a number of reasons,⁵ chief among them being the governmental nature of the administration of the proposed bank, and the desire of the B. I. S. not to impair its own liquidity.

It is possible to trace several different sequences of events through the tangled web of economic affairs in the second six months. The lines cross and recross but they are distinct and separable at times. Some of the difficult decisions were concerned with the lack of short term credits, the uneven distribution of gold, the weakness of the pound, and the German situation. Other problems of a less general nature which were destined to occupy the attention of the Bank, included such matters as the possibility of a clearing system, an aggressive influence on exchanges, and currency stabilization in Spain, Portugal, and Yugoslavia.

CREDIT PROBLEMS URGENT

The first of these problems, the need of middle and long term credit, was by far the most urgent. On it depended

⁴ See *Communiqué* of March 9, 1931.

⁵ The B. I. S. agreed to appoint one director. "International Mortgage Credit Company," League of Nations, Geneva (May 22, 1931), C. 375, M. 155, p. 25. The discussion of this project was closely linked with the gold investigation of the League, which resulted in the publication of a report in December 1930.

directly or indirectly, all the others. However, this could not be considered as an isolated matter, for it was a sign of a general lack of confidence. It was the product, on the one hand, of political fears and, on the other, of price declines. Nor were the imminent price movements purely monetary phenomena. They were mainly economic in origin but were greatly accentuated by psychological factors. There were some values which were out of line in the general price structure, and which would fall relatively to others, even if there had not been a contraction of credit. The question of loans was industrial, political, psychological, as well as technical, and could not be solved without the healthy adjustment of all important economic factors, through both liquidation and expansion.

The credit question had already been brought before the Bank in a number of forms, and had been considered in the meetings. The need was becoming increasingly acute. The Committee on Middle Term Credit, called together in October, continued its investigation in the next half year.* Meetings were held in Basle and in Brussels and reports of progress were discussed at the Directors' Meetings in the light of the general principles of the Bank. One of the difficult specific questions raised early in 1931 was the rediscounting of Russian bills. This was not easy to handle, because of political complications which might grow out of any action taken, and because of the widespread distrust of Soviet credit. The reason given for the refusal to take these bills was that although loans in this case would benefit Russian industry they would go indirectly to the Russian government, and that advances to governments were forbidden in the Statutes. It was understood, however, that the Bank did nothing to prevent the indirect flow of their funds through Central Banks into this form of investments.

The desire for an increase in long term loans was even more urgent than for middle term credits. On this score,

* See *supra*, Chapter IX.

however, there was little immediate hope. The two countries with large gold holdings, France and the United States, were the only money markets which were in any condition for such operations, and there were serious difficulties in each case. Sentiment in New York was generally recognized to be unfavorable to foreign securities. The after-effects of the Wall Street crash were such as to exclude any immediate possibilities of such investments. More attention was, therefore, turned to France. Here various kinds of obstacles existed, but the question was raised whether or not the B. I. S. could alter the situation by urging changes in existing legislation which discriminated against foreign loans by taxation or otherwise. The barriers were not only legal but also political, and psychological. It was hoped by some that if the B. I. S. could convert leading financiers to the realization of long run advantages of a generous loan policy, the psychological reluctance would disappear.⁷

Those who urged these credit possibilities on the B. I. S. reckoned without the banking failures and scandals⁸ which had turned opinion strongly against foreign loans. They overlooked, also, the disturbing effect of the German situation. Moreover, the course of the Young Loan was not such as to encourage French foreign loans. The idea that joint effort might make it easier, politically and psychologically, for France to export gold through loans left out of account the very delicate bases of credit, and the fact that there was no feeling of security anywhere.

Much of the hope and criticism of this period continued

⁷ Gates W. McGarrah, "Bank for International Settlements," address before The American Club of Paris (Feb. 12, 1931; printed by The Guaranty Trust Company of New York), p. 8. "The B. I. S. endorses the view that intermediate credits are necessary and desirable; and to demonstrate that its interest is not merely academic its Board has authorized the Bank gradually to invest \$25,000,000 in such credits of from six months to two years maturity. The B. I. S. hopes that its example will set a fashion that will be followed by others who have greater resources which can be utilized in this type of financing."

⁸ The most striking of these were the *Oustric* and *Snia Viscosa* difficulties, and the *Adam Bank*.

to focus on France. Opinion did not discriminate between deliberate intentions and blind forces which tended to put Paris in the position of holding most of Europe's gold. It is interesting to note that although the United States then held more of the metal, less criticism was turned in that direction, and fewer schemes were brought forward at this time to dislodge her gold. The persistent flow of gold toward France, on the other hand, led to many discussions and widespread comment.

THE B. I. S. AND GOLD⁹

Conversations on these matters between English and French bankers in December and January were followed by others between treasury officials. These aimed to remove the technical difficulties in regard to gold shipments between the two countries and to assure, if possible, that no unnecessary gold movements would take place. The question was made more complex by differences in the degree of fineness of the gold which France and England would take, but this technical matter would have been of little consequence if the pound had not been weakened by drains from more fundamental causes.

One of the efforts made at this time to work out constructive measures was the League inquiry into the gold question. There were persistent rumors that the Finance Committee wished to turn over its gold studies to the Bank for International Settlements.¹⁰ This was not desired in Basle. There was no wish to take up abstract studies of this nature, and the Bank was not equipped to remove the political obstacles in the way of gold distribution, such as debts, tariffs, and fiscal policies. As the result of this, the report published by the League in January omitted the expected recommendation to turn over the investigation to the Bank.

⁹ See *infra*, Chapter XV.

¹⁰ *The Commercial and Financial Chronicle* (New York, Jan. 17, 1931), p. 370.

This was probably fortunate for the B. I. S. It would have placed it in an embarrassing position with regard to the League if it had ignored such a suggestion, and would have brought the antagonism roused by the Franco-British discussions into the Directors' Meetings. This question was very much in the public eye during December 1930 and January 1931.

Meanwhile, the Bank carried out a few transactions in gold dealings. On December 1 it accepted gold from the Bank of Spain to hold in custody. Immediately thereafter it took over a small amount from the Central Bank of Lithuania. These acts were followed by similar transactions for the account of the Bank of Poland and a half a dozen others. The amounts involved were not large, and in no case was the gold actually brought to Basle. The Spanish gold transaction consisted of the deposit of gold in London against a credit with the B. I. S. as a pre-stabilization measure. Incidentally it involved one of those seemingly unnecessary shipments which were so much talked about for a while. Actually the gold was sent from England to Spain in the form of sovereigns to pay customs duty, while at about the same time gold moved from Spain to London in bars to be held in custody there. Later, a very small amount of Canadian gold was bought by the Bank and sold in a few days. Except for this one case the B. I. S. did not purchase gold for its own account in 1930 and 1931, since this would not have been a profitable undertaking.¹¹ They were not in a position to create credits against this gold as were the Central Banks, and could not, therefore, gain by the substitution of gold for gold value assets. The creation of credit against gold holdings was not, in fact, prohibited in the Statutes, as was the issue of notes, and might conceivably be made a part of the later functions of the Bank.

¹¹ Thus, the only purchase of gold was that from Canada, noted above, and the only receipt of gold as security against an advance was from Spain.

In any case the dealings in gold in the early months were limited both in number and in importance.

In addition to these transactions, offers to buy or sell gold in a given center were occasionally made to the Bank, when the prospective seller and buyer did not know of a counterpart available. There was a considerable degree of mystery about gold during these months, encouraged by frequent criticism of those transactions which were known. Some Central Banks did not wish to have gold dealings with certain others. The B. I. S. had no desire, however, to become a dealer in gold and did not wish to have a metallic reserve. In fact, a reserve in the usual sense was not necessary and high grade investments were much more profitable.

It was hoped that an increase in the uniformity of methods of handling gold would ease this shortage. This was one of the efforts of the clearing committee in November 1930, and then, later, in 1931. It was found in the course of the discussion that the cost of transferring gold was increased, and the value made less certain, by the difference in practice in different countries. In some, for instance, it was customary not to credit gold to the sending bank for two days after the actual receipt. The differences with regard to fineness affected England and France in particular. Other peculiarities tended to make the export points vary abnormally between countries, and so to introduce artificial factors into the exchange rates. There was fairly general agreement as to the desirability of increasing uniformity of procedure, and resolutions in the B. I. S. committee were made the basis for an attempt to bring about changes.¹² Even though there was delay in carrying these out, the better understanding of the effect of these differences on value tended to smooth exchange operations.

The rôle of the Bank in the gold question was examined at this time and, in particular, certain special rights that

¹² *Communiqué*, January 19, 1931, and confidential B. I. S. Report of November 24, 1930.

had been granted the Bank in respect to its holdings. These protections were granted the Bank in Article X of the Hague Agreement with Germany. It was provided that:

The Bank, its property and assets, and also the deposits of other funds entrusted to it, on the territory of, or dependent on the administration of, the Parties shall be immune from any disabilities and from any restrictive measures such as censorship, requisition, seizure or confiscation, in time of peace or war, reprisals, prohibition or restriction of export of gold or currency and other similar interferences, restrictions, or prohibitions.¹³

This agreement was signed by the representatives of Belgium, Czechoslovakia, Greece, Germany, Great Britain, France, Italy, Japan, Poland, Portugal, Rumania, Yugoslavia, and the British Dominions. Although the immunities were inclusive it seemed desirable to the management that a definite interpretation should be made by the signatory countries, so that the Bank might be able to work out a greater degree of order in the gold exchange standard and understand more exactly what special protections its deposits in various countries enjoyed. The later question of the gold value of the B. I. S. deposits with Central Banks was to throw more light on methods of increasing the effectiveness of the metal.¹⁴ It was hoped that the Bank could offer special safety to offset the higher interest which Central Banks had often obtained by holding foreign assets with private banks.

In fact it was because of a very general worry about the gold exchange standard that the reduction of discount rates in New York on December 25 and in Paris on December 31 from two and one-half to two, in each case was viewed with favor in most European Central Banks. The pressure on the pound had become alarmingly evident some months before. There was a persistent gold drain causing considerable

¹³ The first "of" was replaced by the word "and" in section 10 of the Charter which corresponds in a general way to this provision in the *Trust Agreement*, Cmd. 3484, p. 22.

¹⁴ See *infra*, Chapter XIV.

anxiety. The influence of reparation payments on the pound was slight and had been altered very little by the clearing functions of the B. I. S. In fact, there was, in 1930, a tendency for the Reichsbank to shift from pounds to dollars, because the request of the B. I. S. for currencies which must eventually be paid to the United States required considerable dollar assets from Germany. This did not change the net volumes, but it did alter the temporary situation. Another difference under the Young Plan as compared with the Dawes Plan was that the balances on deliveries in kind were not held in pounds, as they had been to some extent by the Agent General, but were in reichsmarks.¹⁵

Various devices for lessening the strain on English gold were brought forward as the situation just referred to became clear. For instance, it was proposed in many journals that the Bank of France should give a credit to the Bank of England to prevent the flow of gold from London. The B. I. S. might have urged this step if there had been a clear need, but it was known at the Bank that such a loan had been offered informally and had been refused in England. Moreover, later events were to demonstrate the ineffectiveness of such lending. The situation was not considered serious enough at the beginning of 1931 to call for such special support and there was a good deal of opposition in London to measures which would seem to make the Bank of England dependent on the Bank of France. There was, thus, practically nothing that the B. I. S. could do except act as an intermediary in informal conversations, cultivate a spirit of coöperation, and remove technical obstacles whenever it might be possible.

REPARATION QUESTIONS

Usually, however, the German situation crowded these English exchange difficulties off the first page of the newspapers. The latter were viewed mainly as technical prob-

¹⁵ See *infra*, Chapter XIII.

lems, at this time, whereas the possibility of a reparation default was taken very seriously. The first marked exchange crisis in September and October had been mitigated by the help of the B. I. S., the Lee, Higginson credits, and the ability Chancellor Bruening showed in forming a cabinet.^{1*} This reassurance was disturbed by the speeches which Dr. Schacht had made in America and in Germany, insisting that the burden was unbearable, politically and economically. The increasing difficulties of the German government as winter came on led to a widespread opinion in 1931 that a moratorium would be asked for, if some kind of revision proved out of the question.

At this juncture feelers were put out in Berlin and were met by strong statements in England and elsewhere that revision was impossible, at least for the present. This served to postpone the issue for another six months, since examination showed that a moratorium under the Young Plan would not help Germany immediately. The situation of the Reich was very dark during December and January. In February, on the other hand, there was considerable improvement. The continued firmness of the Bruening government had surprised almost every one. Rigid internal decrees giving hopes of an improved budget, and the participation of the French in the second Lee, Higginson credit indicated a slight easing of political tension. Anxiety had reached a climax in December and was not so acute again until the late spring, despite disturbing political speeches, Dr. Schacht's protests, and occasional *Nazi* demonstrations.

During all this time possibilities for resolving the reparation tangle were discussed informally in Basle, but no definite project could be presented. The knowledge that the Bank Governors would take the matter up unofficially during these months made it possible to avoid the more controversial formal discussions. The tendency of these conversations was to emphasize the inadvisability of an immediate Young Plan moratorium. The Bank was in a posi-

^{1*} See *supra*, Chapter VI.

tion to explain the creditor point of view to Berlin—the view that Germany's balance of trade was likely to improve, and that her main difficulties were caused by internal politics.

CURRENCY STABILIZATION

Later events were to prove that the links between the reparation question, the pound sterling and the gold exchange standard were closer than was at first evident. Currency stabilization had been regarded as a natural part of the development of Central Banking coöperation through Basle, for it was essential to have as many currencies as possible on a solid basis, and important to the proper working of the gold exchange standard that each country should be protected from sudden drains of capital or gold. Sharp fluctuations were always possible as long as European currencies were uncertain, and it was therefore natural that the Bank should try to prevent such disturbances. Unfortunately circumstances prevented it from accomplishing tangible results during the first two years. The main efforts were directed to Spain and there political disturbances upset all the carefully laid plans.

These plans for the stabilization of the peseta had been discussed as early as the third Board Meeting in July.¹⁷ When assistance in such readjustments was approved in principle M. Quesnay went to Spain twice to talk with Central Bank officials there. These consultations were followed in the later months by visits of Spanish Bank officials to Basle and by conferences in Paris. The report prepared by M. Quesnay in November 1930, encouraged the Bank of Spain officials to plan an early return to gold. With this in view they secured from the B. I. S.¹⁸ an advance of three million pounds early in December 1930, and began negotiations for a foreign loan. Before these negotiations had gone far they were interrupted by the threat of revolution in the latter part of December.

¹⁷ See *supra*, Chapter VI.

¹⁸ See *supra*, p. 220.

This menace to financial reorganization was followed by a period of calm during which the Bank officials proceeded with their conferences. The loan arranged with the Morgan Bank in April 1931, was not planned directly through Basle, but was an indirect result of the Bank's efforts in behalf of currency stabilization. In any case the loan, though actually opened in April 1931, was never used, for just at this time the government was overthrown and the King and Queen had to leave the country. The Central Bank returned the money unused and the policy of the new government with regard to stabilization was not clear for some time. Under these conditions it was impossible for the B. I. S. to carry on its work for the peseta. A further depreciation took place and some inflation, accompanied by frequent wide fluctuations. Thus the work which had been so nearly complete had to be abandoned.

Other currency stabilization was being worked out during these months at the same time, but not mainly through the Bank. These were in Portugal and Yugoslavia. The Bank was not asked to take any part in the preparations in Lisbon in 1931. This aloofness was due in the main to political complications between the government and the Bank of Portugal, which made outside assistance inadvisable. In any case, there were no great technical difficulties nor any urgency that the plans be carried into effect quickly. The work was accomplished in July 1931, and calls for no special comment, for the B. I. S. adhered to its principle of not intervening unless requested.

Yugoslavia indicated a desire for outside help. Negotiations for a credit from France hung fire for a considerable time. The result was that the government in Belgrade received funds from Paris in the spring of 1931 and the Central Bank was granted a slight amount of assistance through the B. I. S. in the summer.¹⁹ The efforts of the officers of the Bank in aiding stabilization were restricted, on the one hand, to specific acts such as this credit and, on the other,

¹⁹ See *supra*, Chapter VI, pp. 118, 122.

to general advice such as characterized their activities in many countries. They did not develop a comprehensive plan as they had in the case of Spain.

Despite the difficulties encountered there is no doubt that the Bank combined all the various facilities which had previously been supplied to countries about to stabilize their currencies. In particular, it was able to furnish the foreign exchange facilities²⁰ and the expert advice. The need for these services was less urgent than just after the war, but it was to become more important after the disorganization of the gold standard troubles of 1931. It is probable that its chief services along this line are destined to come with the eventual readjustments of the gold standard. The early efforts are nevertheless instructive. The Spanish work had been carried out to a point of technical completeness when it was interrupted. Yugoslavia readily took advantage of the advice offered. Although the later collapse of the gold standard was spoken of by those who were critical of the Bank as a sign of its weakness, this inference was not justified by the facts. Indeed, the Bank was well equipped to aid currency stabilization in a world where the principles of stability were generally accepted, but it could not establish a standard of its own in a world of widely fluctuating values.

CLEARING FACILITIES

Despite the difficulties of 1930, a real technical advance, comparable to the development of deposit methods, was made. This was the working out of a basis for clearing between Central Banks²¹ which would make smoother the necessary operations without actually interfering with existing institutions or altering the clearing mechanisms.

A committee had been working at the problem since its first meeting on November 25, 1930. It had taken up de-

²⁰ The part played by the B.I.S. when England accumulated foreign balances in 1932 is particularly interesting.

²¹ See *infra*, Chapter XI.

tailed technical questions connected with gold and capital transfers, the theoretical results of an inclusive system through the B. I. S., and ways in which the Bank might take part in the shifting of capital so as to ease the flow. The first methods of attack resulted in the recommendations, with regard to gold dealings, and the increase of uniformity in market practices, which have been mentioned. Further investigation led to a large measure of scepticism as to the desirability of any attempt to clear a large share of the world capital movements through the B. I. S. The later stage of the conferences brought the announcement in January which showed that the Bank was already a clearing house:

After an examination of the recommendations of the Commission for transactions in Currencies and Gold, the Council of the Bank for International Settlements has decided that the different Central Banks, when they have to receive from other Central Banks funds proceeding from international payments or transactions in currencies, shall inform the other party, whenever possible, that the Bank for International Settlements is their correspondent for the receipt of such sums.²²

Thus, Bank A, owing funds to B, would inform its creditor and the B. I. S. that funds on deposit at the B. I. S. would be shifted from its account to that of the creditor bank. This resolution was followed immediately by a number of transfers under this plan, and amounts totalling several million swiss francs were shifted each month through the B. I. S.

A further resolution leading in the same direction called for an inquiry into the desires of Central Banks as to their gold holdings. Although no facilities for holding gold at the B. I. S. existed, and no radical move to establish clearing systems was contemplated, it was considered important to know the aims of the authorities. The result of these inquiries was the tentative arrangement in February 1931,

²² See *Communiqué*, January 19, 1931 and *The Financial News* (January 20, 1931).

of the "gold swap system" referred to. This project consisted of reporting to the B. I. S. amounts of gold moving in and out of Central Banks. It was hoped that this information would make it possible for the Bank to know where gold might be obtained with the least possible displacement. Such a system would not, of course, influence open market dealings but would gradually tend to make easier the temporary or offsetting transfers.

These efforts may be summed up under four headings.²² The first step in the direction of clearing had been made when the B. I. S. held funds arising from reparation transfers for later payments for inter-Allied debts. The second step was taken in January when Central Banks were invited to make their foreign payment through the Basle institution. The third was the attempt to lessen cross shipments through the "gold swap system." The fourth was the projected arrangement of exchange transfer accounts. This new form of account was offered to Central Banks in April 1931. Thus the Bank extended its efforts in the line of clearing, but the result was somewhat paradoxical for the committee had brought no urgent recommendation for a world clearing and the Officers and Directors were even doubtful as to whether any inclusive and ambitious project were advisable.

Although these exchange transfer accounts did not get beyond this initial stage in 1931, they offered interesting possibilities. They were to permit the immediate change from one currency into another of deposits in the B. I. S. The change could be only into one of those ten currencies in which arrangements had been made for rediscounting B. I. S. assets, but this arrangement might well be extended to others at a later date. The rate of exchange would be that normally available at the Central Bank. This would not, of course, eliminate the effect of the exchange rate, but might increase the ease, the anonymity, and the cheapness of the operation.

²² See Chapter XI.

All these problems of capital transfers and gold accumulations, credit and Reparation, the political and the economic, were closely related to each other. They were, in fact, one problem with several different manifestations. The Bank could hope to mitigate the difficulties in some respects, but could do nothing to remove the deeper causes of disturbance. The way in which the problems contended with each other for the first place is partially indicated by the business transacted in Basle, though many important conversations took place which never received public notice.

VARIED EVENTS AND DECISIONS IN THE SECOND SIX MONTHS

In fact, it was one of the virtues of the Bank as a center of coöperation that the monthly meetings became routine matters. Since it was prescribed in the Statutes that these gatherings were to take place for the purpose of approving the past and future business of the Bank, it was no longer necessary for journalists to invent reasons for meetings of Bank Governors. Many informal discussions on the reparation question took place in Basle, for it was an essential part of the Bank's concern to consider everything that influenced the exchange value of the currencies in which it dealt.

German fears were, in fact, very much in the foreground of the sixth meeting of the Board of Directors, which took place on December 8. It was preceded, as usual, by discussions between Central Bank governors who came to Basle in advance. The gathering was presided over by Sir Charles Addis, in the absence of President McGarrah, then in America.²⁴ A report on the progress of the work to prepare for the stabilization of the peseta was made by M. Quesnay. The first report of the committee on middle term credit was also considered and approved.²⁵ The request of Latvia for

²⁴ *L'Information* (December 10, 1930).

²⁵ This committee had met on October 13 and November 8. See confidential report.

shares was granted, and Lithuania was informed that shares would be allotted to her as soon as the national currency satisfied the necessary conditions. The preliminary conversations of the Bank Governors covered some of the broader aspects of the financial depression. *The Financial News* says of the formal meeting: "The Board Meeting . . . was exceptionally calm, though nothing of great importance seems to have been settled."²⁶ The truth of the matter is that the questions under consideration were too complex and difficult to be decided in a few short meetings; they were destined rather to occupy world financiers through many weary months.

Another matter which was not given publicity in Basle, but which was mentioned in various Continental newspapers, was the threat of loss of some of its American deposits through bank failures. The danger was over in a very few hours when the American bank which was in difficulties was aided by other institutions. In any case, the B. I. S. was able to withdraw its funds and put them with the Federal Reserve. This incident would not have led to a large loss in dollars, but might have hurt the prestige of the Bank. Fortunately, no other deposits were in danger. They were, in fact, guaranteed by the Central Banks in several countries.²⁷ Despite the difficulties at this time, both in exchange fluctuations and in bank failures, the Bank did not lose a penny during the first year.²⁸

WAR DEBT PAYMENT

A few days after this meeting, that is, on December 13, the Allies transferred considerable funds on deposit with the B. I. S. to meet war debt payments due to the United States on December 15. This meant the turning over of

²⁶ *The Financial News* (December 10, 1930).

²⁷ See *supra*, Chapter VII.

²⁸ During the second year there was a fairly large loss resulting from the depreciation of the Scandinavian and Japanese currencies. The Bank did not lose directly in the depreciation of the pound sterling, since it was short pounds.

more than 100 million dollars to the fiscal agents of the treasuries concerned, who paid it immediately into the United States Treasury account. Practically all this money was shifted through the B. I. S. The funds on deposit for the Allied treasuries in the name of their respective Central Banks were paid out on Saturday the 13th by the B. I. S. on advice from the Central Banks. This reduced the sums on deposit in Basle by more than 500 million swiss francs, but the net reduction for the month was less than that because of the growth of deposits from other sources. Thus the balance sheet at the end of the month showed a total of 1,578 million swiss francs at par as compared with 1,876 at the end of November.⁸⁹ This figure would have been somewhat higher if a number of Central Banks had not withdrawn small sums, so that they could adjust their year-end statements. If one deducts the long term deposits and capital, the remaining amount, approximately 1,200 million swiss francs at par, is a rough indication of the participation of Central Banks for the sake of coöperation and the benefits the Bank offered.

This was the first decline in the total resources shown in a monthly statement. It should be compared with the situation at the end of June 1931, after the second similar payment made by the Bank for the Allied debts to the United States.⁹⁰ The total at the end of June 1931, was 1,780 million swiss francs at par. This sum indicated a net increase of 202 million swiss francs as compared with December 1930. The growth in deposits was due mainly to the increased participation of Central Banks. There was, undoubtedly, a real gain in influence comparable to the progress in attracting funds. It is not possible, however, from these figures, to make any assumptions as to the future trend of deposits. The Bank was subject to sudden and incalculable influences. The rapid decline of deposits from July 1931, to October was caused by two unexpected events.

⁸⁹ See B. I. S. statements issued December 5 and January 5, Appendix.

⁹⁰ See *infra*, Appendix for Balance Sheets.

One of these was the "debt holiday," and the other the impaired position of sterling which caused Central Banks to repatriate funds to strengthen home reserves.

At about this time both the Paris and the New York rediscount rates were reduced. The New York rate was lowered on December 24 from two and one-half to two per cent—the lowest in the history of the system. The rate in December 1929, had been four per cent. This low money policy lasted for ten months until the increase on October 8 to two and one-half per cent. London welcomed this move in the hope that it might lessen pressure on the pound, particularly if it should encourage a similar action on the part of France. The sterling dollar rate had not so far led to anxiety, but the movement of gold to France caused considerable concern.

Many were puzzled that the withdrawals of gold from London to Paris had continued through December. In fact, there was considerable criticism in the Press due mainly to a misunderstanding of the causes behind this movement.³¹ Some inferred that there were deliberate efforts to encourage this flow. The large accumulation of sterling piled up by France during depreciation and stabilization had led to very large holdings in that currency. The move to repatriate these funds was not a deliberate effort of the government or the Bank of France. Economic forces made it advantageous to bring these funds home in many instances. The authorities were not in a position to accentuate or prevent this trend, although the Bank of France bought sterling from time to time to offset the movement. Moreover, despite large net withdrawals in 1930 and 1931, the French economy, including the Government, the Bank of France, and private banks and individuals, had more than 10 billion francs worth of sterling on which they risked a loss approaching 3,000 million because of the depreciation of the

³¹ J. H. Williams, "The Crisis of the Gold Standard," *Foreign Affairs* (January, 1932), p. 180. Professor Williams comments in an interesting way on the causes of this movement.

pound in the autumn of 1931. In any case, the Bank of France took the appropriate action to stop the flow, and lowered its rate to two per cent on January 2. This was the lowest rate since 1898. The B. I. S. was not able to influence rate changes directly. The problem of the fluctuations of the pound and the continued piling up of gold in Paris was frequently discussed in Basle, but nothing could be done to alter either the technical or the fundamental economic causes, except insofar as the Bank could foster a feeling of good will.

During all these weeks interest continued to center around the gold problem, while the other subject most discussed was the reparation question. This tended to fall into the background toward the end of the month. An editorial in the *London Times*³² saying reparation revision was not possible, was taken to be a significant indication of the official attitude toward the hints that had been thrown out. The B. I. S. was completely neutral in this matter, for, granted the provision for partial reconsideration outlined in the Young Plan, no action was called for unless this machinery was first set in motion. It waited, therefore, for the convocation of the special advisory committee, and the request for a moratorium.

THE JANUARY BOARD MEETING

Two definite steps were taken with regard to the gold question at the Directors' Meeting on January 19. One was the institution of the clearing procedure already referred to.³³ This inaugurated the practice of payments between Central Banks through the B. I. S. The result was important not because of the volume of the transactions involved, but because it indicated a line of progress. To a small extent it would tend to obviate gold transfers.³⁴ Then, again, further measures were taken at this January meeting

³² *The Times* (London, January 1, 1931).

³³ See *supra*, pp. 227-230.

³⁴ *The Commercial and Financial Chronicle* (New York, February 14, 1931), p. 1134.

to enquire into the conditions under which gold was bought and sold in different money markets. This was, in part, a continuation of the work of the October exchange and clearing committee. In addition to this, they planned the "gold swap system" referred to above.

The governors of the participating Central Banks announced at this meeting that they would regularly accept gold of standard fineness, that is, 900/1000 fine. This was a sequel to the announcement in France that the special requirement she had made for a time would be suspended. Until the negotiations in January, France had accepted only gold which was 995/1000 fine. An exaggerated importance was sometimes put on this condition and some even attributed a part of the difficulties of the English exchange to this special rule. At the most, it may have tended to increase slightly the speculative elements in the price of gold. The rumor that the Finance Committee of the League was planning to turn over its gold investigation to the Bank, was discussed in Board Meeting but the *Report*⁵⁵ issued on January 20 made no mention of this intention, nor did it include any of criticisms of countries with large gold holdings.

Among the many questions under consideration again in January was the Spanish stabilization. The Board Meeting conferred further on the progress of the plans. Governor Bas of the Bank of Spain took this occasion to meet the other Central Bank heads who had assembled in Basle before the meeting. The group included a new Director from Italy, Signor Azzolini, who attended as the head of the Italian Central Bank, taking the place occupied by the late Signor Stringher.

In pursuance of a resolution in this meeting letters were sent out from Basle in an attempt to clarify the meaning of the text, which gave the Bank special protections under the Trust Agreements. These letters were sent to those eighteen

⁵⁵ *Second Interim Report of the Gold Delegation of the Finance Committee*, C. 75, M. 31, 1931. II (Geneva, January 20, 1931).

governments which had signed the Agreement at the Hague.^{**} A further legal question which was under consideration at this time was the exemption of the Bank from certain forms of taxation in Switzerland.^{**} The Swiss Federal Council voted at the end of January that only business growing out of Reparation was so privileged. Later consultation on the subject led to an exchange of letters indicating that the other deposits and business of the Bank would be free of Swiss taxation, under the same conditions as those applicable to the reparation funds.

Just after the Board Meeting when the problems of exchanges and clearing were under extensive study at the Bank, an appeal was sent from the Bank of Latvia to aid it in steadying the value of its currency on foreign markets.^{**} This was the first such request, and one which would naturally come to the Bank with more frequency as its experience and prestige grew. Latvia was a shareholder and depositor with the B. I. S. The Directors decided to investigate the matter and deferred decision because it had not been their practice to take an active part in exchange support, although they had given seasonal credits as a temporary aid to countries in a fundamentally sound position.

FEBRUARY PROBLEMS

During February, attention shifted from Geneva to Paris, to Berlin, and then to Spain. English problems still competed with the others as the pound continued to weaken, and rumors of Balkan loans stimulated the idea that France was going to extend credit abroad more actively. The speech of Governor Moret at the General Assembly of the Bank of France pointed to the possibility of more French lending abroad and urged the reduction of restrictions in the bond market. This statement was welcomed by President McGarrah in his speech in Paris on February 12. Meanwhile,

^{**} This question was still pending in 1932.

^{**} See *supra*, Chapter V.

^{**} *The Financial News* (January 23, 1931).

the League pursued its work on the plan for the Agricultural Bank to aid the Danubian countries; Franco-English treasury discussions continued without notable results; and the work on the stabilization of the peseta temporarily interrupted by the resignation of the Governor of the Bank of Spain, was immediately taken up by his successor. Thus, it is evident that there were pressing problems of finance in almost every European center and the Bank had to take some account of them all in the course of its business.

These stirring events did not lead to any direct action of the Board in its eighth meeting on February 9. The business announced in the official communiqué indicates that consideration was mainly devoted to a continuation of the general problems opened up in earlier meetings. For instance, the subjects discussed included:

1. The consideration of the accounts of the Bank, showing a balance at the end of January of 1,707 million swiss francs at par.
2. Approval of the interest rates paid on deposits.
3. A discussion of immunity of gold granted in various countries and approval of progress made so far.
4. Comment on the progress of the clearing of Central Bank funds through the B. I. S.
5. Note taken of the gold exchanged through the agency of the Bank.

These topics give a partial cross section of the work of the Bank and indicate that few controversial questions were introduced into the discussions at this point.

Nevertheless, certain differences in concept as to the Bank's functions recurred in February. One of the two views leading to its origin was behind the urgent desire expressed by financiers of certain participating countries that the Bank extend more middle term credits. These suggestions could not occasion any considerable expansion in the Bank's investments, for a large increase would have impaired the liquidity of B. I. S. assets.

MARCH, THE END OF THE FISCAL YEAR

The agenda for March 9 included the usual routine consideration of past business and only a few new questions. One of these considerations was the decision to subscribe to the newly organized Mortgage Bank, domiciled in Basle, and to announce its general approval of such organizations. Furthermore, B. I. S. shares were allocated to Lithuania. In addition, the business of former meetings was continued, including the plans for the stabilization of the peseta, the middle term credit report, the extension of clearing through the B. I. S., the immunity of gold deposits, and the plans for the May meeting. Proposals for international banks originating in various quarters were informally discussed. The so-called Norman Bank proposed by the Governor of the Bank of England was brought up in this and in later meetings. Very little was known of these discussions, so the ninth and last meeting in the financial year attracted little public comment; it was to a large extent concerned with the further development of business already begun.

The comparative calm which characterized this meeting was to continue in international affairs through most of March. A dramatic turning point was reached on the twenty-second of the month with the announcement of the proposed Austro-German Customs union. This was a critical date in European affairs, the effects of which were more fully evident six months later, when England suspended the gold standard. It marked an about-face in the political spirit which had pointed to a growing *rapprochement* between France and Germany. Before the political tide could be reversed, the financial situation had got out of hand.

The Bank reached the end of its financial year on March 31. The profit and loss account which was issued in a few weeks showed that the Bank had a net profit of 11,186,-521.97 swiss francs. This figure, along with the Report of the Year, was published in May. This was considered to be

a very good showing, particularly since the first year comprised only about ten months, and the average profit was more than a million francs a month. The total resources shown in the balance sheet for the end of March were 1,901,-148,912.91 swiss francs, indicating a rise of approximately 90 million francs a month in deposits from July 1930.

Although the month of April marked the beginning of the second financial year, it was fundamentally a part of the first year in the continuity of events and ideas. For instance, little that was new was undertaken. B. I. S. officials were preparing the year-end *Report* and the various memoranda for the yearly meeting. Discussion of the elections of May had not yet become intense. It is true that the general economic situation was confused, but it did not indicate the advisability of active intervention on the part of the Bank.

In fact, although March 22 has been called a turning point because of the Austro-German Customs proposal, the tragic consequences were not evident for about a month. Even now it is difficult to judge the rights and wrongs of the German move. Some say it was reasonable or even necessary, others that it was a colossal political blunder. There is no doubt that it unsettled a very delicate equilibrium and let loose destructive forces which had been held back with difficulty. The Bank was not directly concerned in this agreement, but, on the other hand, all its business was immediately and seriously affected. In the approaching months, it was to take an active part in all the credit adjustments, the war debt changes, and the gold standard modifications that followed in swift succession. The nature of this work, and its repercussions on the Bank's affairs, will be described in Chapter XIV.

THE APRIL BOARD MEETING

The tenth meeting, held on April 20, again continued with former business, and carried further the plans for the annual meeting. The Central Bank of Norway was invited to

participate. This had not been possible before, since the banking laws of the country had not permitted the Bank of Issue to buy shares. At this time also, shares of the B. I. S. were assigned to Albania and to Yugoslavia to be acquired by the latter when its currency should be stabilized. Bonds of the Amsterdam Mortgage Bank were bought, thus indicating again the desire to further various new forms of credit facilities. The Amsterdam Bank had been organized some months earlier, but the Bank had not participated since its activities had not at first been definitely international in scope and control.

The announcement was made in London at this time that the British Treasury was planning to use the American dollar exchange reserves. It was explained in London that the passing of funds through the B. I. S. made this exchange protection unnecessary, since the pressure on the pound was eased by international clearing.³⁹ The decision caused some concern, however, since it was looked on in many centers as a sign of distress, and observers noted the general uneasiness in England expressed in discussions of the budget difficulty, and the possibility of inflation.

Signs of trouble on the Continent increased in May, but the storm did not break with full force. From Germany there came statements that "either revision or capital help" must be granted. Rumors of difficulties came from the *Credit Anstalt*. At this time the International Chamber of Commerce, meeting in Washington, expressed the conviction that debt and reparation agreements must be revised. The Committee on middle term credit appointed in Brussels on May 4 under the chairmanship of M. Francqui announced no plan for solving the credit difficulties. In fact, there was little that the B. I. S. could do at the moment. Most of the resources included in the 1,943 million swiss francs at the end of April were short time deposits and the Bank could undertake few engagements running for more than six months.

³⁹ *The Times* (London, April 28, 1931).

THE MAY MEETINGS

Several things combined to make the May meetings unique in the history of finance. Never before had there been a gathering of Governors of Central Banks. For the first time there was a corporate expression of the essential unity of world money and credit. Moreover, it was the completion of the first full year of the Bank's operation, while the election of new Directors from non-reparation countries indicated the turning of the Bank toward the wider field of business, following the subordination of the reparation tasks which had already been observed by those following the Bank closely. The discussions emphasized the interdependence of nations in their credit and exchange relations, in their maintenance of monetary standards, and in the struggle for stability. It was inevitable that the representatives of twenty-three countries saw more clearly the resources which the new Bank made available and the responsibilities which rested on them to coöperate with each other in a time of crisis.

On May 18 the Board of Directors assembled. They were occupied mainly with routine matters such as the approval of the accounts and financial statement for the year. They considered the report of the Credit Committee, and recommended that it should pursue further its discussions and studies of ways and means for increasing facilities for financing foreign trade. The meeting was continued on the following day, after the General Assembly of Central Bank representatives.

The election of the new Directors took place on May 19. Up to this time the Board of Directors had consisted of sixteen men from the seven founder countries. The Statutes provided that not more than nine people should be added to the Board.⁴⁰ They indicated that three of the Board

⁴⁰ *The Statutes*, Article 28; the men elected were Dr. G. Vissering of the *Nederlands Bank*, Mr. Ivar Rooth of the *Sveriges Riksbank*, and Professor Dr. G. Bachmann of the *Swiss National Bank*. Dr. Vissering resigned in October, 1931, his resignation to take effect at the end of 1931.

should retire at the end of each year, and three should be elected. The original Board decided not to increase its numbers by nine, but rather to elect three new candidates. This was the subject of heated discussion. During the previous months rumor had fixed the election for earlier meetings and lists of candidates had been submitted at various times. Nothing definite was settled upon, however, in the first year. France was very anxious to elect the maximum number, so that representatives of more of the smaller countries could be included.⁴¹ When the choice was made, it was generally applauded because it strengthened the Board, both in respect to the personalities added and because of the countries represented.

Representatives of twenty-six Central Banks, or banking systems came together in Basle for these meetings. Financiers from the following countries were present:

Albania	Finland	Netherlands
Austria	France	Norway
Belgium	Germany	Poland
Bulgaria	Greece	Rumania
Czechoslovakia	Hungary	Sweden
Danzig	Italy	Switzerland
Denmark	Japan	United States
England	Latvia	Yugoslavia
Esthonia	Lithuania	

As a result of the special arrangements in the United States and Japan, these countries were represented by men sent from private banking groups. The Central Banks of the twenty-four other countries were directly represented. The gathering was the more notable because many of the governors had never met before they came to Basle at this time.

It is interesting to note that the responsibilities of the general meeting had been narrowly limited in the Statutes. It was "invited to approve the Annual Report, the Balance

⁴¹ It was said in Basle that this was the most difficult disagreement so far experienced.

Sheet, . . . and the Profit and Loss account.”⁴² Further than this, it could make appropriations to Reserve and Special funds, and consider the declaration of a dividend. The members were not called upon to take part in the elections of the Board or the officers or to determine policies of the Bank. Under special circumstances they might be summoned to decide either to amend the Statutes, to increase or decrease the capital, or to liquidate the Bank. Shareholders were not entitled to attend general meetings, but only the nominees of Central Banks, or the other substitute banking groups of the countries in which shares had been issued. The meeting thus assumed importance more because it occasioned general discussions and promoted the acquaintance of Central Bankers than because of the actual business transacted.

In addition to the more formal meeting, a series of conferences and speeches occupied most of the two days of the General Meeting.⁴³ The group was divided into two committees, one under the chairmanship of Governor Wroblewski of the Bank of Poland, which considered problems of money, and the other under the leadership of Governor Popovics of the Bank of Hungary, which took up the question of credit. Addresses were delivered by M. Pospisil of the Central Bank of Czechoslovakia, Dr. Reisch of Austria, and Dr. Bachmann of Switzerland. M. Quesnay addressed the first commission on “the B. I. S. and International Payments.” In his talk he explained the work of the Bank in clearing international funds, its studies in the gold problems, its aim to assist in improving the gold exchange standard, and the handling of foreign reserves, as well as its attempt to improve the working of the gold standard, and to encourage monetary coöperation between nations.

Dr. Huelse, in the second committee, discussed the credit problems of the Bank. He emphasized the urgency of the

⁴² *The Statutes*, Article 48; see also *supra*, Chapter V.

⁴³ See *Communiqués* of May 7 and 20, 1931, and the unpublished memoranda.

credit difficulties, and the need for the careful evolution of constructive measures. These speeches by two of the Managers set before the Governors a picture of the mechanism which was already functioning and gave some idea of the aims which it might ultimately achieve. There was ample opportunity for general discussion and the conversations and speeches made an interesting collection of facts and opinions, filling four volumes of mimeographed notes and reports. They mark a notable step in the direction of a larger financial unity.

The men assembled for these meetings had in their hands a brief summary of the year's activities in the form of the *First Annual Report*. It gave a condensed account of its activities in regard to clearing, gold, and credit studies, exchange conferences, and technical discussions. It described, in some detail, the handling of reparation funds, and the execution of its obligations under the Trust Agreements. It explained its main purpose—to further Central Banking collaboration, and stated that, although profits were in no sense a major aim, ordinary business prudence had dictated “thrift in expenditure and care in investments.” The profit and loss account was given with the report. No detailed figures of the distribution of assets or the source of deposits were shown. The attempt to strengthen German exchange as a part of its work in easing transfers was indicated by the fact that the amounts held in Germany equalled 21 per cent of the total assets.

An Appendix to this Report gives the balance sheet for May 30, 1930 and March 31, 1931, the profit and loss account, and the statements of the Trustee accounts. In addition to this it lists the shares sold, by countries, and gives a table with the composition of the personnel. Four charts indicate in a general way the source and employment of the Bank's funds. Thus the Report is a succinct and definite condensation of the facts which had been published from time to time. It follows the general policy of the Bank in not revealing anything which would make possible comparison between the dealings in different countries. It gives no

details regarding interest paid or the yield on the investments made. All these matters were considered confidential and of no significance to the general public.

At the time when the Report was published, financiers were much distressed by the growing seriousness of the crisis throughout Europe. For this reason, neither the Report nor the meetings in Basle received wide publicity. The League meetings in Geneva, the troubles in Austria, ominous word from Germany, and the problems confronting England, all competed for the attention of men of affairs. There was some expression of the general gratification at the way in which the year's work had been completed, and the pleasant atmosphere of the meetings in Basle was taken as a sign of the useful work that would continue to be carried on through the B. I. S.

Because of the different emphasis and meaning of its work the first year has been divided into two periods. The one was characterized by the adjustment of the machinery of the Bank to the financial work it was to do. This was a period of fairly rapid growth, and of preoccupation with the place which the Bank would occupy, its internal structure and its contacts with outside banks (Chapter VI). The other, the second period, is one of slower growth in resources and membership. It was notable, rather, for the preoccupation of the B. I. S. with the larger problems and interests of the financial world, with gold, with clearings, with credit, and the exchanges. It was a time of committee meetings and conferences, of many visits to the Bank, and of the inauguration of various new facilities for the member institutions. Some of these acts are significant merely as experiments, some as beginnings, and some because of the concrete services rendered. With surprising ease the Bank had developed from a vague plan to a solid business undertaking, with a wide influence. Thus after months of hard work it stood firmly on the foundation of practical experience and was ready to assist in the difficult crises of the next twelve months.

CHAPTER XI

THE CLEARING PROBLEM AS SEEN IN 1931

THOUSANDS of gold bars were piled in the vaults of New York and Paris in 1931, shining through wire netting in double rows along dark underground passages. Hundreds of guards watched this fabulous wealth while clerks checked and changed paper tags. These tags indicated ownership, and the shifting of them could transfer millions of dollars with little more than the stroke of a pen, or the changing of a few book entries. In 1930, when the B.I.S. was a going concern this new clearing system, developed with surprising rapidity after the war, was taken for granted. It had to recognize the fact that the mountains of gold piled up in New York and Paris were extravagant concrete evidence of the intense desire for security as well as for the quick transfer of funds.

In 1931 each country felt an increasing need for a solid foundation for its money. Distracted by swift changes in values and the melting away of assets with postwar inflation, some thought that the gold exchange standard, combined with the easier shifting of funds from center to center, would make the metallic reserves more effective. There was a widespread hope that the cancellation of cross payments, and the knowledge that funds could be moved quickly, would lead to greater stability. There was a real need for confidence in the convertibility of money. It was, of course, important to lessen the scramble for gold. Each feared the attempt to accumulate gold when he saw it in a neighbor, and yet justified the same course of action in the name of national necessity when it was practiced at home. Fears bred mercantilism, and, because a favorable balance

of trade was not easy to achieve, more complicated means of easing exchange pressure and making gold effective were devised.

The plan for the Bank for International Settlements was a part of this general movement. To be sure, the occasion for establishing it was the new reparation agreement, but the motive power was to a large extent the desire to economize gold. There was a widespread desire to ease transfers, to regularize the gold exchange standard and lessen foreign exchange fluctuations. These fluctuations were looked on, by some, as evils in themselves, and not as mere symptoms of underlying maladjustments. In some cases they had probably been so. In most instances, however, the adverse forces had very deep roots and could not be eliminated by any new financial device. In any case, the hope that the Bank would solve these problems was very widely held, and in some quarters fantastic accomplishments were expected.

There had been many such unrealizable hopes in Paris. As has been seen, the idea of a "world clearing system" was very important in the formulation of the Young Plan. When the negotiations in Paris were halted by almost insuperable difficulties in the earlier stages¹ the plan for a new and comprehensive organization served to call out energy and hope. The suggestions brought forward almost simultaneously² by a number of the experts contained several novel ideas, but the one which made an immediate appeal was the usefulness of an international clearing house.

It was quite natural that this should be the case. In the first place, the obligation to transfer war payments led to roundabout movements of capital: for instance, some funds went from Germany to France, from France to England, and from England to America. This involved, on the face of it, irrational and overcomplicated procedures. In some cases, the strain on the various exchange markets

¹ Erich Welter, *Die Reparationsbank* (Frankfurt, 1929), pp. 7, 8.

² See *supra*, Chapter I.

involved real dangers and called for definite protective measures as substitutes for the transfer clause in the Dawes Plan.

Then, in the second place, banking history has been characterized by the gradual extension of the clearing principle. There was, first, clearing within a bank; second, clearing between banks in a city; and later, national clearing systems. A further development, which overlapped the other in time, was clearing between nations. In the light of this trend it was reasonable to suppose that at some time international clearings would be assimilated into a more complete and consciously planned system. This idea was suggested in the Young Plan in very general terms. The precise steps in its development were left for later conference.

These further steps were indicated again in the Statutes which provided in Article 24 that the B. I. S. should offer certain exchange facilities if it proved desirable.

The Bank may enter into special agreements with central banks to facilitate the settlement of international transactions between them.

For this purpose it may arrange with central banks to have gold earmarked for their account and transferable on their order, to open accounts through which central banks can transfer their assets from one currency to another and to take such other measures as the Board may think advisable within the limits of the powers granted by these Statutes. The principles and rules governing such accounts shall be fixed by the Board.

These indications were still very general, partly because a gradual development of the clearing principle, referred to above, had resulted in many diverse systems and precedents. These procedures, overlapping in many cases, offered interesting data for the Bank, but none of them could be taken as a pattern for a "world system" centered in Basle.

In all cases, however, they tended to extend the region of par transfers, and to lessen exchange rates between different areas. In some they brought about a central accumula-

tion of balances and an approach to a uniform means of payment. In no instance, however, could they entirely wipe out differences in interest rates between widely separated areas. This evolution had resulted in seven main types of clearing systems. These were, the Scandinavian clearing, the British Empire clearing, the Latin Union, the Postal Check Payment System, the German Giro System, the Federal Reserve Gold Settlement Fund, and the interbank clearing systems in large money markets such as that in New York.

The characteristics of these various clearings differed widely. It required long study to discover how a world clearing would differ from already existing systems, and further development of the plans for the Bank made it obvious that the fulfillment of some of the ideas expressed in Paris might be delayed. The Statutes were so framed that the obligatory functions of the Bank were reduced to a minimum, while the discretionary activities, including clearing, were made exceedingly comprehensive. How soon and how far these potentialities would be exploited was a matter of doubt. The idea of a world system has continued to interest the general public, as well as a large number of financiers. In fact, it is this aspect of the Plan that most closely linked it with earlier suggestions for an international financial institution. As far back as 1892 the idea was proposed, and a number of suggestions made, for instance those by Wolf and Luzzatti.

Various events in the early months tended to redirect attention to this problem. There were, for instance, the sudden, and sometimes irrational, flights of capital from Germany, the unexpected pressure on sterling exchange, and the quick ebb and flow of gold from New York. All pointed to the need of some offsetting and balancing device. Moreover, the work of the Bank as a reparation-debt clearing house was considered highly successful. It was urged that this kind of service be developed further. Then again, it was clear that something must be done to make the gold

exchange standard more orderly; the Bank seemed the proper agency. For these three reasons, a number of proposals were made in the very first year. A system of transfer was instituted, comprehensive studies were begun, and widespread inquiries set on foot to find out what was really wanted by the Central Banks.

It had become more and more evident that the Central Banks were disturbed by abnormal exchange and gold movements, due to both economic and political causes, but it was difficult to determine how the Bank should intervene. Evidently some steadying force was needed, and a number of different adjustments were possible. It was thought that better technical management of international payments might improve conditions, or, perhaps, a change in the size and nature of these payments might be necessary. Then again, it was not certain that easy clearing and frequent cancellation of international claims were desirable. These questions had to be answered, at least tentatively, before the Bank could go far in constructive effort. In fact, they presented more serious difficulties than the practical steps in organizing a system.

REPARATION TRANSFER A SPECIAL TYPE OF CLEARING

There were, in fact, two very different possibilities. A clearing system could function as one more agency in transferring capital without in any way changing the economic forces or conditions prevailing. An instance of this was the clearing of reparation and debt payments. In this case, the deposits were credited, debited, and transferred at the rates of exchange set in the respective money markets. Or, on the other hand, a clearing system could attempt to modify those rates, and lessen the effect of time and space on international transactions. This was the idea in the minds of most of those who talked of a world clearing.

The way in which the differences between markets would be absorbed or lessened would depend mainly on the handling of balances due. Obviously, if balances were paid im-

mediately, there would be practically no alteration in the existing situation. If, on the other hand, balances were held, pending the eventual creation of a counterpart, there had to be some account taken of interest rates in the different centers concerned, and of exchange rates both at the time when the balance was due, and when it was paid off. Such facts became of great importance as possible types of systems were considered.

The necessary distinction between an active and a passive clearing system supplies the answer to a question frequently raised. Why was there such concern over clearing methods in Basle when a system had already been established? The answer is that reparation and war debt payments were mainly received and transferred in dollars. There was no attempt to offset unlike things, such as two different currencies. If the Bank were short a certain kind of money, it considered this condition a separate problem—an exchange risk balanced by an investment opportunity. It was not a normal part of the transfer system. There was no attempt to have a multitude of claims in different currencies pass in and out, or to allow balances to wait for future liquidation in various money instruments. It is possible that the simpler of the two systems for reparation clearings was not envisaged in Paris. The substitution of the Bank for the Transfer Committee implies a more active influence on the exchange problem. In any case, however, the reparation and debt transfers through the B. I. S. led to a clearing of claims and not of currencies.

Some hoped that the B. I. S. could establish a clearing which would go as far as the Federal Reserve Gold Settlement Fund in eliminating the effects of space. Serious consideration showed, however, that this was by no means possible.⁸ Others hoped that the offsetting payments, if brought together quickly and completely in a central system, would reduce the balances due to a comparatively

⁸ Shepard Morgan, "Constructive Functions of The International Bank," *Foreign Affairs* (July, 1931), pp. 580-591.

small figure. They reckoned without many of the obstacles which must be overcome in such a process. There were others who thought that the B. I. S. could furnish credit to meet unpaid balances out of the general pool of resources left in its keeping. They reasoned that since a debit in the account of one depositor would be offset by an increase of credits of another depositor, this debit could be adjusted by the Bank, although it would be necessary to charge and pay interest on these balances. The rate could be low and the balances due would be small. Further than this, they hoped that the B. I. S. could stimulate credits from outside sources which would offset debits arising out of the trade of different nations. If this could have been possible, it would have gone far toward leveling foreign exchange rates but the Bank had no power to accomplish these ambitious ends. In fact, it could not eliminate either space, time, or one-sided indebtedness.

All these expectations implied a power to interfere in economic tendencies which the Bank did not possess. Certainly it would have to fulfill a more modest rôle, at least in the beginning. In any case the Bank did a number of things. That is, the reparation debt clearing was quickly organized.⁴ Moreover, the handling of the interest on the Young Loan and other special payments, notably for governments, constituted a type of clearing. Then, further, the committee charged with clearing studies met in November.⁵ Later, in January, 1931, the first of a number of steps was taken to increase interbank clearings. Meanwhile, several other tentative proposals and arrangements were put before Central Banks.

The concrete questions arising in the course of daily deposit and investment business called for the answer to a number of very practical questions. For instance, there was the basic problem as to what the Bank had the power to do. In respect to clearing the answer was quickly made—it could do nothing except insofar as it was exerting the power

⁴ See *infra*, Chapter XII.

⁵ See *supra*, Chapter X.

given it by Central Banks who might wish such a development. Then, second, what did it wish to do? Here the answer was less immediate and less conclusive although one thing was generally admitted. The Bank wished to prevent completely unnecessary fluctuations but it did not wish to postpone those that were inevitable. Further than this there were the questions as to the opportune moment for the Bank to extend its efforts along these lines, and just what form a "clearing" should take.

Time alone could bring a completely satisfactory answer to these questions. The power of the Bank would either increase or diminish. In the latter case, the Bank would be incapable of the task of clearing. Then, again, the aims of Central Banks were sure to become clearer with the repeated conferences in Basle. The time and manner would be indicated eventually by the results of the preliminary steps and suggestions made by the B. I. S. The investigations made at an early date confirmed the opinion in Basle that the clearing problem is fundamentally the foreign exchange problem. No constructive action could be taken without a policy and a theory in regard to exchange rates and the function of gold in the financial system. Moreover, clearing is the key to the question of the possibilities of an international currency. The hopes for a greater unity in finance were bound up with this whole group of factors. The influence of the idea was not limited to the more technical exchange problems. It widened in concentric circles to the farther reaches of economic life, and beyond this to the complex political relations between nations.

In the meanwhile, pending the solution of many basic problems, anything the Bank could do to clarify the issues and to demonstrate lines of progress would be of the utmost importance. One by one the Bank eliminated the unessential elements of the question and the problem was divided into its different aspects. There were, for instance, technical arrangements and the question of unnecessary cost, the possibility of exchange stability and the causes of

interest rate variation. A number of other special problems emerged. The Bank was a laboratory; from its abstract studies and concrete experiments would come the principles to guide the clearing policies of Central Banks. It is of minor importance that quantitatively, the B. I. S. clearings formed an extremely small part of the total of international payments. It did not matter *where* the transfers and clearings were executed but it mattered very much *how* they were done.

THREE KINDS OF PROBLEMS

The Bank faced the clearing question squarely and came to certain decisions in the second stage of its development; early in 1931 a brief survey showed that the clearing problem of the B. I. S. is divided into three main parts. There is, first, the theoretical basis and motives for expanding such facilities. There are, in the second place, the ultimate possibilities of achievement through the new institution, and there is, third, the actual development of new facilities in the early stages of the Bank. Considerable difference of opinion in Basle and elsewhere can be discerned on all these different subjects.

A survey of international payment methods reveals the need of many readjustments. Probably the first hopes in this direction were too sanguine. The mysterious workings of credit in the past century have given rise to boundless hopes for the control of value and purchasing power. The stroke of a pen can transfer thousands of dollars in the form of bank deposits. Most of the commerce of the world is carried on by means of paper counters which have no intrinsic worth. It is surprising that this very artificial system has worked smoothly for decades, and yet it is reasonable to suppose that the simplification and the rationalization of payments can go further. In the light of the large sums paid through clearing houses like that in New York, the cumbersome process of moving gold—the stowing of

gold in boxes and shipping back and forth by steamer—seems extremely crude and old-fashioned.

Although the elimination of some of this work was one of the motives behind the development of a clearing system, it was not expected that gold movements could be dispensed with even though they seemed to be one of the glaring inconsistencies of financial life, and yet it was considered a corner stone on which rested the pyramid of credit, a structure delicately balanced but firmly supported at the base. Almost every one agreed that an improvement in methods could be devised; every one desired to see the relationship between the slender commodity foundation and the vast superstructure clearly demonstrated and explained. Even if some shipments should always prove necessary, it was important to know why, and to what extent.

Other motives, besides the elimination of physical shipment lay behind the clearing plans. One of the most important was the desire to see Central Bank collaboration strengthened by the agreements and close contacts that would come with making payments through a common agency. Then there was also the more ambitious hope that, through clearing, a greater degree of economic stability could be achieved in foreign exchange rates, in commodity prices, and in interest rates. Others, with the same aspect of the matter in mind, hoped not for stability at existing levels, but for a large increase in purchasing power by means of severing international payments almost entirely from their connection with the supply of gold.

There were, in addition, certain other motives which played some part in these plans. One of these was the desire to keep the exchanges in the debtor nations steady by the help of any system which might ease capital movements and relieve the strain. This idea was encouraged by the success of the Bank in the transfer of Reparation and Debt money. Insofar as the Bank actually helped to ease transfers, and to keep the reichsmark stable, it was living up to

the hope expressed for its clearing capacities in Paris. Then there was a natural wish to increase the prestige and profit-making business of the Bank by this logical extension of its work. Furthermore, some hoped, quite naturally, that the B. I. S. could lessen the dependence of the less highly developed financial centers on the older money markets.

DIFFERENCES AS TO PROBABLE EFFECTS

Despite the reasons very actively urged in favor of a new clearing system, some opposed the idea just as emphatically.* There was, in fact, a sharp disagreement as to the effects of such a move on the economic system in general, and on the exchanges in particular.⁷ The divergence of views can best be indicated by an examination of the two extreme cases brought forward in the argument, one to prove that clearings would increase gold movements and the other to prove the opposite.

It was usually taken for granted, by those who first urged the cancellation and clearing of debts through a central organization, that this offsetting process would decrease the movements of the standard metal. That is, they assumed that the number of dollars' worth of gold, multiplied by the number of miles it traveled in a year, would be less if clearings were facilitated. There were some, however, who held a completely opposite view. They claimed that there would be a narrowing of the gold points and that this would lead to more frequent shipments. Since gold would move sooner and oftener, there would be no net reduction in transport—there might even conceivably be an increase. A choice between these views is important to the understanding of practical advantages to be expected.

Arguments against an international clearing house were based sometimes on the first and sometimes on the second of these assumptions. Some of those who said gold ship-

* See *infra*, pp. 273, 4.

⁷ Alfred Lansburgh, *Die Reparationsbank*, edited by Erich Welter (Frankfurt, 1929), pp. 42-47. Per Jacobsson, "The International Bank and Monetary Policy," *Index* (Stockholm, September, 1929), pp. 11-14.

ments would be small claimed that this would be harmful since an adverse exchange position would be less conspicuous and would not be corrected so quickly. They held that the psychological effect of gold being shipped helped the Central Bank to enforce a restrictive policy when it was needed. Others argued that more frequent shipments would take place and that they would be disturbing.

These theoretical objections carried considerable weight. Other less abstract objections to the formation of a clearing were occasionally taken into account. From the beginning it was urged that there would be no gain, and considerable loss, if a new mechanism should supplant existing agencies, which had earned their place by efficient functioning. In fact, the exhortation in the Plan against competition with existing organizations was in part aimed to quiet this fear. Then again, there was some worry for fear a closer financial linking together of nations might raise troublesome political issues. A further, more technical argument, added to the theoretical objections to narrowing the gold points, was that the intervention of the B. I. S. might complicate rather than simplify the payments, since it would in some cases substitute a triangular for a bilateral arrangement. Why, it was asked, need payments between two countries take a round-about course through Basle? This criticism would, of course, apply more particularly if there were no cancellation of claims.

Accomplishments of the Bank for International Settlements in the investigation and organization of clearing in these first two years must be viewed in the light of what is desirable in the distant future. It is important to know how much effort should be expended to develop different possible functions. Clearing is one of the major proposals. It is essential that the fundamental needs and possibilities of clearing be understood, whether it is put aside, or whether it becomes the magnetic north to guide the Bank's course. There had to be first, in 1930, a study of the abstract possibilities, then of the generalized facts of international ex-

change and transfer, and later, in 1931, concrete experiments and plans.

World settlements are complex, involving large profit or loss. The business man, in making practical decisions, cannot take advantage of the averaging process implied in the phrase, "other things being equal." Every exchange rate is played upon by hundreds of forces. It is practically impossible to tell how a change in any of them will affect all the others.

Progress was made in the discussions at Basle. Whereas in the first months one could hear prophecies of startling development at the Bank—world clearings, a central pool of gold, an international money, a leveling of interest rates—later proposals mentioned were simpler and more attainable. Some of these views were not expressed by the staff themselves but emanated from the Bank as vague rumors, perhaps inspired by chance remarks. Very soon, however, the discussions became more concrete. A region of useful effort was staked out with caution. There is little doubt that these discussions did more to clarify the subject of clearing than some twenty years of vague theorizing. This contribution of the B. I. S. should be a valuable help to Central Banks in their future plans and policies.

RATIONALIZING INTERNATIONAL PAYMENTS

The concept of rationalizing international payments, the first aspect usually brought forward, is here used to mean the increase of efficiency and the resort to the simplest and most direct methods. Undoubtedly there is room for improvement in this direction. Possibly some suggested changes may prove to be specious or may be offset by disadvantages, but critical appraisal of exchange processes reveals a number of seemingly useless manœuvres. Three types may be observed frequently. There is, first, the shipment of gold from a country at the same time that gold is moving in exactly the opposite direction. There is, second, roundabout transportation, the sending of gold by A to B

when B in turn must send it to C. Then, third, there is the shipment of gold which could sometimes be avoided by the mere earmarking in the vaults of a Central Bank.

The total expense involved in these shipments of gold is not great. As one journal said, the money spent on this would not be worth saving at the cost of the time and consideration of experts of the caliber of those who formed the League Gold Committee.* Nevertheless, there is a flaw in the system calling for attention if these shipments are really unnecessary. It is worth knowing why irrational and duplicating labor must be exerted to support monetary mechanisms. If the expense is really unnecessary, it is at least one possible reason for extending clearing facilities. It is certain, however, that it would never be a main reason, and could be kept in the background if it were not a symptom of more serious maladjustments.

Rationalizing international payments, then, as the phrase is here used, includes three main objectives. The first is the offsetting or avoidance of payments which move in opposite directions at the same time. The second is the development of counterparts, either credit or goods, which will make gold payments less necessary. In the course of the usual discussions this aspect of clearing is not often included since it implies a more active functioning of the clearing agency than is normally contemplated. Nevertheless it is a natural consequence of the necessary work of a really inclusive system, once the more mechanical aspects have been taken care of.

The third is the reduction of the unproductive expenses which come from gold movements which must continue to be carried out. This calls for shipments for shorter distances and under more uniform conditions. These various aims imply better information, communication, and anticipation of future exchange movements, whereas none of them can contemplate fundamental changes in the long time and large scale capital transfers.

* *The Financial News* (Jan. 22, 1931).

THE EXCHANGE OF FUNDS IN THE HANDS OF SPECIALISTS

Most of this work is now in the hands of specialists, speculators, arbitrageurs, and exchange dealers, with its greatest concentration in London, although the facilities are scattered all over the world, since the transactions generally require agents in two places. None of this business directly concerns the manufacturer or farmer in normal times. He prefers to leave it to experts. As far as possible he hedges risks, and takes care that his part of the contract protects him from fluctuation in each case. This is not always possible. In some places there is an insufficiency of specialists, and in many money markets the Central Banks have tried to fill the gap.

Thus, apparently unnecessary risks and expenses occur despite the large number of exchange dealers who modify fluctuations by quick and frequent intervention. The material expression of the uncertainty takes two forms: first, there are fluctuations in value which lead to reactions in a few minutes or a few hours; and second, there is the physical movement of gold. These are considered by some to be flaws in the financial machine, while others accept them as useful or, at least, of negligible importance. In any case the curve of a day's exchange rates will be notched by many small changes, while, at the same time, the list of merchandise leaving many ports will include boxes of gold which have already made the rounds of many banks without ever having passed into circulation.

Those changes in value, which are corrected almost immediately by movements in the opposite direction, are caused partly by the differences in dealers' estimates. These estimates are influenced by information coming in from outside markets as to other exchange rates—that is, the dollar rate in Paris is affected by the franc rate in New York—and, also, by facts which may be discovered regarding the balance of trade, taxation, general prosperity, and a wealth

of other data. Any wide variation of rates from the norm will be affected by the increase in the supply of bills or the falling off of demand. There is a certain compensatory action so that reactions are usually quick, and divergence from par is kept between narrow limits.

In the course of these fluctuations, whenever the price of bills on center A rises unusually high, gold shipments to A take place. The reason is very simple. Those who have debts to discharge in Germany, for instance, must secure bank deposits, cash or other assets in Germany. These are supplied them by exchange dealers. When these dealers run out of resources they must build them up by buying mark bills maturing in Germany. It may be, however, that the price of such mark bills will rise, in New York, to twenty-six cents per mark whereas a dollar's worth of gold will buy more than four marks in Germany. It then becomes advantageous to send gold to Germany where it will buy mark assets. If, on the other hand, the mark falls and the price of the dollar rises much above four marks, it is cheaper for the German exchange merchant to buy gold and send it to New York. Against the deposits thus built up in the United States, the German exchange dealer can draw finance bills in dollars, and sell them in marks at a price which will cover the cost of gold and its transportation.

Thus, the value of foreign bills will fluctuate between an upper limit set at the point where the price will be equal to the cost of buying gold and shipping it, and a lower limit set at the point where foreign exchange is so cheap that the dealers in other centers will send gold instead of depreciated bills. These two limits are, of course, the gold points. They are determined by the cost of gold in each of the currencies concerned, or par if the currencies are convertible, and the cost of transportation, including insurance and commissions, between the two centers. The value of gold in the other market figured in the home currency is repre-

sented by the par of exchange if both are convertible.* Moreover, the gold points between two given centers are influenced by the cost of getting gold in all other centers and shipping it to the place where funds are needed.

It is clear, then, that if space were annihilated, and transportation costless, the exchange of the funds would always be at the rate determined by the ratio of gold contents of the units as long as the currencies were convertible. This assumption has a practical bearing on the problem insofar as it approaches the actual situation of two countries immediately adjacent and on a straight gold basis. In such cases the gold points are very close to par. The Scandinavian countries often satisfy these conditions, and in some respects the interdistrict clearing of the Federal Reserve. The opposite extreme is to be observed usually in time of war when distance increases costs because of various risks combined with legal prohibitions which drive traffic in metals into hidden channels. The gold points themselves, therefore, sometimes move on both sides of the par of exchange, widening and narrowing with the speed, security, and distance of transportation. The more usual, rapid fluctuations within these limits indicate the temporary influence of market conditions.

The gold points are usually two- to four-tenths of one per cent removed from par. This is the approximate spread when currencies are convertible, when transportation is safe, and both economic and political conditions are stable. As has been indicated, however, there can be very wide variation. In fact, the practical obstacles hindering the shifting of gold from center to center are often as great as the legal ones which come with inconvertibility. It is sometimes easier to get industrial gold in non-gold standard countries than it is to move gold from markets technically on the gold standard. During war time, the gold points always widen. In fact, the depreciation of gold on a paper standard

* The par of exchange is the ratio of the physical weights of the metal in each unit.

may be considered as a kind of widening of the gold points.

One of the most striking instances of the relation of depreciation to the practical conditions of shipment is seen in the discount of the dollar in the autumn of 1931. The decline of almost one per cent on some of the markets was due mainly to material factors, but these were so serious as to accentuate the difficulties of maintaining the gold standard and to react on sentiment. For a short while the physical and psychological obstacles seriously impaired the usual working of the gold standard. The United States had plenty of gold, judged on the basis of any normal demands. There was, for a few weeks, however, a real shortage of transportation facilities. This led to a decline of the dollar, since a dollar in gold in New York was not for the moment equivalent to gold in Europe. A possible delay of more than three months had to be reckoned in the cost of shipping.

Thus there occurred an unusual state of affairs. Insurance companies refused to cover more than a certain amount on each boat crossing from New York. This amount, multiplied by the number of suitable boats, limited the sums arriving in Europe. Insurance entered into cost through the loss of interest in holding gold for later shipment. Even so, the totals thus shipped amounted to more than 200 million dollars worth of gold the third week in October 1931. The amounts desired were, for a while, in excess of capacity so that space was booked ahead for more than three months. During 1931 and 1932 many investments in New York were turned into gold earmarked for foreign account. Of course these funds earned no interest during the waiting time nor during transport.¹⁰

Here is another of the seeming irrationalities of foreign exchange. Gold earmarked with the Federal Reserve should in theory, and in the circumstances prevailing in 1931, be as good as gold in the vaults of any Central Bank. Nevertheless, bankers were willing to pay the cost, and incur the

¹⁰ The Federal Reserve rate in New York was 3½ per cent at this time.

delay of moving the gold thousands of miles. There was practically no demand for gold for internal circulation anywhere. This was just the situation which a clearing system would aim to avoid, and yet at the same time it brings out some of the difficulties which a more logical system would face. The dollar exchange was at the shipment point, and the zone of exchange fluctuation was abnormally wide. These difficulties with the New York exchange formed one of many episodes in the postwar decade. Present-day clearing is characterized by many seeming irrationalities but the surprising ingenuity and alertness of the experts and agencies have been developed.

There are weaknesses in almost any system of exchange dealings so far devised, in that they do not take account of the changing sentiments and the failure of confidence which makes for sudden capital flights. Small fluctuations which might well be offset or suspended become cumulative. The material and the psychological factors interact in ways which cannot be calculated in advance. In the case of the depreciation of the dollar, technical difficulties accentuated the psychological distrust, and distrust put unprecedented strain on the material factors, such as ships and planes. One would have expected the gold points to have been narrower on account of the possibility of earmarking gold in New York. Because this failed to bring about the expected effect some doubt arises as to whether any pooling of gold could steady exchanges during a crisis.

THEORETICAL POSSIBILITIES

As the theoretical possibilities of an ideal system are examined it becomes evident that there are a number of different points at which the limits of exchange fluctuation might be set under the hypothetical conditions of increased clearing. There are two extremes, one, the present situation in which exchange rates fluctuate in a zone determined mainly by the amount of interest lost during the time of sending a draft and receiving the return confirmation. In

the case of New York and London, the two-way time is about twelve days. Then there is the added cost of possible one-way gold shipment. This would make the variation approach four-tenths of one per cent for direct costs of gold shipments. A clearing system would at the very least diminish the number of shipments and so limit them to the more favorable ways which are available.

The other extreme for the hypothetical new gold points would be the loss of interest for one day or less and the negligible costs of changing the earmarking of the gold, plus perhaps, some charge for storing gold in a central place. This would reduce the exchange fluctuation zone to a deviation from par of an amount which could be completely neglected by the producer dealing for foreign markets, and which would offer little incentive to the exchange specialist to operate in these differences. This is an extreme and limiting case. Between these two possibilities, some narrower zone of adjustment must be chosen in order to judge the probable results of a new system of clearing.

Certainly some modification of the gold points can be anticipated as the result of improved clearing. Even so, analysis and experience both indicate that the smaller day to day fluctuations *within* the gold points are the first to be affected by a clearing system. These would be modulated before any change in the gold points themselves was to be anticipated. To be sure, they are not large variations but even so they introduce an element of risk which must be accepted by speculators, or preferably, hedged. Insofar as they are not merely short segments of a long time trend which is going to lead up, or down, to a new level of value, they are usually wiped out by quick reactions. The return is quicker and the variation less wide as the ability and resources of exchange specialists increase. It is for this reason that some maintain that lessening the incentive of specialists to trade in the exchange markets will have unfavorable results.

There is no doubt that exchange dealers serve a useful

purpose. They have various tools in their hands which have come to be extremely effective. There is great variety in their transactions. They can arbitrage between gold and bills, between spot and forward exchange, as well as between securities and goods. They can go the rounds of the various markets for the best rates on a particular currency. They operate on small margins and with lightning speed. It is worth considering, however, whether the tools which they use could be as effectively employed by a central organization, or whether, if this is not the case, the development of a new organization would seriously hamper or lessen the effectiveness of these instruments. The history of the past century has shown the need for rapid expansion of all monetary mechanism to meet commercial needs.

As an answer to such objections it is claimed that if these tools were in the hands of one central organization with contacts in all the important markets, a wealth of economic data, and an experienced personnel, the results would be even quicker reactions, narrower fluctuations, and a broader market for all exchanges. Such a development would, of course, put a considerable strain on any conceivable organization. One outstanding difficulty of a central organization would be the practical impossibility of distinguishing between short and long term fluctuations. Thus there is a constant danger that small fluctuations will lengthen into long waves of depreciation. The attempt to correct small deviations might cause rates to get out of line with economic conditions. This possibility would lead to serious distrust, and violent speculative attacks. If, however, a movement in this direction should be inaugurated the B. I. S. would have certain natural advantages in performing the task since it is in immediate and constant contact with the Central Banks of more than twenty-six countries.¹¹ It is likely that this number of banks will increase gradually. Moreover, representatives of ten countries who are

¹¹ See *Second Annual Report*, Annex I.

on the staff of the Bank are in a position to interpret the data from many money markets.

Since many theoretical advantages and disadvantages have been suggested in discussing the theory of an all-inclusive system of international exchanges, it is worth considering further these abstract possibilities, although practical limits imposed on the B. I. S. preclude the realization of such a system even under favorable circumstances. An ideal inclusive system, if realized, would make it possible to offset all differences arising between countries in their payments abroad. This fact can be seen most clearly if one supposes an economic world in which there are only four countries. At the end of any one day the debits would equal the credits. Thus a central clearing house which would hold all the claims would have assets from some members balancing liabilities to the others. It is still possible that there would be a small discrepancy arising from the fact that the settlement hour would cut across the dynamic flow of wealth in a purely artificial way.

This small and negligible residue, if it occurred, might be a result of the lag in the acknowledgment of some debt arising out of imports, which would last for only a short time, and could never grow to a sizeable figure. It would be similar to the unevenness in the flow of a liquid through a closed system of tubing. Even though the total amount in the system did not change, there might be a temporary excess at some point, indicating that physical limitations would not permit of an instantaneous diffusion throughout the canals, even though the fluid could circulate without obstacle in and out of the various branches to the points for which it was destined.

In general, however, the offset would be complete as long as only such short time fluctuations of exchange rates occurred. Changes in value caused by temporary disequilibriums do not require that balances be paid. Such unpaid claims could be held over pending the accumulation of

counter claims. That is, the fluctuations themselves would tend to disappear, and the curve of exchange become smooth. Discrepancies would be registered in the accounts of the clearing house, but no counter value need be shipped from one country to another unless the offsetting credit failed to materialize. A closer comparison of such theoretical assumptions with practical situations reveals many difficulties.

Under normal conditions the commerce between nations is made up of standard lines of commodity exports and imports, which do not change rapidly over short periods, and a flow of long term investments, often closely paralleling trade, which continues to be predominantly in one direction for a period of years. In addition to these items there is a flow of short time investments which moves in directions determined mainly by the habitual methods of financing foreign trade, usually in the past through London. There is a third kind of payment intermediate between the commodity trade, and the short term items that is gold, which moves, sometimes to pay balances, and sometimes gives rise to new debits which must be covered by credits. Despite a traditional presumption that gold is the balancing item, to the exchange merchant a transaction in the metal is no more the liquidation of a balance than is any other arbitrage or credit transaction.

In a clearing system, however, all balances would emerge into great prominence even though they were small in size and of short duration.¹² If there existed a system such as that posited here, it could conceivably obviate entirely the flow of gold, except as one of many commodities. It could also make less necessary the movement of short term credit, except as it was the customary instrument of a fairly stable trade. The drawing of finance bills to meet unanticipated short time debts would be greatly reduced. The clearing house would find its credit balances depleted on one side and built up on the other. It would be able to grant credit to the country which was in temporary need, and could hold

¹² See *infra*, the problem of balances.

this in suspense, offset by the growth of deposits of countries which had a temporary excess of assets. Then, when the movement turned in the other direction there would be a cancellation of former claims and a balance of indebtedness.

Such a clearing house, if organized would have to be protected by strong political influences and developed in a reasonably stable period. Moreover, it would operate only with countries whose commercial interchange, though not static, was subject to no violent changes. It would have to take for granted sane and regular monetary policies in the member countries. It would flourish only if there were stable tariff policies and world peace. Granted these conditions gold movements could be almost entirely eliminated and interest and exchange rates kept very nearly steady. If these conditions were ever realized an international currency, which did not, like gold,¹³ have intrinsic value equal to its face value, would also be possible.

Unfortunately, however, these conditions seem to be remote. In the everyday world, political forces threaten the economic stability of all countries. Tariffs, taxation, wars, changes in currency and banking laws, for instance, may change the flow of capital or goods without warning. Under these conditions small discrepancies are not always wiped out by counter movements. The balances due in one currency may come to be worth more or less in another on the day when they must eventually be liquidated. Facts proved that differences in interest rates between the countries participating in the B. I. S. usually represented real differences in the estimated future value of assets in those countries. For these reasons the exchange problem of the B. I. S. or of any similar organization is very real and the difficulties connected with unpaid balances prevent the organization of a world clearing system.

No mere technical advance by means of the centralization of claims between nations can prevent the growth of

¹³ Gold is, of course, the standard international means of payment.

uncovered debts in such times. Only slight temporary changes can be taken care of by mechanical improvements. Any attempt to go further than this would have to go to the roots of these economic and political differences. It would have to explore all the factors influencing the value of money in each country and try to make solid the basis of credit. There are, of course, a large number of possible combinations which would lead to debts being balanced by credits within the workings of one system. In fact the more complicated relations might make for simpler solutions. For instance, if Belgium owed Sweden money, and Austria were indebted to France, the B. I. S. might use a payment due from Austria, to pay Sweden in discharge of a Belgian debt, which France would be planning to cover in view of a debt in Belgium.

A survey of such possibilities reveals the fact that if the B. I. S. should establish a clearing system one of three hypothetical situations would be realized. These are three mutually exclusive cases. Either (a) the gold points would be substantially the same as at present, or (b) they would be closer together, or (c) they would be further apart. As has been said above, it is usually assumed that (b) would result, and much of the argument for a clearing is based on this assumption.

Arguments on this point must reckon with the fact that, by definition, clearing leads to a reduction of balances to be liquidated since more payments can be offset. The remaining debts can be liquidated, as before, either by credits or by gold, goods rarely being used for this purpose. Special emphasis is always placed on gold in this connection, because credits if so used, tend to become merged with the original body of transactions, and are not looked on as balancing items, particularly if conditions are stable. Gold shipments, however, are much more conspicuous and are often thought of as the abnormal transaction, and as the means of striking a balance. Although this distinction is arbitrary, to a considerable extent, it is almost universally

accepted. It is logically possible that, although with additional clearing facilities, fewer balances will be paid, a larger part of them will be met in gold, and a smaller part in short time credits. This situation, however, is not in accord either with past experience or the desire to reduce the cost. The expense of paying with finance bills involves only the interest charged, allowance being made for the premium or discount on exchange, whereas paying in gold means interest charges plus the cost of shipping, handling and insurance.

When gold is shipped, the interest rate of the country where it is bought is most important. When finance bills are drawn, on the other hand, the interest rate in the country where the debt is paid is usually most important. These rates make up a part of the exchange rate differences, that is, Germany in paying the United States in finance bills will cover the New York rate, but if finance bills are not available in Germany, gold is bought there and interest at the German rate is foregone. The shortage of New York bills will lead to a premium on New York credits and a discount on German funds. Thus, the exchange will move against Berlin. The reactions are usually quick in normal times.

The exact effect on cost of the increase or decrease in the volume of gold shipments cannot be estimated. It is not known, for instance, at what point the law of increasing or decreasing returns would apply to the expense involved. In any case the direct cost of such transactions is of little consequence compared with the indirect effects. It is true that the cost affects the exchange rates, since the greater the cost, the greater the potential fluctuation of rates, but the significant problem is the effect of gold movements on the credit structure, through psychological, technical, and monetary changes.

Some argue that many small shipments probably have less effect than infrequent large ones and it is possible that the quick ebb and flow of metals in small quantities means less violent contraction and less rapid expansion of credit,

If this is true, the narrower gold points would mean that credit would be less sensitive to gold movements, or, to put it in another way, gold movements of the size and kind that influence credit would seldom occur. Moreover, whenever such movements did take place they would suggest the emergence of some abnormal economic factor, and would be a danger signal which would command universal attention. Evidence on the other side of this question is to be found in the difficulties experienced in certain instances, notably Austria and Greece, in trying to peg the exchange at a definite figure. The financial reconstruction experts found it more satisfactory after some experience to leave a zone of fluctuation between the high and low of the exchange rates.

Obviously, new clearing facilities would have some influence in increasing the fluidity of credit, and postponing payments. They would, thus, decrease the immediate repercussion of a debit balance on foreign exchange rates. Then again, it is probable that earmarking would increase. Even so, gold would undoubtedly move on many occasions. In fact, there is no reason to prevent this entirely, and no way of making it completely unnecessary.

Granted the successful working out of details, the advantages and dangers are fairly clear. A schematic representation of the argument is as follows:

- A. An efficient clearing system will lessen the number of gold shipments between countries, since it lessens the number of payments.
- B. It will decrease the cost of shipping gold for either or both of two reasons.
 - 1. on the average, and in respect to total quantities, gold will not move as far (mainly earmarked).
 - 2. the smaller number of shipments will make possible the choice of the most effective methods, that is, the law of increasing cost would probably apply to gold shipments, and as they are fewer, the less costly will be used.
- C. A decrease in the cost of shipping gold means a narrowing of the gold points (by definition).
- D. The narrowing of gold points may bring about more fre-

quent shipments, since a smaller deviation will make them worthwhile at reduced cost; thus the tendency to decrease shipments will be checked by the declining cost and a new point of equilibrium established.

- E. If there are more frequent shipments, they will be either:
 1. smaller in volume, for if the contrary were true, according to the law of diminishing returns, increasing costs would probably widen the gold points.
 2. or, less costly, in the aggregate—though perhaps almost the same in total volume (if the law of diminishing returns does not apply).
- F. There may be less frequent shipments, because of the large proportion of cancellation of claims:
 1. at a higher unit cost.
 2. at a lower unit, and lower aggregate, cost.
- G. The practical question which must be answered is whether it is desirable to have:
 1. more frequent small movements.
 2. a greatly reduced volume, and cost of shipments.
 3. less frequent high cost shipments.

The answer to this question has not yet been made; certainly in the course of rationalizing clearing, both advantages and dangers are anticipated. The advantages, already outlined, are mainly three. The first, the least important, is the elimination of unnecessary work. The second is the automatic result of centralization which increases the combination, cancellation and offsetting of claims. The third is the possible stimulus to the creation of short time credits to bridge temporary gaps, and the consequent better distribution of funds. Further indirect influences of progress in this direction would come after the more direct gains. More active effort to control money and prices, which is implied in any deliberate holding in suspense of unpaid balances, is very remote.

A number of dangers suggested by those who opposed this development can be recapitulated briefly. There was, for one thing, the frequently urged warning that the Bank should do nothing to undermine existing speculative and exchange facilities. It was generally recognized as impor-

tant to develop efficient foreign exchange markets to maintain smooth commercial and financial relations. Second, it was feared that a central organization might not be sufficiently flexible or have a large fund of information. Then again, it was contended that the centralization of functions, and the handling of these complicated cross payments on a large scale would put an unprecedented strain on the judgments and capacities of those in charge of the B. I. S. or any similar organization. It was urged that in a central clearing house the efforts made would have to be supplemented by expert services in each market and, therefore, that it was important to have all the agencies at the periphery strong and efficient rather than to build up new resources at a central clearing.

There is, in any case, a strong tendency at present to simplify and accelerate the flow of credits from country to country, to reduce physical movements of gold, and to prevent cross payments. This development needs conscious encouragement and there is no doubt that the Bank in Basle can help. It is even possible that one of its greatest services will come through the development of clearing centers in regions which have none as yet, or the B. I. S. may encourage Central Banks to make efforts along this line. On the other hand, this advance may be greatly assisted by the taking over of certain types of payments which are well adapted for B. I. S. transfer, notably inter-Central Bank clearings. There may result, from many-sided efforts, a concentration of technical services, or even of gold, in Basle. Events in 1930 and 1931, however, proved that it was not able to take over this work as a main task.

It is possible to summarize briefly the theoretical *results* of an ideal clearing system.

A. *Economy*:

1. decrease of gold transportation costs.
2. simplification of operations between banks.
3. fewer idle funds—saving of interest.

- B. The lessening of *foreign exchange* fluctuations:
 - 1. narrowing of the gold points.
 - 2. quicker transfer of funds through finance bills.
 - 3. a change in the relation of gold as a commodity and gold money, making the connection less immediate.
- C. Decrease in the spread of *interest rates* in different countries:
 - 1. quicker flow of short time funds.
 - 2. leveling influence on money rates exerted by the interest rates charged on balances due at the clearing house.
 - 3. indirect influence on internal discount rate policies.
- D. Effect on *money, prices and production*:
 - 1. increased velocity of circulation of money between countries.
 - 2. greater velocity of circulation within countries, smaller reserves.
 - 3. greater effectiveness of money tending to keep prices from falling, to stimulate production.
 - 4. decreasing gold production, less used for monetary purposes.
- E. Increase of financial *coöperation*:
 - 1. coördination of policy resulting from participation in an inclusive organization.
 - 2. a closing of the gaps between money markets as the result of the quicker flow of funds.
- F. *Political-economic* effects:
 - 1. greater security for all international debts.
 - 2. a decline in the influence of government on movements of funds.
 - 3. a realization of the destructive effect of war on financial machinery.

THE PROBLEM OF UNPAID BALANCES

Beyond the technical question of simplification and rationalization lies the fundamental economic problem. The critical point in any clearing plan is how an international system should handle uncovered balances. In the early years of the Bank there were no balances such as would be involved in the clearing of funds between different currency systems. Most of the clearing was, in fact, done in dollars or pounds. The rest of the transfers were executed immediately at exchange rates quoted in the various markets

where funds were desired. Thus the matter of unpaid balances was still one of theory rather than of practical experience.

This question brought the Bank face to face with the exchange problem, for an unpaid balance must be designated in some one currency. The value relation of the balance due and the balance available is subject to change between the time when it is incurred and the date of discharge. Even if the balances were payable in gold, the Bank needs assurance that gold can be had promptly and at a fixed price. Speculative and geographic factors make the ownership of gold at one point of different value from the ownership of the same amount of the metal at another. The Bank immediately becomes a sharer of responsibility for debts if it allows balances to remain unpaid. If, on the other hand, there is immediate and complete covering of all obligations the clearing facilities are restricted to a very narrow field.

It is probable that many who have studied the Young Plan and even some of those who helped in its formulation imagined the new international bank could free itself rapidly from the intricate foreign exchange problems which have burdened banks for many years.¹⁴ There was some reason to think, at first, that because of its central position and diversity of holdings and commitments this would be the case. It became evident soon, however, that such a view was both too simple and too optimistic.

The exchange problems of the B. I. S. were threefold. There was, first, the fact that the Bank must meet every legitimate request for a particular currency and so must make a careful distribution of assets. The second was hedging depreciation risks¹⁵ by a proper distribution of investments in different currencies. The third consideration was a lessening of strains attendant on the persistent trend toward certain currencies such as francs or dollars, a trend governed largely by factors outside the Bank's control.

¹⁴ See *supra*, Chapters VII and VIII, for a consideration of the Bank's exchange problem in connection with deposit and investment methods.

¹⁵ See Chapter VII for discussion of the guarantee of investments.

The summary of exchange protections given in Chapter VII indicated that, of a possible twelve ways of limiting losses, only two or three were of immediate practical importance. In fact the weakness of the Bank's exchange position became evident in September 1931. As long as values remained fairly stable the Bank was protected automatically by the very nature of foreign exchange; that is, since foreign exchange values are ratios, the decline in one is essentially the increase of all the others in relation to that one. Inasmuch as the Bank scattered its holdings over a wide surface, many losses in depreciated exchanges were offset automatically by gains in the others. This situation is more evident if one supposes a closed system with two currencies. In such a situation any exchange loss would arise from the disproportionate increase in the holding of the currency which suffers depreciation. As long as the Bank confined operations to exchanges fluctuating within the usual gold points, it can be assumed that this principle was actually in operation and the absence of losses during the first eighteen months is some indication that this was so.

However, even with these possible expedients at the disposal of the Bank there are still notable handicaps which limit the possibility of becoming a good foreign exchange center. Some of these are:

1. Location in a small market.
2. Communication facilities not completely satisfactory.
3. Deposits mainly sight or short term.
4. A persistent trend in the early period, towards pound and dollars, then, later to french francs.
5. Currency stability practically non-existent in the early years.
6. Small resources, and lack of political influence make it impossible to control fluctuations of any one currency.
7. The contraction of foreign lendings makes its efforts to redistribute capital of no quantitative importance.

The last three of these limits can be summarized under the one inclusive heading that the deflation and adjustment of the postwar period destroyed confidence all over the world. The normal risks were multiplied many fold by this fact.

The problem of balances, clearings and the exchange risk of the B. I. S. is not susceptible of dogmatic statement or clear-cut prognostication because each phase is dependent on every other. Balances would not be so difficult a problem if exchange risks were less. The exchange risk would be much less if an effective clearing were in operation, and a clearing is mainly hampered by the risk and technical problems in the handling of balances. It would be possible to break this circle by one bold stroke if there were no danger of political interference in economic life. Granted sudden incalculable disturbances, which would destroy confidence under adverse conditions, such an ambitious attempt would involve tremendous risks.

SUGGESTED MODELS

Various systems have been suggested from time to time as models for a B. I. S. clearing. The Gold Settlement Fund of the Federal Reserve was the one most frequently brought forward. Several others were proposed but were quickly found to be inapplicable to the situation the Bank faced. The British Empire clearing was mainly an extension of London's activities and was carried on in sterling. The German Giro system could be copied in many of its mechanical details, perhaps, but the distances were short permitting of overnight communication in all cases, while the reichsmark offered a uniform accounting unit. This was true likewise of the large city clearing organizations. The Scandinavian clearing system was something like that of the British Empire, but included a central gold deposit. Moreover, it had not stood the strain of postwar conditions, so it did not establish a useful precedent for the B. I. S. The *postal* clearings were convenient for small sums but the exchange risks were offset by such high rates, that it was not a useful model for commercial transactions.

The Latin Union, on the other hand, was not in any sense a clearing system. It was simply a legal approval of the monetary practice generally carried on. The five-franc

pieces interchanged between certain countries contained silver of the same value. It was a simple matter, involving practically no risk, to agree to accept them as interchangeable. This agreement broke down with the war, however. The B. I. S. could perhaps facilitate the establishment of such systems, in suitable regions, but no such cumbersome form of payment would be used in general commercial payments, and no clearing principles were used in this instance.^{1*}

Thus the analogy which was thought to be more useful was found in the Federal Reserve inter-district clearings. This system covered a wide territory. In the normal course of events, before the war there was an exchange rate between different American cities. Moreover, different rates of interest prevailed in the different districts, and even with the Federal Reserve System, the rediscount rates were not uniform. Before the Gold Settlement Fund was established, it made a difference to credit where gold accumulated and even though transactions were carried on in one currency they were not necessarily at par.

The aims behind the system were those which would be served by a B. I. S. clearing system. These were to ease the flow of capital and prevent the danger of sudden stringency in any region, to equate interest rates as far as possible and to lessen or eliminate exchange fluctuations between the member districts. Like the B. I. S., the Federal Reserve Gold Settlement Fund cleared only for the Central Banks of the district, that is the twelve Reserve Banks. It aimed to minimize gold movements and unify the payment system so that no artificial obstacles to trade would arise. Certainly the main idea in both cases was to serve the public interests.

Furthermore, the autonomy of each Reserve Bank within its own district, and its independence of the Board in matters of credit policy strengthened the view that a model could be found here for the B. I. S. The Reserve Board ob-

^{1*} It was finally liquidated in 1932.

viously worked toward the harmony and coördination of aims in the different regions, but it could not impose its will with regard to money rates. A comparison was drawn between this relationship and that of the B. I. S. to participating Central Banks. Unfortunately, however, the Bank could not exert an aggressive influence in any country even though it could indicate the best ways of working together and could build up a spirit of coöperation. If monetary policies were closely knit together by such means, there would be a more solid foundation for international clearings.

Despite certain likenesses, however, the changes inaugurated in the United States by the Gold Settlement Fund were out of the reach of any international clearing system. The American transfer mechanism practically eliminated gold shipments; it enforced par clearance for most exchanges of funds, and lessened the differences in interest. By rediscounting facilities, it made possible the ready shifting of capital from district to district. It was, in short, successful in its aims but only after overcoming serious obstacles. It was too much to hope that the B. I. S. could put into operation a comparable scheme since it had infinitely greater handicaps. The one most powerful factor in limiting the international possibilities was that the moneys dealt in were under different political jurisdictions. They were, thus, subject to different fiscal policies, and influenced by national boundaries which hemmed in gold and securities in times of crisis. The Federal Reserve, although confronted by many troubles, was spared this insuperable difficulty.

Thus material and political difficulties prevented a large accumulation of gold in Basle such as that in Washington. Legal differences tended to prevent the compensating movements of investments that served in the United States to offset balances. Variation in fiscal policy threatened the stability of money and capital in some countries, so that the rates of exchange varied widely. In the United States, on the other hand, any change in monetary policy affected

all districts alike, since the accounting unit was absolutely uniform. Moreover the attempt in the United States to knit together the different districts by economic and political measures prevented a wide spread between interest rates. In fact the very forces which tended to support the Gold Settlement Fund, worked to separate nations from each other and make more difficult the task of monetary coördination.

Thus the analogy broke down at the most important points. A Gold Settlement Fund was not immediately realizable at Basle. The earmarking of gold in scattered centers proved to be unsatisfactory in some emergencies, such as the exchange troubles of 1931. One of the more difficult policies of the Federal Reserve, the insistence on par clearing of checks, was quite out of the question with the B. I. S., for there was no way in which it could put pressure on member banks. The use of an accounting unit, such as the dollar, was denied, except insofar as gold weight might serve this purpose. Moreover, despite the independence of Federal Reserve Districts in the United States, the divergence of rediscount rates was a less significant influence separating districts than were other factors working toward a unified monetary policy.

In fact an ideal type of clearing system was realized in the Gold Settlement Fund. It was safe, quick, simple and effective. It was the result of very great financial efforts, of the unusual situation of a currency unified for remote banking regions, and also, in some measure, of the easy gold and credit situation prevailing in the United States. Once well established, the system was firm as a rock. It was midway between those régimes which dealt in one currency only, and the attractive concept put before the B. I. S. of a system linking together different currencies. Prior to the institution of the Gold Settlement Fund, New York dollars and San Francisco dollars were not the same—afterwards, they were identical for all practical economic purposes. The plans for a world clearing system were based

sometimes on the expectation of some kind of world currency, and sometimes, more naïvely, took no account of the influence of different national currencies.

For all the various reasons which have been indicated, measures taken in Basle could not assure safety of balances, nor the equivalence of funds in distant places. They could not make possible telegraphic transfers of gold unless it were gathered into a number of centrally located pools and, since gold must move and balances must be labelled in different currencies, par clearings were out of the question. Even in 1930 and 1931, however, speed of transfers could be increased. It was even feasible to consider plans for a gradual accumulation of gold at strategic points, earmarked for the B. I. S., and making possible a considerable volume of transfers on the same basis as those in the United States, but such a hope had to be postponed until more quiet times.

In the light of these hopes and theories, the steps actually made in Basle assume a new importance. Four different clearing measures were suggested or put into operation, in addition to the general studies, and analyses made by the clearing committee.¹⁷ They were, first, the so-called reparation clearing; second, the establishment of a Clearing of Central Bank funds; third, the "gold swap" system; and fourth, the suggested inauguration of exchange transfer accounts. Further plans under consideration but not actually put into effect would have increased the significance of each of these four measures. Foremost among these was the suggestion that the Central Banks should agree to keep with the B. I. S. ten per cent of their foreign exchange deposits. Other suggestions for uniformity of gold dealings, redistribution of capital, and for a uniform interest rate had a close bearing on the acceleration and simplification of international payments.

As has been suggested above, reparation clearing was a clearing of claims but not of currencies. For the most part the Bank, in conformity with the Young Plan, asked Ger-

¹⁷ See Chapter IX for the chronological sequence of these measures.

many to turn over her annuity installments in the currencies which were to be called for in order to meet later debt payments. This led to large deposits in dollars, and considerable holdings in francs and pounds. The shifting of the custody of these claims from Germany to the B. I. S., then to reparation creditors and finally to the fiscal agents of treasuries for later transfer to the United States treasury, involved little or no foreign exchange business for the B. I. S. The convenience of the system is obvious; the reduction of clerical work, the elimination of lost interest days, the ease and security with which every stage was characterized led to real satisfaction with the new machinery. Indirectly there were benefits in the increased assistance from the Central Banks, better knowledge and control of the deposits in various money markets.

All this, however, lay completely outside the region of an international exchange which would be called on to set debts in one currency against claims in another. The Reichsbank still entered the foreign exchange market in much the same way as before. Some transactions were eliminated but this changed the complexity and not the nature of war debts payments. In fact, the ultimate breakdown was almost as certain as if these conveniences had not been invented.

Central Bank transfers through the B. I. S. went further in the direction of the reciprocal interchange of funds. The system planned was widely approved and used at once for shifting funds. It was, in fact, a useful complement to the deposit business of the Bank. Out of such a method of discharging international obligations might develop with time a clearing very much like that which was at first thought of. The growth in influence would be dependent on the stability of B. I. S. deposits, and the extent to which the movements of funds offset each other. It is conceivable that guarantee of deposits at a minimum figure and a partial balance of interchanges would make it possible for the B. I. S. to progress to the further stage; that is, it might

allow temporary unpaid balances and a short position in some currency in the interest of a further compensation of claims.

The beginning of this arrangement in January 1931, was encouraging, but growth was stunted by the chaotic conditions prevailing during the next twelve months. Both deposits and transfers declined rapidly in the summer. For this reason, and because of the setup of this arrangement, there was no attempt to relate this to the further question of an exchange clearing in the narrower sense of the term. Balances were paid at once. The exchange rates were those obtained at, or through, the Central Banks and set in the outside market by the usual method of bids and offers. It was a convenience to the Central Banks that this was open to them through Basle but for the immediate present there was no appreciable influence on interest rates, or on gold movements.

The suggested "gold swap" system approached the problem from another angle.¹⁸ It endeavored to lessen gold movements by a better knowledge of where the metal was available. This would prevent roundabout movements, and would occasionally make a shipment completely unnecessary. The plan was put forward early in 1931. In response to an inquiry by the B. I. S. participating Central Banks agreed to furnish information regarding purchases and sales. The result was the tabulation in Basle of facts regarding some twenty-six Central Banks. The success of this measure would, to a certain extent, make the pools of gold, here and there, more generally available, lessen the attempts to hoard it, and might serve as a step in the direction of "gold settlements funds" in a number of different places. The attempt to make the interchange of gold more standard, in technique, was part of the same general policy. Unfortunately events in 1931 put a stop to practically all such efforts as then most Central Banks preferred to take their gold home.

¹⁸ Only one or two transactions resulted from this plan.

A further suggestion for an exchange transfer system proposed in 1931 aimed to go much further than these three other clearing methods in attacking the basic question of exchange rates. The proposal put forward in a letter to Central Banks was not put into operation, but remained merely tentative.¹⁹ The idea behind it was approximately this. Any Central Bank could have a deposit with the B. I. S. in any allowed currency with special privileges of converting it at once into any of the other listed currencies. The rate at which the conversion would be made was, according to the suggestion, the average between the high and low quoted by the Central Bank in the country to which the funds would be transferred, at a given time, say at midday. Ten currencies were designated because the Central Banks had guaranteed to rediscount suitable B. I. S. assets coming from other money markets. By this means the Bank could always obtain currency *at a rate*, in any of the ten markets. This rate would be close to that at which it would transfer the deposits on request from Central Banks. It might be able to make the shift without having recourse to the selling of assets from another market, if it had already a long position in the country of purchase, or if it felt justified in going short in that currency.

The advantages offered to the Banks which would wish to join this system were mainly four. The rate might be better than that obtainable through other means, and there would be a guarantee that exchange would be always available even in times of crisis. Moreover, it was assumed that the transfers would be quicker and also would be simpler to execute, since the B. I. S. would have assets available in a large number of centers, and if the movements back and forth were compensating to any extent, a real clearing would be established, and many transactions would nullify each other.

This exchange transfer system was the only proposal made by the B. I. S. which did not lead to concrete results.

¹⁹ See Chapter VII, pp. 135, 143, 148, 149.

There were two main reasons for this. One was that Central Banks do not supply exchange as a general rule. They leave this work almost entirely to the private banks. The second reason was that even when a Central Bank wishes exchange, it usually accumulates only one currency because the causes which lead to the need for exchange reserves almost always determine that one currency is preferable. The plan outlined by the B. I. S. in 1931 was aimed to meet a different situation, that is, the necessity of acquiring quickly a number of different currencies, or of moving rapidly from one to another.

There were other reasons brought forward for delaying the operation of this plan. It was alleged that the rates of exchange offered would not be better, in many cases, or even as good as those obtainable through the open exchange markets. Then, some feared that the rediscounting offer might break down in a time of crisis when it would be most needed. If this were true, the system could offer no security. As for the speed and economy, it was thought by some that these were already furnished by the ordinary deposit facilities the Bank offered, combined with the Central Bank clearings through Basle. The proposal thus was mainly valuable in stimulating discussion, and indicating what was wanted, and what was not, in the development of new machinery. The response to the plan added valuable information to the reports and studies already discussed in Directors' Meetings.

The idea that the Central Banks should guarantee to leave a certain percentage of their deposits with the B. I. S. was a concept that was related to some plans for readjusting the clearing and transfers to an improved gold exchange standard.²⁰ If Central Banks continued to keep a portion of their currency reserves abroad, or if there was any regularity with which they built up or employed foreign exchanges for any purposes, such an arrangement would greatly

²⁰ See unpublished report presented by Dr. Huelse at the General Meeting in May 1931.

strengthen the B. I. S., relieve the pressure on gold stocks, and make possible a gradual advance toward a world clearing house. Under these conditions, the depletion of deposits from one direction would mean the building up in another. Since the depletion would come from a debtor country, and the creditor would have its resources correspondingly increased, both changes would be reflected in the B. I. S. in such a way that they would offset each other.

The crisis of 1931 destroyed this scheme along with the gold exchange standard. The scramble for the gold, the depreciation of foreign exchange reserves, and the sudden movements of capital, made this guarantee impossible and unwise. It was a policy of the Bank to encourage Central Banks to keep their funds liquid and use them when needed. Moreover, the gold standard crisis distorted the meaning and reduced the volume of all the clearing work of the Bank, even including the formal services in the case of Reparation, which ceased for the time being. Both the technical bases of these early efforts, and the spirit which roused hopes of a sincere coöperation were dealt a serious blow. The practical work of the Bank was altered, and the early stage of experiment and study was interrupted by grave events.

The fruits of these early plans are of real value to guide further effort. It was clear that certain Central Banks preferred to pass their funds through the B. I. S. and others did not. It was evident that in some cases it was preferable to have exchange bought in the open market and not through Central Banks. Central Banks were willing to supply information, and glad to look on some clearing facilities as a useful addition to coöperation. In general they did not wish an independent clearing house, a monopoly of exchange or clearings, the accumulation of gold in Basle, aggressive interference in exchange or gold markets, or an attempt to let money markets hold international debts in suspense. In fact, Central Banks do not need many different currencies.

THE PROBLEM CLARIFIED

Theoretical studies conducted at the Bank during all these months contributed many facts. They clarified the assumptions in gold point analyses, indicated the impossibility of cutting out gold movements, distinguished between the economic significance of long and short fluctuations, and showed that any effort to postpone inevitable adjustments through clearing would have unfortunate results. The upshot of repeated conference and investigations was that the Bank had to move very slowly in instituting a clearing house, that many technical points in the transfer of funds could be improved, and the collection of facts and opinions at the Bank would be of service whether or not the Bank itself went further in this direction.

It became increasingly clear that in the organization of a world clearing there would have to be ample exchange protection, and that extreme caution must be observed as to the holding in suspense of unpaid balances. Commodities such as gold or goods were the only means of payment which have universal acceptability. No attempt to change this will be effective. In fact, for the immediate future no international currency except gold can be made a basis of international interchange. If, at some time, the plan of clearing a large part of the world debts through one center should be put into effect, it is probable that interest at a high rate would have to be charged, and some claims on gold as a possible offset to debts would be essential.

Thus, many of the early hopes had to be rejected one by one. An international money was seen to be out of the question. A Gold Settlement Fund at the Bank was considered unfeasible. The stimulation of capital backflows to equalize interest rates and supply counterparts for debts became ever more difficult to realize. Confidence and hopes for stable exchanges melted like other myths, during the troubled times of reconstruction. Political interference

with economic life destroyed many of the fundamentals of Central Bank coöperation.

Fortunately, as the difficulties in the way of a clearing system became more formidable, the need for this particular kind of development began to seem less urgent. It became obvious that fundamental economic factors controlled exchange rates and that the fluctuations due to purely mechanical and occasional factors were comparatively small. Moreover, these fluctuations could be handled by existing agencies, supplemented by the B. I. S., whereas the others, due to such causes as crop failures, tariff barriers, revolutions, industrial collapse, and war debts, could not be greatly influenced by the systems of transfer. Finally, confidence was bound to strengthen the existing constructive forces affecting currency values, if these basic conditions were good, or would weaken the industrial and financial structure if they were essentially unfavorable.

Gold points will remain. Shipments will continue, clearings will go their roundabout course over the face of the earth for many decades. Basle will be one of the listening posts. It will become increasingly important as a laboratory of method, a point on the main lines of communication, and a deposit bank for Central Banks. Eventually, in some far-off time, Central Banks may guarantee deposits in the B. I. S. in order to enlarge their clearings, gold may be accumulated, and exchange and interest rates influenced by the shifting of B. I. S. funds. It is stimulating to speculate on these possibilities, while we weigh the past achievements of the Bank. Somewhere between the modest beginning, the sincere exploration of theory, and the gilded hopes which will never be realized, the Bank has a rôle in aiding international payments.

CHAPTER XII

REPARATION THEORIES AND AIMS

THE reparation problem is a special aspect of the work of the Bank. It was important in the origin, for without it the Bank would not have been created. It was important in the early weeks when the Bank had to develop the routine procedures necessary in handling annuity payments. It was important throughout the first financial year because it was directly and indirectly the source from which a considerable part of the Bank's resources were drawn. And it was of significance because it led to the crises of 1931, in which the Bank was so actively concerned.

It has seemed wise to isolate the reparation phases of the Bank's work from those which are more especially banking matters. Thus the deposit, investment, credit, and clearing policies have been discussed first. This separation of the major and minor interests corresponds to the organization within the Bank itself and also to the general policies which the Directors sponsored.

A consideration of the part which Reparation played in the development of the Bank must include a brief survey of events since 1929, an analysis of the political and economic forces in Germany, and then a detailed description of the Bank's work under the Hague Agreements in executing specific duties in connection with German payments.

INTERRELATION OF ECONOMIC AND POLITICAL INFLUENCES

For twelve years, political fears and financial instability caused distress in Europe, while tasks which would have been troublesome even in prosperous times became increasingly difficult. Wealth had been destroyed, and whole classes

of the population impoverished. New boundaries, a changed industrial technique, and unreasonable profit expectations made normal economic relations impossible. Under these conditions the more important European countries had to weigh down their credit machinery with war debts, reparations, and increased taxes, and at the same time, press on external markets for larger exports.

Over and over again during this stormy period the economic life of nations seemed to move rapidly down a steep incline toward destruction. Efforts to stop the terrifying descent seemed temporarily paralyzed; futile gestures merely emphasized the rapidity of the fall. Then just as the situation seemed hopeless, a tremendous exertion of force would hold industry and finance from destruction. These efforts incited temporary confidence but, once relaxed, the reaction set in with distressing certainty.

Three times the German economy seemed doomed. Three times hastily prepared measures stopped the disintegration and prolonged conferences evolved ingenious safeguards. The years 1921, 1923, and 1931 marked the blackest periods, but other serious times of trial occurred between these dates. Each solution was followed by renewed confidence, and then by another wave of despair. The reasons for these difficult times are various. Germany was not alone in suffering from the strains of postwar reconstruction, nor was she free of all blame for her own difficulties.¹ Internal and external forces alternated to strain her political and economic systems to the breaking point. Moreover, foreign help was given at those times when foreign demands had proved excessive. Germany was not allowed to slip over the brink, even though she was not relieved from heavy burdens of debt.

One of the measures devised to preserve the stability of Germany was the Bank for International Settlements. The Germans hoped that by joining in this institution as an

¹ See Parker Gilbert's *Report* (Berlin, May 21, 1930), p. 2. *Special Advisory Committee Report* (Basle, Dec., 1931).

equal, by the normal and coöperative working together of Central Banks, much might be done to improve credit and inspire confidence. Nevertheless, opinions in Berlin differed as to the value of the Bank and, in deference to certain sound criticisms made, one must admit that most of these hopes were disappointed despite the successful clearing and transfer of reparation payments during eighteen months of the world economic crisis.

From the German angle, these clearing functions of the Bank were of considerable importance, even though this fact was not widely admitted. It relieved the Reich of the expense of the Commissioners' organization in Berlin; the cost of clearing through the Bank was less; the exchange transactions were somewhat easier. Other services of the B. I. S. not generally recognized, but none the less important, grew out of Central Bank coöperation through Basle, and developed facilities to aid Germany in understanding the creditor point of view. The unfolding of events revealed both capacities and limitations. Some of the drama was played in Berlin, some in Washington, Paris, and London, but a number of significant episodes took place in Basle.

Certain aspects of Reparation indicated above are economic, and with these the Bank for International Settlements was concerned; others are political and lie outside its scope. In 1930 the B. I. S. was called a "Reparation Bank," and was judged on the basis of what it could do to help Germany meet the Young Plan payments. For instance, the increase of German exports, the easing of transfers of money, the "investment trust" possibilities of the Bank, received much attention. These were indeed economic questions but it soon became evident that many political obstacles stood in the way of such functions.

In other words, despite the efforts of the Young Conference the economic aspects of Reparation were still subordinate to the political. The efforts to change this situation resulted in the Bank. Moreover, the very statement that the Report was to be considered as a "complete and final settle-

ment”^a indicates the hope that payments would be absorbed into the normal currents of capital flow between countries, that they would not call for further conferences, nor be the subject of political campaigns and international jealousies. It is quite possible that the attempt would have succeeded if the world had continued to be as prosperous as it was in 1928 and 1929.

Hopes for a real improvement were based on the fact that the annuities named in Paris were lower than former demands and the machinery for executing the obligations was improved. Moreover, the withdrawal of the foreign Commission was intended to eliminate the visible signs of tribute. If the negotiations had not brought an immediate wave of disappointment, and had not been followed by the severe economic depression, other issues might have taken the place of Reparation on the front pages of the German newspapers. It is clear that the removal of the payments from the economic to the political spheres is dependent mainly on their size relative to normal international transfers and internal taxation. If the sums are so large as to form a considerable part of the budget, and to raise frequent tax problems, they become very quickly internal political issues that stir the general public to intense excitement.

For instance, in Germany special economic measures, such as the reduction of the salaries of government employees,^a have roused universal protest, and have become the bases of political agitation. The most moderate government may be forced to press the issue in its external policies, and the matter becomes a subject of constant debate and uncertainty.

There is, of course, no cut and dried rule as to when economic issues become political. In the case of Germany, for instance, satisfaction in the matter of disarmament might at one time have reduced the relative importance of reparation payments. An example of this kind of influence was the temporarily favorable reaction to the Geneva pronounce-

^a *The Young Plan*, Cmd. 3343, p. 3.

^a See Government Plan, *Frankfurter Zeitung* (Oct. 1, 1930).

ments on the minorities in Poland. This allowed the postponement of the payments question for some little time. Many similar events in the postwar period proved the close relation of political and economic desires.

The result was that certain aspects of the matter lay entirely outside the scope of the B. I. S. Statesmen were busy with a succession of critical decisions. A typical instance of the problems involved occurred when the public realization that new special taxes and economies must be put in force led to the large vote polled by the extreme parties in Germany on September 14, 1930, and then, to the flight of capital in October. In such episodes the B. I. S. was relatively powerless to help. Within Germany, protective measures, the shortage of capital, high interest rates, unemployment and distress, came with a new wave of despair in 1930, and these difficulties in turn were greatly aggravated by the world depression.

Outside Germany, the political aspects of the question developed mainly from the fight for export markets, the increase of tariffs, and the growing mercantilism and gold accumulation in a number of countries. These tendencies made it more difficult to find relief at the time when Germany's political situation was extremely delicate.

Both the nature and aims of the Bank made it powerless to remove such causes of disturbance. It could not remove the threat of revolution hanging over some countries and preventing the normal flow of capital. It could offer no special hopes to Germany to counteract the nationalism and anti-foreign sentiment which gained ground rapidly during this time.

Moreover, all these tendencies acted on each other in such a way as to keep the reparation question in the foreground and to enflame resentment against those who were considered to have made Germany's task more difficult. The magnitude of the disturbance was such that the palliative efforts of the Bank, such as investment in Germany and the easing of transfers, were ineffectual and confidence could

not be restored until political tendencies became more encouraging.

Many volumes have been written on the reparation question and the various conferences and committees. They have given to hundreds of persons a comprehensive understanding of the question. Later, summaries will undoubtedly bring together the most valuable parts of this material and interpret it in the light of ultimate decisions. There can be no attempt to do so here. The matter must be considered, of course, because of its relation to the Bank, but only special aspects will be chosen for comment because of their close bearing on the Bank for International Settlements. Certain events, for example, are of importance, because of their effect on foreign exchange and credit, and the work of the Bank as Trustee is an indication of later work which may be undertaken.

THE TRANSFER PROBLEM AND THE REVOLT OF GERMAN YOUTH

The rapid evolution of events made up a stirring drama. The two currents which turned the tide against Germany again and again are distinct in their nature and origin, even though the streams united in times of great stress to form one almost overwhelming force. On one side, there are the strictly economic difficulties which go to make up the "transfer problem." On the other side, there is the spirit of youth in Germany revolting against the burdens which the war had laid upon the nation. *Transfer* was, in its essence, the foreign exchange problem. It became urgent in this period because the inelastic demands of the German government for foreign funds brought irresistible pressure on the currency, the value of which fell in other markets because of the large number of marks offered for sale.*

In view of the many disturbing forces, it is almost useless to speculate on the possibilities of transferring reparation payments under ideal conditions. These conditions were

* See *infra*, p. 317 and following.

far from being realized. Even though every important money center made efforts to protect the mark exchange, once the difficulty was clearly realized the distortion of normal payment conditions was too great. German credit, in the strict sense of the word, existed only for a brief period just after the Dawes Plan was put into operation, when full transfer protection was given to Germany. With this protection gone, there developed a persistent weakness of the mark in 1931, and an almost complete freezing of credits in Germany, a definite proof of the reality of the transfer problem.

Different versions of the "transfer theory" vary greatly in value to international finance. Thus many of the general ideas throw light on the causes of postwar currency troubles and the economic depression. Others are significant mainly in showing how national desires can build themselves logical support, while some imply a vague confidence in a natural equilibrium, not to be justified by the prolonged distress in all countries. This confusion arises partly because the German case does not furnish evidence for transfer difficulties under all conditions, but only when payments of very great size are required of a country weakened in its material wealth and deprived of hope and courage. In fact, the difficulty of transfer is proved for a group of possible cases, but by no means for all likely instances.

Such abstract reasoning as is usual in analyzing international payments can be applied to the German situation, provided the hypothetical case is elaborated and intangible factors given their full share in determining conclusions. Further than this, it is possible to proceed from the abstract hypothesis, through the actual case, to some idea of how other specific cases should be handled. For many reasons it is important to know what extra burdens can be added to the normal credit transactions between nations, and this possible increase can be judged only after an examination of the interaction between technical and monetary difficulties, as well as the human and political forces.

POLITICAL FORCES

It has been generally recognized that political life is very important in Germany. The psychological factors which were to prove so powerful in the economic world were very articulate there. It is true, that many underestimated these forces in the German situation, mainly because the expressions of revolt came principally from younger men. Observers did not appraise properly the growing power of this section of the voters. They sometimes forgot that all under thirty-five years of age in 1930 considered themselves to be the victims of a long series of catastrophies over which they had no control. They had suffered the war, defeat, inflation and unemployment. They saw little opportunity for personal advancement, and no normal outlet for their energy. The result was a deep smoldering resentment, and energies running riot because the normal channels were blocked. Here was, therefore, plenty of political capital and a body of motives to unite the young in revolt.

Thus the key to the German situation lay in the attitude of its young people. To them the honor of the Reich and the necessity of complete independence of action had overwhelming importance. They were willing to risk much for a cause. They were quick to insist that credit in the financial markets of the world should not be bought by political humiliation. They found in Reparation a scapegoat, and the depression was easily blamed on the Treaty of Versailles and the burden of debts. In illustration of this fact, some of the major events growing out of this revolt will be outlined below to indicate the results of this internal conflict.

In contrast to the political manifestations of difficulty, the transfer problem as usually outlined, is extremely abstract, but it seems less so after both aspects of the struggle have been described. In fact, these two widely separated lines of force drove German economic life rapidly forward toward a surprising destiny. Paralleling these two influ-

ences, there were, on the one hand, the wild enthusiasms of Nazis and Communists and, on the other, the mass of technical factors working for and against the mark on the exchanges. Only the briefest sketch can be given here, for though they concerned the Bank directly, they constituted only a minor part of its activities.⁶

An outstanding tendency in German political life since the war had been a movement toward dictatorship, developing mainly within the framework of the constitution. The changes of government in 1930 paved the way, while the gains of the Right and Left in September forced the issue. Behind these particular political manifestations lay all the broken hopes of 1929 and earlier years.

OPINION AFTER 1929

Even the rather cynical German public opinion had expected progress in 1929.⁶ The Bank had been hailed by some as the solution of the reparation question. Many looked upon it as an agency to increase German exports without in any way interfering with the commercial aims of creditor nations. It was thought that it could protect the mark exchange, for the Bank could invest in Germany. The more optimistic writers even went so far as to expect that a fraction of Germany's payments would be paid out of Bank profits, and saw ways in which the annuities would be absorbed in the growing prosperity which the Bank was to further and in which it would share. Enthusiasm for the new institution was aroused by the hope that it would remove disturbing factors and allow constructive forces free play. This was the point of view in some quarters in 1929. Thus, even though Germany was disappointed in Paris, even there, the disappointment was tempered with expectation of some help from the Bank.

Then emphasis tended to shift.⁷ The term *Reparation*

⁶ See *infra*, the outline of political events and opinions, pp. 302-311, and II, the transfer theories and conclusions, pp. 311-337.

⁶ See also comments in Chapter I.

⁷ André Pépy, *Le Plan Young* (Paris, 1930), p. 104.

Bank disappeared from the newspapers. The word coöperation appeared oftener. Various useful measures for Central Bank collaboration were pointed out. The institution created in Paris was shown to be the fulfillment of a long-felt need. The Statutes of the Bank when they appeared in 1930 contained the word *Reparation* only four times,^{*} whereas the suggestion of coöperation between Central Banks appeared in many articles; economists began discussing the possibilities of development and investment schemes, of monetary control, the economy of gold, and other subjects made urgent by the general depression. Thus, just when the importance of Germany's problems to the world at large increased, the interest in them slackened. Moreover, the political guise in which these problems presented themselves created strong motives for the Bank in Basle to emphasize the other part of its tasks.^{*}

This tendency was not received with complete satisfaction. Germany was suffering from her own peculiar difficulties and the world depression as well. She was forced to reduce expenditures when the cost of social insurance was rising, to increase exports when tariffs in other countries were being raised, to face a growing spirit of nationalism in Germany when other nations were hesitating over disarmament. The one constructive feature in the Young Plan, from the German point of view, was the Bank. Here seemed to be a slender basis for hope. When this led to disappointment, there was an increase in resentment against those who had promised relief and then disclaimed active responsibility.

Many had overlooked the fact that the committee that met in Paris considered all aspects of Reparation and thought their settlement was final. The men who came to Basle were not given a direct mandate to ease the German situation. There was obviously a gap between the implica-

^{*} *The Statutes*; see Appendix.

^{*} President McGarrah, address (Paris, Feb. 12, 1931); see Guaranty Trust reprint.

tions which had been drawn from the Young Plan and the workings of an International Bank such as the Germans found in operation in 1930. The Berlin view was very critical and even if the whole truth was not widely known, at least there was some ground for this surprise.

It has been noted that the Bank was given a dual aim.¹⁰ The question as to whether there was a fundamental conflict between the two cannot be answered dogmatically. Certainly there were some who thought the payment of large sums as Reparation would actually hinder coöperation and the solution worked out in Basle for the sake of effective operation does not clear up the fundamental difficulty. It was, in fact, possible for those who ran the Bank to discharge all their functions with regard to payments loyally, without relinquishing plans for wider efforts. On the other hand, one should recognize the importance of the use of reparation deposits to supply the B. I. S. with funds.

Complete separation of Reparation and Coöperation was not possible. Germany was an important unit with which the Bank must deal and whose interests it must serve. The payment of large sums, through the Bank, was a major aspect of the German situation. The Bank was bound in the interests of coöperation and constructive banking to help German credit and exchange. Within the limits set by its resources it did so, constantly. For two reasons, however, this accomplishment failed to satisfy German desires. One was that the efforts of the Bank in this respect were not given wide publicity. The other was that the Bank did not, or could not, carry out some of the more ambitious suggestions in the Young Plan.

In the first place, the Young Plan envisaged an institution that would promote world trade by financing large projects, particularly in undeveloped countries, and thus serve the interests of German trade.¹¹ Then in the second place, the Plan indicated that real coöperation called for a

¹⁰ See *supra*, Chapter I.

¹¹ *The Young Plan*, Cmd. 3343, pp. 9, 11, 31.

reduction of obstacles to the free working of economic forces. These two hopes were grievously disappointed. The Plan could not, of course, bind the nations to a liberal policy, but it implied efforts in this direction, either through the activities of the Bank in particular or through other efforts of the nations subscribing to the Plan.

A third reason for claiming that Germany had been deceived by false hopes was that the financial relief offered by the reduction of annuities was wiped out by the rapid fall in prices that took place in 1930. This meant that the monthly payments were equal to or greater than the Dawes schedule in terms of gold or goods. Thus, in three respects, the Young Plan seemed to bring disillusionment—it did not extend Germany's export trade, it did not lessen tariffs and other international obstacles, and it did not offer as much direct relief as its authors had intended.

Germany had counted on these things and more from the Paris conference. The first offer which they made was much below the figures finally accepted.¹² While it is true that they would naturally offer much less than they might expect as a final settlement, nevertheless, the way in which the offer was made and the attitude of the press indicate that they hoped for extensive gains. The flight from the mark, a very alarming episode during the course of the long negotiations, indicates disillusionment in Germany as well as bearish sentiment outside.¹³ It is probable that they would not have been willing to have revision at this time if they had not expected larger concessions although a categorical statement is unwise in so complex a situation.¹⁴ A final agreement was made possible partly by the hopes which Dr. Schacht entertained that there would be an increase of exports through the new Bank. This might, in fact, have been possible had not future economic troubles,

¹² *The Times* (London, April 18, 1929), p. 16; see *supra*, Chapter II, *The New York Times* (April 13, 17, 20, 1929).

¹³ Reichsbank Report, 1929 (Berlin, Feb. 11, 1930), pp. 3, 5. Some said this was engineered from Paris to bring Germany to terms.

¹⁴ J. M. Keynes, *New Republic* (May 1, 1929), pp. 296, 297.

combined with limitations placed on the Bank's activities effectively stopped efforts along this line.

While attention was being focussed on this matter the whole complexion of economic life altered. All nations were faced with declining production. This was first observable in the United States in July 1929, although it was not generally recognized for several months. The recession in other countries came a little later. They were all faced with the political and economic necessity of trying to preserve the standard of living, export trade, budget balance, and social stability. In so doing they resorted to measures which intensified national rivalry and ill feelings.

THE SEQUENCE OF EVENTS IN GERMANY

Then it must be remembered that negotiations at the Hague in August 1929, brought further disappointment to Germany.¹⁵ The spirit of antagonism which came to the surface there lessened the prospect of any concessions in the interest of German export trade. Moreover, the bargaining led to the renunciation of a small sum which was to have gone to the Reich. This sum had at first been allowed to Germany in view of the overlapping of the Dawes and Young Plans.¹⁶ Further adjustment of the conditions governing deliveries in kind also brought some loss to Germany. Changes in the unconditional and conditional payments, though of small consequence, served to underscore the necessity of giving way. The discussions regarding property settlements, and the evacuation of the Rhineland, were all conducted in a spirit of distrust. The result was that the German desire for the departure of French troops probably led to disadvantageous compromises and some loss of prestige.

Then, a month later, in October 1929, the struggle for and against the acceptance of the Plan grew very heated.

¹⁵ Gustav Stolper, *Der Deutsch Volkswirt* (Sept. 6, 1929), p. 1655. Dr. Herman Lufft, *Ruhr und Rhein* (Feb. 28, 1930), p. 275. Dr. Reichert, *The Dawes Way* (Oct.-Dec., 1929), pp. 201-205.

¹⁶ See *supra*, Chapter II.

Negotiations at Baden-Baden did not satisfy Germany, but there were no outstanding modifications of the Plan to be singled out for serious objection. The main difference of views was over the question of the scope of the Bank. The question of location was compromised. The changes in the Plan which resulted from casting it into legal form made it somewhat plainer than before that the wide hopes would not be realized.

Further doubt was introduced by the informal suggestion that Monsieur Quesnay be made General Manager. This was taken by the Germans to mean that the principal creditor nation would make efforts to dominate the Bank. This incident was not widely known in Germany but it may have been a factor in stimulating increased agitation against the Plan, which led to the Hugenberg referendum in December when the parties of the Right tried to defeat the Plan.¹⁷ The subsequent popular vote, however, supported the decisions of the Paris and Hague conferences, and the possibility of acceptance seemed brighter than it had been before. Feeling against it continued to run strong, but the view expressed by Dr. Lotz¹⁸ that it was the lesser evil as compared with the Dawes Plan, was, probably, a representative opinion. The resistance of Dr. Schacht, President of the Reichsbank, however, became constantly more articulate.

In the next month, January, the discussions were seriously troubled by the new Schacht protest. The successful conclusion of the conference was threatened for a few days. Finally, Dr. Schacht's approval of the Agreements as President of the Reichsbank was secured under pressure from the government. This was evident when Herr Curtius, who was then the Minister of Foreign Affairs, said that a consortium of private banks would be organized to participate in the new Bank if the Reichsbank persisted in its objections.¹⁹

¹⁷ Less than 6,000,000 votes were cast in Germany in favor of this referendum.

¹⁸ Dr. Walter Lotz, "Reparationen, Dawes Plan, Young Plan," *Neue Wirtschafts Rundschau* (Budapest, Feb., 1930), p. 24.

¹⁹ This would have corresponded to the arrangements in the United States and Japan.

A few weeks later, on March 7, Dr. Schacht resigned as President of the Reichsbank, and in the months to come as a private citizen made many speeches against the Young Plan.²⁰ In some quarters he was regarded as a willing leader for the group of Germans who wished to repudiate the whole agreement. It should not be assumed that he was motivated by personal ambition in this but there is no doubt that his attitude strengthened the movement for revision. It is also true that he honestly felt that the interest of the nation lay in this direction even though risks were involved. In any case his speeches and writing in Germany and abroad tended to focus the steadily growing discontent on the Young Plan.

On March 11, Dr. Luther was elected President of the Reichsbank. On March 12, the Reichstag formally approved the Young Plan. A number of other events followed which had a bearing on the German point of view. A new defense law was passed on the 19th of the month. At this time it was considered advisable to raise the bank rate from 5 to 5½ per cent (on March 24). Finally, on March 27, the disagreement over social insurance policies forced the resignation of the government, and Bruening succeeded Mueller as Chancellor. For the moment it looked as if resistance to the Plan had subsided, and just at the time when the new Bank was being organized, there was a more conciliatory attitude.²¹

Unfortunately the evacuation of the Rhineland on June 30 was marred by a number of tragic happenings. It was accompanied by violent demonstrations on the part of the Separatists, leading to the destruction of life and property. This roused the nationalists to counter riots. The collapse of a bridge at a midnight festival in Coblenz cost many lives, and although it had nothing to do with the political aspects of the event, the whole impression was that the thirtieth of June was a time of mourning rather than

²⁰ *The New York Times* (Mar. 8, 1930), p. 7.

²¹ See *supra*, Chapter III.

rejoicing. There were accusations that the riots were stimulated indirectly by the French, and the longed-for event was in reality a tragic occasion.

The economic crisis, meanwhile, was increasing the strain at every point. On July 18, 1930, the Reichstag was dissolved again as the result of disagreements on financial proposals.²² The Premier called for a new election, hoping that it would increase the strength of the middle parties in Parliament,²³ and aid budget reform. Unfortunately this expectation proved to be unjustified. The results of the election were to weaken these groups, and to present the Premier with an increasingly difficult task. Foreign opinion continued to ignore or to underestimate the importance of the political trend in Germany and was destined to have a rude awakening.

Astonishment and apprehension greeted the result of the September 14 elections. It was as momentous for Germany as the British elections (October 27, 1931) a year later were to prove for England. The moderate parties lost a score of seats in the Reichstag; the Communists gained 22 and the National Socialists gained 95 seats. It looked for a while as if no majority would be possible. It at once stimulated nationalist ardor, and Communist opposition. The center parties and the other moderate groups were wedged between the two extremes. On several points the Right and Left agreed, and one of these was opposition to the Young Plan. Anti-foreign sentiment grew. National Socialist leaders urged their followers to cast off the dependence on foreign capital, even if it meant a decline in standard of living.

There were in Germany at least seven million people who took extreme views on national policies. Nationalist propaganda, guided by Hitler, and speeches of Communist leaders called the Plan "slavery." In short, they preferred to risk

²² *The New York Times*, Reichstag dissolved July 18, defeated July 16.

²³ Mildred Wertheimer, *Foreign Policy Information Service Reports* (Sept. 3, 1930), p. 3.

the complete withdrawal of foreign short term capital rather than meet all the political and private obligations which had piled up such a huge debt for Germany. The prevalence of this idea can best be accounted for by the fifteen years of hardship which had been experienced. Little satisfaction had been secured, either in diplomacy or in business, and the growing depression made patience extremely difficult.

One good effect came out of this surprising vote. It awakened a new sense of responsibility in the middle parties. They realized that the country was menaced by an uncompromising foreign policy and violent internal changes if they did not rally to the support of the government. They put aside the minor issues which separated them in normal times and supported the Bruening government through the critical months to come. This favorable factor was not evident soon enough to reassure the general public in Germany and abroad. The flight of capital in the autumn of 1930 was the worst since 1923, except for a very brief period in the spring of 1929. The disturbance to economic life was considerable. The Bank for International Settlements used its available resources to stem the tide but the damage was none the less real and the Bank received little credit for its actions.

From this moment on the question became not one of *whether*, but *when* and *how* the reparation controversy could be opened up again. A technical basis for reconsideration was thought to exist in the change in prices and gold values which was a part of the general crisis. There were grave doubts, however, as to the expediency of a move by Germany. Some thought that it would be better to await a sign of change in United States policies, or perhaps some indication that European creditors were ready to sacrifice a part of their claims in the interests of economy and progress. The instability of the German political situation constituted a menace for the rest of Europe and, therefore, the arguments for opening up the discussion were impressive.

Fortunately, however, the year 1931 began with a few weeks of comparative calm so that the government was able to postpone the issue.

Opinion in responsible German circles was summed up in the phrase "we stand upon the Young Plan." This meant, usually, the Plan as a whole—not only the definite requirements but the vaguer proposals. It was claimed that the obligations placed on Germany were closely associated with the obligation to lessen trade barriers. Thus it was customary in Berlin to quote the conclusion of the *Report* that the continuance of "one-sided economic discriminations" would, if continued, raise serious obstacles.²⁴ There were some who claimed that the Statutes were narrower than the Plan, others, that the Bank had neglected to do what it could. A few urged that political pressure should be brought on the Bank so that it would go further and do more for German affairs. There were indeed two tendencies in 1930. The more insistent critics pressed for a revision of the whole agreement. Others claimed that it was still possible to use the Bank and, through it, to find means for helping Germany.

THE YEAR 1931

In the dark days of December 1930, all the proposed economic measures seemed to end in privation, higher taxes, and lower wages. No hope was apparent unless it came from outside. Then things took a turn for the better in 1931. The winter had been warmer than usual, a fact which mitigated the distress. Some slight political satisfaction was won at the Council meeting in Geneva in the discussion of the Polish question. The solidarity of the center parties had been gratifying. The government decided to postpone the issue a little longer.²⁵ Bruening's speeches in January and February indicated lessened tension in the Reich, and more calmness in all parties.²⁶

²⁴ *The Young Plan*, Cmd. 3343, p. 31.

²⁵ See *supra*, Chapter IX.

²⁶ *Frankfurter Zeitung* (March 1, 1931).

It was clear to those who were concerned with these problems that a number of possibilities lay before the government. The first and most obvious was to ask for a moratorium under the Young Plan. This would not bring any immediate financial relief, however. It only provided for a partial postponement of transfer and a later reduction of collection within the country. The difficulties during the winter were mainly collection rather than transfer and in this the Plan provided no way of gaining an immediate respite. The second mode of action was the calling of the Special Advisory Committee.²⁷ Here again lay difficulties which made it unsuitable for the existing need. It was assumed that this would mean an investigation by a group of experts and there was considerable likelihood that criticism of internal politics would arouse to greater intensity the existing resentment against foreign interference.

A third possibility was the attempt to arrange a political conference, irrespective of and outside the Young Plan. This would imply the treatment of a number of political and economic matters and would be dependent for its success on concessions and bargains. It was known that such a step was contemplated, but the feelers put out by Germany were answered unfavorably, not with direct replies, since there was no direct question, but the statements made were emphatic enough to show that if the idea were carried further it would meet with rebuff. The fourth possibility advanced by Dr. Schacht and others was the immediate cessation of payments without waiting for international adjustment of claims. This was not favored by the government, nor by a majority of the citizens in the early part of 1931. They recognized the acceptance of the Young Plan as involving some responsibilities on their part, and feared that the effect on credit would be disastrous to Germany. The fifth possibility, and the one adopted, was to work and

²⁷ Later events proved that the Committee did not concern itself with internal problems.

wait, hoping that there would be a more favorable turn of events.²⁸

Having abandoned this possible mode of relief, German politicians turned in other directions. The result was the announcement on March 22, 1931, of the preliminary conversations for the establishment of a customs pact between Germany and Austria.²⁹ Although this was at once pointed out in the European Press as an important event, its full significance was apparent only later. Resentment and suspicion became gradually apparent, and mounted to a wave of such proportions in France, that the whole future of finance was altered.³⁰ The incident which gave this feeling diplomatic and economic force was the collapse of the Credit Anstalt, and the subsequent rescue work, freezing of credits, collapse of the gold standard in England, and chaos and readjustment in months to come.

Thus, matters stood in April 1931. There was a strong current of objection in Germany to the Young Plan, but it had not gathered enough force to break through the doubts and fears that the majority entertained. Moreover, the Reichsbank was in a fairly strong position according to outside appearances, so the transfer argument could not be invoked. The additional facts that German export trade had suffered less than that of most countries, and that the reparation creditors were facing grave budget difficulties led to caution. But events rushed on, bringing one swift crisis after another. The reparation question was thrown open with unexpected violence and a moratorium arranged in the next few weeks.³¹

The preceding outline of events in Germany shows the gradual building up of a new political organization, the National Socialists, and the growth in power of some of the

²⁸ The second "Lee, Higginson" credit was arranged in February 1931.

²⁹ See *supra*, Chapter IX.

³⁰ Paul Einzig, *Behind the Scenes in International Finance* (London, 1931).

³¹ This later period will be described in Chapter XII.

older extremist organizations, notably the Communists. Both repudiated the spirit and forms of the modern banking world as they understood them. Both hoped for bold measures, and a disregard for former engagements. The Nazis frankly wished a dictatorship, drilled their young followers in military fashion, had secret gatherings, and stimulated violent demonstrations. Their activities worried the German investor as well as the foreign capitalist, kept the situation unstable, and fanned the flames of revolt. They made the process of governing difficult, the Young Plan less secure, and hampered indirectly the efforts of the B. I. S. to assist in German recovery.

THE BANK AND REPARATION

The things the Bank could not do were more conspicuous at this time than the things which it could accomplish.²² Its limitations dampened the hopes of some of those who had stressed the Reparation side of its work. The Bank could not influence political factors such as tariffs or disarmaments and the Polish question. It could not directly modify economic factors such as production, markets, exports, and the price level. It could not support the Young loan. Moreover, its influence on capital movements, interest rates, and the exchanges was very slight.

On the other hand, the services the Bank rendered were occasionally overlooked in the general confusion and controversy. It was hard to find a calm unbiased view. Its functions as reparation agent and clearing house were ably fulfilled. Its work as trustee and administrator of the different loans was efficiently carried out. Its assistance in the exchange crisis of 1930 was promptly rendered. Its investments, its moral influence, and its later furtherance of joint credits for Germany amply justified its existence. It did much to sustain confidence in Germany, and to help those who were influential in government circles in forming a policy for national action in the reparation matter. Its

²² For the clearing of reparation payments see Chapters X and XIII.

indirect help through the work of simplifying exchange and transfer dealings between the main money markets reinforced its position as a central influence in European finance.

Complete reconciliation between the hopes mentioned above and actual accomplishments is not possible. The Young Plan proved to be ill adapted to the crisis that broke on the economic life of nations. It became increasingly clear as conditions grew worse that a "long run" instrument, the Bank, had been created to fill an immediate "short run" need. The discrepancy was one of considerable practical importance. Those who criticized this discrepancy ignored the fundamental question whether, if this situation had been clearly foreseen at Paris, there would have been sufficient courage and farsightedness to construct an organization with power to meet the problems.

When these difficulties were realized some urged that the Bank should disregard the limits set by its youth and sacrifice itself, if that should prove necessary, in an attempt to stem the downward movement, and to resolve reparation difficulties. Others maintained that the Bank could attract sufficient capital and moral support from other institutions to give it the needed power. Both groups urged an aggressive policy, and asserted that quick action would turn the tide in the other direction. These views did not prevail. The arguments were unconvincing mainly because they dealt with intangible factors; they rested on vague estimates of the force of the downward movement, its probable duration, and the amount of long term investment, or credit expansion which would bring about recovery. Unfortunately there was an absence of scientific data on which to base measures to halt deflation.

VARYING CONCEPTS

During all these years the Germans had watched the gradual evolution of the ideas behind reparation figures with increasing despair. The first concept was direct ap-

propriation, that is, the victor taking what he wished or could extract. It did not amount to a theory but rather to the public expression of desire until it was incorporated in the Treaty of Versailles in connection with the thesis of Germany's exclusive "war guilt." The idea then took the form of requiring replacement of all war losses.³³ It was the dominating idea from 1918 to 1924 and led to a resentment in Germany which was to color the opposition to the milder demands of later years.

The second general idea behind reparation demands was that of capacity to pay, a formula suggested in 1919 and further developed in Washington for the war debt settlements and applied with certain modifications to the reparation question. It influenced all decisions from 1924 to 1929. The concrete expressions of this concept in the Dawes Plan were the transfer protection, the gold clause and the prosperity index. The gold clause was the attempt to fit the capacity formula to future events. These provisions indicated the various interpretations to which this concept was susceptible. They pointed to the limits set, within a country, by the ability to press down the standard of living and, without, to the limits set by the normal flow of capital to finance trade.

Capacity to pay was an advance over the earlier concepts in that it recognized the mutual interdependence of nations, and the importance of preserving the economic integrity of Germany. It failed because the cumulative effects of payments were underestimated. Any country asked to pay to its limit would probably have a diminishing capacity for both material and psychological reasons. This was true not so much because of a perverse spirit on the part of the debtor, as on account of the interests of the creditors. For at once the creditors were faced with a difficult dilemma. If they loaned money they financed the "dumping" of exports in competition to their own products,

³³ Eleanor L. Dulles, "The Evolution of Reparation Ideas," to be published elsewhere.

and risked capital loss as well. If they refused to lend, on the other hand, they would cut the possibility of political payments and perhaps endanger the security of previous loans.

In 1929, a third attempted solution of the problem of reparation payments was the effort to take the matter out of politics and encourage lending. It was hoped, at last, to eliminate the bitterness and controversy. In fact the Young Plan made this the central idea behind the new machinery set up. The Bank was to make possible the non-political administration of payments. It was to foster and accelerate commerce so that the obligations would be absorbed in the growing volume of new business.⁸⁴ The hope of a constructive step forward was very real and was consistent with the removal of political manifestations by the winding up of the Reparation Commission, the abolition of foreign controls, and the evacuation of the Rhineland. And, in addition, it provided for the second notable reduction of the sums to be paid.

This same principle was to dominate all later considerations of the problem. Unfortunately the technical measures taken in Paris were ineffective in view of the economic depression. For one thing the reduction anticipated was largely wiped out by price declines; annuities were equal to about the same in goods or gold. This was true even for the annuity set for 1931, amounting to 1,685 million reichsmarks as compared with the Dawes Plan schedule calling for 2,500 million.⁸⁵ For another, the Bank could do nothing to stimulate export trade. Then, further commercialization proved impossible. Finally the unwillingness of creditors to receive payments in goods made new political complications. Thus, while the capacity formula was not com-

⁸⁴ See *supra*, Chapter II. This idea was insisted on by Dr. Schacht in part to give a future basis for claiming that the Allies had not carried out their obligations under the Plan. It was looked on in a less legalistic way by some of the delegates, however.

⁸⁵ *The Young Plan*, Cmd. 3343, p. 16; *The Dawes Report*, World Peace Foundation (Boston, 1924), p. 385.

pletely abandoned it was reinterpreted and tended to prolong the political nature of the question. As the crisis grew worse the payments passed beyond limits set by these two concepts of "replacement" and "capacity" and by the summer of 1931 Reparation was back in the pre-Dawes stage.

It is probable that this rapid retrogression set in because of the abandonment of the special protections in the Dawes Plan as well as because of the unprecedented economic decline. The transfer protection had been replaced by the Bank, but these two arrangements were totally unlike in their results. The gold clause had been omitted when amounts were reduced but the event proved that the Germans made a poor bargain in this respect. The Prosperity Index had been sacrificed and the country freed of foreign supervision but the gain proved to be political rather than economic. Six years of progress was lost as the result of a wrong forecast of economic trends, and underestimation by the Allies of political unrest in Germany.

Even though later events proved that Germany did not achieve notable gains by the new arrangement, it should be remembered it was considered quite possible in 1929 that the gold clause might work against the interests of Germany.** Moreover the prosperity index was designed to increase the payments and so counted as a liability for the debtor. When these facts are considered in connection with the reduction in the amounts to be paid, and the expected political advantages of the Plan, it is easy to understand that some of the German delegates in Paris thought they had made a reasonable settlement. Moreover, there was some transfer protection provided in the provisions for calling the Special Advisory Committee and the request for a partial moratorium.

It is interesting, even if inconclusive, to speculate as to the probable working of the Dawes Plan under conditions

** Shepard Morgan, "Conditions Precedent to Settlement," p. 223, and Jackson E. Reynolds, "The Bank for International Settlements as the Focal Point of the Settlement," pp. 227-234, *Proceedings of the Academy of Political Science*, November 14, 1930 (New York, Jan., 1931).

such as prevailed during 1930 and 1931. It seems likely that the difficulties which overwhelmed the Young Plan would have been even more crushing. The extremist political movement might have developed more rapidly with the continued presence of foreign commissions. The accompanying flight of German capital might have been equally marked or actually more rapid if the transfer clause had come into operation. Moreover, there is no reason to think that private foreign lending would have continued, since it ceased with what seemed to be a decrease in the public burdens of payment. Finally the assistance of the Bank had been of real importance in short emergencies, and the talks between the French and Germans in Basle had prevented many disturbing incidents. Thus it seems likely that the Young Plan failed not so much because it was different from the Dawes Plan as because it embodied the same heavy claims in face of the same intense opposition within Germany. If this is true any method of exacting large sums would have proved impossible.

As time went on it became more and more clear that Germany could pay for a short time sums which would not ruin the country but which would still keep the matter a central political issue. The third concept, taking Reparation out of politics, therefore, called for greater reductions than the second. It became one that was increasingly difficult to apply since each aggravation of the depression made the public more ready to condemn economic mistakes, or resent taxation. Reparation thus became a political problem in almost every country. The balance of receipts and outpayment in France and England was altered, while the United States was agitated by a declining trade balance and a rising budget deficit.

During the later years the legal side of the claims had to be ignored to a considerable extent. The question of justice to private creditors or between former combatants seemed more and more abstract. The bondholder became relatively less articulate as taxes rose to meet budget

deficits and the manufacturer became louder in his demands. At the same time the bankers were not slow in predicting the collapse of credit which actually occurred with the loss of confidence in Europe. Politicians saw that it would be impossible to reach a solution agreeable to all the groups, even within one country, and so they grew more inclined to make a bold stroke, hoping to be able at last to relegate the question to the background.

A new state of mind, somewhat concealed by public speeches, developed among politicians in 1931 as they saw that it was difficult to maintain the standard of living in creditor countries at the expense of the German workman or manufacturer. The wage earner in many countries, rightly or wrongly, blamed reparation payments for his unhappy fate. Moreover, the need for economic security became as urgent as for political security and both pointed to a necessity of more rapid liquidation of the war, even at considerable sacrifice of paper claims. These ideas were first expressed in Germany, but soon spread with an invincible force to other countries.

In the end, therefore, it was realized that receiving payments presented problems as well as paying. This was recognized early, and frequently repeated, but did not gain consideration by politicians for some time. Thus, the Germans called for a reduction of tariffs, and theorists pointed out that real payments would have to be made in goods. But the complex interaction of economic events prevented a general recognition of the truism. The decline of business in 1930 led to the opposite extreme in certain cases, for then the importance of reparation payments as a factor in the depression was probably exaggerated, and the epidemic of tariff laws was dramatic evidence of the fear of imports.

The main periods of development of reparation theory are thus three, first the Versailles Treaty to the Dawes Plan in 1924, second, The Dawes to the Young Plan in 1929, and third, the Young Plan to the 1932 settlement. These broad periods were dominated by different views, but

these views cannot be isolated, nor rigidly confined between the narrow limits suggested. The later doctrines, for instance, were advocated by Professor Keynes⁸⁷ in the early discussions of 1919, whereas the idea of seizure and war guilt continued to influence some even during the informal debates in the Press in 1930. It is impossible here to enter into the complex arguments or to describe the many conferences devoted to the fixing of German payments. As an aid to understanding the part the Bank played in this matter the more important meetings have been listed in a chronological table.⁸⁸

A few of the outstanding dates were:

- 1919 Treaty of Versailles (June).
- 1921 Allies declare German default (May).
- 1923 French and Belgian occupation of the Ruhr (January).
- 1924 Dawes Plan (April).
- 1925 German prosperity at its height, export surplus. Great Britain returns to gold standard. Several United States debt agreements concluded.
- 1926 British debt agreements.
United States-French debt agreement.
- 1927 Federal Reserve of New York rediscount rate lowered.
- 1928 French franc stabilized (June).
- 1929 Young Plan signed (June).
- 1930 Bank for International Settlements opened (May).
- 1931 Hoover Debt Holiday and Reparation Moratorium (June).
- 1931 Special Advisory Committee meets (December).
- 1932 Lausanne Conference (June).

TRANSFER THEORY

Despite the changes in theory and the confusion of settlements, through all these years the general purpose behind the reparation demands was to transfer wealth from Germany to the Allies. The justification brought forward most frequently was the alleged responsibility of Germany for the war. It is true that these claims were sometimes of

⁸⁷ *The Economic Consequences of the Peace* (London, 1920).

⁸⁸ See Appendix, pp. 509-522, where a more complete schedule of events is given.

more importance because of the political pressure they exerted on Germany and the restriction to her development, but in general these other reasons occupied the background as the Allies tried to collect funds to satisfy their own taxpayers. In this inclusive sense the whole problem was one of transfer, but in the narrower sense the phrase referred to the exchange problem of Germany and the aspects of her economic life and payment potentialities which were a part of her foreign exchange position.

In the early years after the war the conditions of transferring wealth had been incompletely analyzed even in Germany. Gradually the difficulties pushed their way to the fore until they were recognized in laying the foundation for the Dawes Plan. Then they sank into the background in Paris, and were considered outdated, or of little importance. Finally, in the critical weeks of 1931, they were reinterpreted and given greater weight in the conferences of bankers and politicians. Thus, new principles in international finance were written in large characters across the pages of economic history.

The roots of this theory lie far back in the development of economic thought. It was first given form and substance during the restriction period in Great Britain in the early nineteenth century and owes much to the arguments of Ricardo, Thornton, Boyd, and others of that time. In fact the contributions in the hundred years since have made comparatively little change in the theory of International Finance, and the advance during that short period was an impressive achievement. It would certainly be wrong to regard the description of transfer difficulties as essentially new, even though it is admitted that their present manifestations are modified by recent events.

Obviously the present problem takes on special characteristics because of the political forces which brought it into existence. It was also more difficult than any previous problem because the sums to be transferred were larger. This fact affected not only the quantitative but also the quali-

tative aspects of payments, that is psychological, political forces, and furthermore the amount of production called for by Reparation affected the nature of production. In addition to such new difficulties, the complications of international credit and commerce had been increasing steadily for decades. Trade was many-sided and had dozens of ramifications linking it up with out-of-the-way regions. This situation allowed for many possible solutions without making any one of those solutions easier in the long run. The most constructive new element was the increased importance of Central Banks, and the opportunities which they brought for warning and coöperation.

Thus old ideas were presented in a new form; in the case of reparation theory the term *transfer* was used to distinguish that aspect of payment from collection—or *aufbringung*. One of the important contributions of the Dawes Plan was that it made a clear-cut difference between the different phases of German payment. It gave an official stamp to the fact, already widely recognized, that the German government might perform its obligations loyally and with real zeal and yet be in a position where it could not make the payments in the currencies of the Allies. This might come about either because the mark exchange could not bear the pressure of large purchases of foreign currencies, or because for some reason, the creditors in the interests of their domestic programs did not wish to facilitate these transfers.

It was technically easy to separate the two parts of the process. The German government paid the required sums into the Reichsbank in marks; it was then up to the creditor countries to see that these sums were turned into other currencies at such a pace that they did not break the exchange or diminish in value in the process. In actual fact in the four and a half years of the Dawes Plan, with the work carried out by experts at the Reichsbank, in consultation with the office of the Agent General for Reparation, there was never at any time any apparent difficulty in get-

ting the required currencies, although it had sometimes been difficult to get the required amounts in particular currencies, notably French francs.

In fact the smoothness with which these tasks were executed made some contend that the distinction had been unnecessary and that there was no transfer problem separate from collection. Experiments were made in Berlin to try to discover the effect of transfers on exchange rates. These were carried out sometimes by spreading the purchases smoothly out over the month, and sometimes buying what was needed in a few days. No fluctuations in the rates corresponding with these dealings were observable. The funds needed were absorbed into the total volume of exchange transactions, and the inference was drawn that the aggregate sums flowing in both directions were greater than some imagined. It is generally recognized that only a part of the credit operations are known statistically and it is possible that those growing out of visible trade or giving rise to uncovered balances may have been counted as a larger part than they really were. For this reason the operations under the Dawes Plan were surprisingly easy.

This fact, however, does not disprove the existence of the transfer problem, but merely shows that these safeguards were sufficient protection to the exchanges during the period in question. A number of abnormal factors influenced the exchanges at this time and made the tasks easier for the experts. The existence of an unprecedented volume of loans to Germany is well known, and the temporary assistance from this source was to lead to grave difficulties later. There was, moreover, a period of prosperity in Germany unusual in the postwar years. In 1925 for the first time a favorable export balance emerged but acute difficulties appeared after the transfer clause was abandoned.

Even though transfer was a distinct problem there is no doubt that collection did influence the transformation of payments into other currencies. This was taken into account in some versions of the theory. Moreover the

exchange operations had certain repercussions on collection. The two were closely connected at many points, since they were two parts of a coherent economic life. Nevertheless, the division of the responsibility into two stages had an economic as well as a political significance. The significance was evident when it was observed that the removal of the protective clause increased the anxiety of private creditors and so may have intensified the question of priority of claims, while the decline of lending, already rapid because of the depression, was accentuated, and accompanied, occasionally, by flights from the mark.

The special character of transfer arises from the fact that it does not present a problem within a nation, but is essentially international and is based on the differences between currencies employed to discharge payment. The task was, concretely, to buy the required amount of foreign exchange with a sum as small as possible in marks. The best exchange rate which could be expected was par since the inelastic requirements to buy other currencies brought persistent downward pressure on the mark. Experience had shown a strong tendency for other currencies to rise under the pressure of this demand, and efforts were sometimes required to offset this tendency. In fact the characteristic weakness of the mark constituted the transfer problem.

All the elements which affected the supply of foreign bills available to German purchasers bore on the exchange value of the reichsmark. These were first, commerce, credit and confidence, then as basic influences, prices and interest rates, and, in the third place, behind these factors the quantity of money in circulation, the volume of goods, the rapidity of turnover of money and goods, the national resources, wealth, taxation, and political conditions of the country. Beyond these closely related factors were all the other economic, political, and social characteristics of the nation which came to make up its physical wealth and the esteem in which it was held by other countries. There were very few things which did not enter into the relationship

of the mark to other currencies, some occasionally and some more frequently.

This problem would have disappeared if marks had been acceptable to creditor countries to discharge war obligations, but of course mark payments would have meant no payments at all to most creditors. Moreover, goods could not be received in large quantities. Obviously, gold was ruled out because Germany had too little, and the Allies did not wish it for they knew it would weaken the structure of international trade to wipe out these small reserves. They wished to be paid in their own money or one of the outstandingly strong currencies and ignored the essential preliminary steps which would make this possible on a large scale. The task of the Germans was, thus, more complicated than was at first apparent. They must buy this exchange without making their internal problems impossible of solution through progressive depreciation and constantly rising taxes, and without losing all their gold and capital resources, or paying a large part to any country in goods, either directly or indirectly. They must press for decreased consumption and increased exports. The Allies wished to receive not what Germany had to give, but something else which they had, their own money.

To this more general side of the transfer question, there were three possible answers acceptable in theory to the Allies. One was for the Germans to borrow almost as much as they paid, that is, to postpone payment almost indefinitely. The second was to spread a growing trade over such a broad surface that it would not be apparent that Germany was displacing the exports of the receiving countries. The third was to reduce the requirements to a comparatively small fraction of the value of world trade so that Germany could accumulate foreign bills without at the same time dumping her goods in large quantities in creditor countries. All three solutions were adopted at different times, and were successful under certain conditions. This variety of solutions serves to indicate the varied aspects of the transfer

problem, and the changing will of the creditor. In the end the solution was determined not by abstract theories but by the decline in commodity prices which made the third way out the only one consistent with the stability and security of economic life.

Clearly these solutions were different from those applicable for collection. The internal problem was one of taxation, the power of the government to take from its citizens a large share of the wealth produced. This in turn rested on political strategy, and the aggregate wealth produced. All the natural resources of the nation went to make up this amount—the wealth in the soil, invention, efficiency, physical endurance, and the rate of population increase. It is true that through export and import trade, these influenced the amount of foreign exchange available, but this was the second instance, and an after-effect, cumulative in importance, but not bearing instantaneously on exchange rates.

Collection, so defined, differed from transfer in its motives, its technique, its limits, and its time sequences. Thus in collection the government was motivated by the desire to achieve a conciliatory foreign policy even at the cost of requiring a large share of the national income for foreign payment. The technique was the clever distribution of burdens so they should fall on those groups which would be most willing to bear them, on those who would fear them less, and in directions which would not paralyze production. The limits set were those which made democratic government difficult when a major aim was to reduce the standard of living for some intangible purpose. Collection, of course, preceded the transfer of payments, although in the period of special protection the direct connection seemed to be broken by the shift of responsibility to the creditors' Commission.

The act of transfer, on the other hand, involved the technique of the foreign exchange and capital markets. The motivation was that behind the daily bargaining of the

market place, whereas the immediate aims included the stability of the currency and the smooth working of the bill markets. The point of view called out was fundamentally that of the specialist in finance and not of the politician, sociologist, or industrial engineer. Then, again, the limits were set by the volume of foreign payments, bills, commerce, and lending of various kinds. The time of transfer was after collection but varied with upward or downward swings of the exchange market. It could not be scheduled to a definite rhythm such as that set for taxation.

The complicated relations involved cannot be comprehensively treated because of the very great volume of data and number of different ideas. Even the narrower question of the exact interaction of collection and transfer is the subject of a large number of theories. Many of the facts in themselves allow a number of contradictory interpretations, though the later years of reparation payments indicate conclusions not at first obvious. It is important to isolate some of the points of controversy in order to bring to a focus the light of new truths reflected from actual events.

Some of these points at issue may be listed, although no list can give an adequate description because they vary widely in nature and in number of adherents. Most of them were considered open questions and subjects of debate during the entire decade. The main questions were:

1. Must Reparation be paid out of an excess of exports over imports, exclusive of capital movements?
2. Can exports be increased by any considerable amount?
3. Can borrowings pay a large part of Reparation?
4. Can tariffs prevent a considerable expansion of German trade?
5. Do the creditors really want payment accompanied by all the indirect results?
6. Does taxation automatically bring about a decrease in consumption and, therefore, price declines in Germany?
7. Does payment automatically bring about price increases in the receiving countries?
8. Can the German standard of living be kept materially lower than in creditor countries?

9. To what extent can the future be mortgaged?
10. At what rate is the future discounted?
11. Is the decline in consumption in Germany approximately offset by the increase elsewhere?
12. Is the value change so great with the increased volume of German exports that receivers do not gain much in terms of value nor Germany lose as much as was expected?

In contrast to this a number of assumptions were arrived at fairly early in the treatment of the question, and are taken here as premises for further comment. These were briefly:

1. Reichsmark depreciation on the exchanges cannot be made the *main* mechanism for increasing German exports.
2. Loans used to pay interest on the capital of a debit will increase the total obligation in geometric proportion and so reach impossible amounts if continued.
3. The motives for paying on the part of the debtor decrease, other things being equal, with the distance from the original agreement.
4. The receiving countries will not allow free entrance to an unlimited increasing volume of imports.
5. Lowering the standard of living in any country—Germany—below the level established as normal becomes increasingly difficult as the decline is greater, and at some point will lead to social and political upheaval.
6. The increase of exports will increase imports to Germany in a certain ratio so that the excess of exports grows much more slowly than does the total volume of exports.

WIDE VARIETY OF ESTIMATES AND THEORIES

The treatment of these matters at the hand of different economists varies in part according to their views on the classical theory of international trade and, in some cases, according to political motives or individual business experience. Although there is not usually a conscious bias, in a matter including so many intangible elements, selection is important and the elimination of some factors as unessential may lead to a very special orientation in the direction of arguments regarding transfer possibilities.

It was possible to arrange the views of different economists in a series according to whether they thought transfer of Reparation was easy or difficult. It will be readily seen that these views fall into five general classes differing in detail within those classes but similar to a considerable extent in their practical application. At one extreme were those who make reparation payments depend on an immediate, steady, and sufficient export surplus. Thinkers of this group came inevitably to the conclusion that the payments were impossible. At the other extreme were those who consider that the payments could be so discounted that borrowing operations could postpone the burden for years and remove it entirely from the present economic life. Certainly, loans seemed for a while to lessen the relation between payments and an export surplus in confirmation of this reasoning. Those who held this view were the more optimistic group and their arguments led to the expectation of large transfers from Germany.

Before it is possible to accept or refute any of the analyses in this mass of theories it is helpful to consider that the decision must necessarily be governed by the relative size of the sums. There are indemnities so small that they could be met by either form of solution, that is by an export surplus, or by credit operations. On the other hand, there are sums so large that it is inconceivable that Germany could pay them by producing an excess of exports over imports, or even by the more elastic possibilities of borrowing. The problem becomes then very complicated. Many variables must be kept in mind, but it is clear, even in the face of these difficulties, that the practical conclusion must lie somewhere between the two extremes, the limiting possibilities existing only in abstract reasoning.

Where, then, can one place the reparation problem between the theoretical extremes? A conclusion on this point is subject to conditions in the actual world, and is not one of pure theory. Experience showed that in the first ten years of reparation payments Germany secured an export

surplus in only two years. It is clear then that in the existing circumstance, the claims did not permit an easy fulfillment, and lay some distance from the assumption of easy adjustment. The size of the sum was so great that the borrowing solution was not to be counted on and broke down in times of great need. It is clear that it could not solve the question for Germany, however feasible in theory such a solution may have been.

It is apparent that the actual experience in paying reparation cannot be used to disprove either extreme of the theoretical arguments brought forward. All it can demonstrate is that under those conditions existing in Europe after the war, the payments required of Germany were not transferable. It is possible that, as the pessimists have said, only those payments which can be made from exports are practicable, but the breakdown of the German payments does not prove this, since many conditions interfered in unexpected ways. It is possible, on the other hand, that, as the optimists said, borrowing could ease those payments not made out of exports but here again one must admit that borrowing conditions were abnormal, and precluded this solution for Germany.

The important point to establish is whether or not these seemingly exceptional difficulties were themselves the result of the reparation demands. The pessimists assume that this is so, while the optimists deny the assumption involved. The answer is critical to the interpretation of transfer theory and yet it cannot be urged with absolutely conclusive proof. There is little more than a *post hoc ergo propter hoc* argument to go on. The event does justify certain presumptions, and warnings point to the possibility of more exact quantitative refinements in other cases, and under different conditions. It is generally admitted that the payment of Reparation at least intensifies those political and sociological forces which enhance the technical and automatic difficulties limiting trade expansion. Moreover, it does lead to a competition for markets, downward pressure on prices

not apparently offset by the inflation in receiving countries, and also to political antagonism, mercantilism, gold standard difficulties and tariffs. The link between cause and effect is close, though the amount of pressure cannot be measured.

There is a vast difference in the elasticity which different economists impute to the system of international payments.⁹⁹ These payments arise partly out of export trade and to this extent they are not quickly expansible. If they arise mainly out of loans, they may grow with great rapidity, limited only by the willingness to "discount," and not by the material factors of commerce. The emphasis on the latter aspect of payments grew as the rapid development of credit in the twentieth century gave some ground for expecting great elasticity. Germany, however, had to look for more concrete assistance than such theories or hypotheses afforded.

Prices are the main mechanism of adjustment in all these theories. Some posit a marked decline of prices stimulating exports and reducing imports. Others, who impute greater elasticity to the economic system and count on the spread of the effects over a wide surface, assume only a small price change but one setting up a differential stimulating production in Germany. Still others consider that the possibility of accumulating foreign exchange is limited precisely by the fact that no wide spread between the prices in Germany and in other industrial countries will be permitted to occur. They argue that the downward pressure of values in competing countries will tend to parallel the movement in Germany and limit the spread which theory indicates as desirable.

Between the two extreme views one can, then, distinguish three types of analysis. The first assumes that slight price changes in Germany will occur offering some stimulus

⁹⁹ There is a theoretical mathematical limit set by the accumulation of interest charges added to principal, which would double the sum in short time when interest is paid from new borrowing.

to exports but the effects will be small, partly because the discrepancy will not be large, partly because the response of production and commercial mechanisms is sluggish, and partly because of artificial barriers built up in receiving countries. The second group expects a large movement in prices, and a quick response of trade, although they also admit that tariffs may be increased to hinder this in part, and that physical limits to commercial expansion may appear in Germany. They would agree to the working of the mechanism in classical fashion if the sums were kept in some familiar proportion to international commerce, rather than made so large as to dominate the whole volume of exchanges. The third group assumes that price changes are small and not necessary since the operations are absorbed in loan transactions, and only gradually liquidated by commerce and an export surplus.

Definite policies are based on these different views. The first holds that a number of factors, for instance prices, costs of production, import of raw materials, and export markets determine the conditions under which internal payments are made. In so arguing they imply a rigidity and simplicity in the economic system not actually existent. The situation is such, according to their reasoning, that any hard and fast barriers such as tariff walls, a shortage of raw materials, or a lack of flexibility in German productive capacity at once make Reparation almost impossible. They point with insistence to the need of German export expansion as the only basis for fulfilling these obligations.

In contrast to this, the second view calls for complicated policies, and makes success dependent on the spread of prices; this is made easier if a price increase is permitted in the receiving country and no competitive price declines in other countries parallel declines in Germany. Then again, the third view, taking a quite different line of reasoning, indicates that the spread in interest rates should be allowed to attract the maximum possible capital flow toward Germany, that the price movement could be left

free of interference, but that capital should be encouraged to move in the direction opposite to German payments.

The German task would obviously be made definitely easier if all these methods of adjustment were left free in creditor countries, and the German efforts to acquire exchange by the different methods were not countered or limited by laws or competition. In other words, on the side of policy these desiderata were not mutually exclusive. Various conditions can be outlined which would, if realized, make large payment possible, and almost every interested country has stressed the importance of realizing one of these conditions at some time, that is, such developments as creditor inflation, low tariffs, price differences and so on.

It was generally recognized that tariffs, inflation and the free flow of capital all play a part in the accumulation of the necessary foreign exchange. The mere existence of plenty of foreign exchange at the times when the Reparation Agent wished to accumulate it for German account does not prove that this arose without distortion or alteration in international economic relations. Financiers anticipate future events, producers often adjust prices in view of expected development, and price inflation often discounts the creation of purchasing power. To the exchange experts buying foreign bills and deposits, these preliminary processes were not always evident. In fact they were hard to detect until they became cumulative, and rolled up a large burden of difference between nations.

For instance, there were times, short perhaps, but none the less distressing, when Germany sold her capital goods, her art treasures and real estate which would normally not attract foreign buyers. This occurred because of the downward pressure on the mark, and the need of foreign exchange, actual and anticipated. This was not part of any normal or permanent adjustment and although exchange was made temporarily easier, the fundamental basis for reparation liquidation was far from attained.

Then, if the second type of theory is analyzed further

it is found that within the theories of the reactions of price and trade to reparation demands, there were a number of different views. There were those who thought the competitive position of Germany would be established by increased efficiency, invention and the development of new processes or resources. There were others who thought that it would come through a progressive lowering of the standard of living, wages, and the quality of goods consumed in Germany. This would be accompanied by some selling out of the resources of the nation, control of industry, and the depletion of the health and strength of man power. A further group judged that the adjustment of prices could be accomplished mainly by monetary changes in the first instance, and the real changes spread over a long period of time, perhaps by inflation of the price level in creditor nations, paralleled by a *relative* deflation in Germany.

Experience has shown that the case is complex and that all the factors mentioned played a part. There was a price decline in Germany relative to that in competing countries. There were various forms of inflation in some of the creditor countries, though not universally recognized as such. There was a decline in the German standard of living and the selling of some capital assets. Moreover, trade did expand, efficiency increased, and the tariff problem became a very live issue with the creditor nations. Although these facts exclude the more simple view which limits repercussions to the immediate trade factors, they do not prove that the variety of adjustment necessarily makes solution easier in the long run. That is, the situation was disturbed because the tendency for inflation was offset by competitive price declines, because expansion of commerce brought some unsettlement to the loan market and stimulated legal restrictions against foreign borrowing. Thus, instead of becoming easier the task seemed more difficult.

Among these theorists are some who have carried their analysis of the deflationary tendencies in Germany very far. They have relied on the working of taxation to depress

prices by cutting down the purchasing power of the German people. Of course it is clear that taxation for the collection of reparation payments within Germany would occasionally work prices up, but in general, because it was a subtraction from German purchasing power, it would decrease demand. Unfortunately for the working out of fact in the grooves set by theory, the protection of exchange meant a partial isolation of Germany and the prevention of the full influence of this decline of purchasing power on imports through the rise of foreign exchange. Those who saw catastrophic declines early assumed that reichsmark depreciation on the exchanges could not be a main mechanism and must be kept within rigid limits; this interfered with the full and free adjustment of values to the pressure exerted by reparation requirements.

There is, for several other reasons, a perverse tendency for the price decline in Germany, and the price rise in creditor countries, if it takes place, to have less than a proportional influence on commerce. This tendency is in addition to influences growing out of the attempt to restrict exchange movements, and is in part the result of distance and of the diffusion of economic forces over space. Moreover, there is a tendency for each change to set up limiting forces, as inflation brings a conservative money policy, and exports lead to tariffs in the receiving country. So interest rates increase and cause an increase in German prices. Then, again, distortion of all factors tends to arouse suspicion and makes the problem pass quickly beyond the limits of easy solution, or of reliable prophecy. The obstacles which exist are, thus, sufficient explanations, without taking into account the controversial questions of German motives.

For example the principle of "equal costs" in constructing tariff measures, if strictly applied in most of the creditor countries, would effectively exclude German and other wares, and make all payment impossible. Furthermore, loan operations could not fill the gap if the prospect of a

commercial adjustment were ruled out. Certainly, Germany would be embarrassed to meet the interest on existing debts, without being in a position to consider the piling up of new loans. Moreover, the psychological disturbance would ruin Germany as a capital market.

Thus even those who reject the simpler statement of Professor Moulton and Dr. McGuire in their book on German capacity to pay come back to a more intricate formulation of the general proposition which they advanced in 1923. There is no doubt that this discussion at an early date was comparable to that of J. M. Keynes in influencing public opinion and in pointing out real difficulties.⁴⁰ The comparison with the 1870 indemnity seemed exaggerated to some, but the analysis of the difficulties of the resulting economic depression, and the abandonment of the attempt to anticipate the far distant future all indicate that this was an instructive parallel. The limits of the view on the theoretical side were mainly the subordination of money-price factors, and the underestimation of the loan operations as a temporary facility.

Deflationary theories count on the subtraction of purchasing power as a preliminary step in the transfer of real wealth, and build up a complicated monetary machinery for the working out of this. The views of many outstanding economic leaders fall into this general category. Such men as Professor Keynes⁴¹ and Professor Taussig,⁴² have in their analysis elaborated the complex mechanisms which make these tendencies felt, though they generally deny the possibility of an adequate adjustment of the balance of payments to meet reparation demands. Their thought runs

⁴⁰ The mention of certain thinkers as holding significant theories should not be taken to imply that they are the only men holding such views. They are merely taken as types, and in some cases as leaders of certain views.

⁴¹ J. M. Keynes, "The German Transfer Problem," *The Economic Journal* (March, 1929), p. 1; "A Rejoinder" (June, 1929), p. 179; "A Reply by Mr. Keynes" (September, 1929), p. 404.

⁴² F. W. Taussig, *Archiv fuer Sozialwissenschaft und Sozialpolitik* (October, 1928), pp. 225-250.

in value terms and they are acutely conscious of the manifold credit and production changes which come with these tendencies. Professor Ohlin⁴² with some modification of these views has demonstrated that inflation and deflation in the usual meanings of the terms are not necessary for the execution of payment. His argument does not attempt to prove that reparation payments are in fact possible, but rather that, if they are possible, they might be accomplished through taxation and the direct subtraction of Germany's power to consume, without much effect on price levels.

A different view expressed by Dr. Anderson modifying some of the ideas later outlined by Ohlin has stressed the budget reaction on spending power. This may be called the automatic deflation view. It implies that the deduction from purchasing power by taxation will cause just the amount of price change to bring about a restriction of consumption in Germany, whereas the opposite effect in creditor countries will lead to their consuming a larger share of world goods. There is a close relation between this view and that of Professor Ohlin, although the two are separately developed, and formulated in different terms. Both theories approach a degree of abstraction which make them difficult to apply to actual policies.

The discounting of the future was by far the most optimistic view and was held by a considerable number of practical men, as well as by theorists. Among those who inclined to this belief were Mr. Owen D. Young and many New York bankers. Mr. George P. Auld also expressed opinions of this sort. There were a number of strong arguments to support the expectation. One was that for a number of years, reparation, if not actually paid out of loans, was so counterbalanced by opposite capital movements that the exchange problem did not arise. It is true that the loans played their part in improving industrial equipment and, so, reacted on payment possibilities in many ways, but the

⁴² Bertil Ohlin, "The Reparation Problem: A Discussion," *The Economic Journal* (June, 1929), p. 172; (September, 1929), p. 400.

primary and immediate effect was to increase the supply of foreign bills available. Moreover, the increased expansibility of credit, and the growing elasticity of the economic system seemed for a time to be a permanent development, although the crisis brought sudden disappointment later.

Support to this concept can be found, for interest rates did open up profitable differentials, but the menace of the growing capital burden increased gradually, and was only kept from overwhelming German credit entirely by the reduction of reparation demands when the private obligations grew larger, and by the drawing up the *Still Stand* agreement of 1931. Thus the most optimistic hopes were gradually abandoned and the idea of wide diffusion over time and space gradually discarded in favor of the more realistic consideration of whether it was worth while making Germany pay. Paying through gold and capital goods or by means of infinite depreciation was first abandoned, then, paying through increasing discounting and loans; and, finally, paying through export surpluses was reluctantly given up in a number of countries, and tariff walls were increased.

Professor Allyn Young had early pointed out the disturbing effect of speculation and sentiment on the working of these mechanisms. He had set forth in an impressive way the argument that if the adjustment of any of the price-trade-interest factors were pressed to the limit of tolerance this distortion would immediately set in force adverse speculation and that the process of restoring an equilibrium adjustment would come to a halt.⁴⁴ There would be a point somewhat short of the theoretical limit, at which the maximum result would be expected, but this possible effectiveness would be greatly lessened if other forces increased adverse speculation. He assigned to capital forces the utmost importance but pointed to the limits of strain which he thought could be tolerated.

⁴⁴ Allyn A. Young, "War Debts External and Internal," *Foreign Affairs* (March, 1924), pp. 404-406.

Despite the frequent criticism of German borrowing those who followed the situation knew that loans were not necessarily used for unproductive purposes. On the other hand, taxation and other forces leading to price declines were not always destructive. Germany was certain to enjoy some benefits from the stimulus of this emergency as an offset to numerous disadvantages. There is no doubt that legal and political interference acted in two ways, first as a protection, notably in the case of the exchanges and gold, and more conspicuously as hindrances, in the case of tariffs, and credit restriction. It is true that in some ways the Dawes Plan interfered with the free working of economic forces more than the Young Plan, but this had been to the interest of Germany, whereas during the early years of the new settlement, the interference of tariffs was very grave and was not balanced by any adequate protection. The Bank for International Settlements could not aid materially in the difficulties that followed. Moreover, various attempts at banking control worked sometimes to the advantage and sometimes to the disadvantage of Germany.

Even this complex problem can be reduced to simpler terms, however, for one or two facts stand out which should be a useful guide to international finance and to fiscal experts. In the first place there was a transfer problem, even though it was evident intermittently and in varying forms. Moreover, in the second place, the technical mechanisms to make Reparation possible, however accurately described in theory, and however solidly material in actual life, engendered disturbing counterbalancing forces. Thus large international payments tend to become impossible, and German reparation obligations fell into this category. Further than this the Allies were forced to reject in turn all possible means of payment as too disturbing to their internal economic and political life. Bond values, tariffs, and restrictions in 1931 furnished conclusive evidence of this dilemma. Moreover within Germany, revolt, opposition, and physical limitations increased faster than inven-

tion, economy, and price declines, making payment progressively more difficult where collection and transfer interacted most perniciously.

Finally, the Bank for International Settlements could not make the way easy, could not protect German exchanges, increase exports, and prevent legal interference with free economic adjustment, nor could it make payments large enough to be acceptable to the Allies or more palatable to the German public.⁴⁵ Certain rigid and quick acting protections had been included in the Dawes Plan, but these were omitted from the Young Plan. In the balance of these forces a new international organization was no adequate gain for Germany to compensate this loss. Even though the Bank was destined to render great service to economic life, this constructive product would not come through its functions of facilitating Reparation.

⁴⁵ Wilhelm Lautenbach, *Die Reparationsbank*, edited by Erich Welter (Frankfurt, 1929), pp. 28-34. Dr. Lautenbach concludes that the Bank has little or no capacity to aid transfers.

CHAPTER XIII

THE REPARATION MACHINERY

DURING all the heated discussion of right and justice, men of long experience and ability have been executing the payment and transfer of unprecedented sums as reparation by Germany. From the coming into force of the Dawes Plan until July 1931, these payments had been made without interruption or apparent technical difficulty.¹ This has been no small achievement. It is a tribute both to the individuals who have been occupied in this work, and to the fundamental excellence of the machinery of international transfer of funds.

It is true that this period of orderly payment followed one of exchange crisis and monetary disaster,² but the difference between the two conditions before and after 1924, is to be found in the frequent and arbitrary political disturbances that upset normal financial relations. These political factors were very real, and were to become again an important influence on the reparation problem. In fact, it cannot be otherwise when conditions force citizens to be seriously disturbed about their future standard of living. Nevertheless, economic machinery, insofar as it can be abstracted from political affairs, has seemed adequate to the strains put upon it. The nature of the mechanisms and the way in which the payments were made are significant in an analysis of the work of the Bank and its responsibilities in regard to Reparation.

¹ *Report of the Agent General for Reparation* (Berlin, May 21, 1930), pp. 1, 2, 305. See former reports for earlier discussion of some of these questions.

² Frank D. Graham, *Exchange, Prices, and Production in Hyper-inflation, Germany, 1920-1923* (Princeton, 1930). I cannot agree with Professor Graham in his estimate of a small net loss as the result of inflation in Germany for, as he says, much of the damage cannot as yet be appraised.

Even though general opinion considered the B. I. S. to be the Reparation Bank an examination of the procedure shows that this responsibility of the B. I. S. was very small. For instance, its main function was to act as accountant of the payments. Once the funds had passed temporarily from the hands of the governments into the custody of Central Banks or the B. I. S. the managements of these funds became a matter of banking procedure. The sums concerned were not distinguishable from those which were left with the Bank in the ordinary course of business. The liabilities, once incurred, were in no way different from others growing out of the handling of deposits and the Bank could ignore the political origin of these funds. Fortunately the moral and legal problems which made the question so disturbing did not enter into its field of action and the policy of neutrality^{*} adopted was the only possible course. It follows from this that if the Bank is to rise to real importance it must play a significant rôle outside the field of Reparation.

Thus, although methods of handling reparation payments did not dominate B. I. S. policy to any great extent, they aroused general interest inasmuch as they showed an intricate financial mechanism working smoothly and efficiently. It is evident that the sums handled were very large and the flow of funds was one-sided.⁴ Moreover, special arrangements, such as the deliveries in kind, were without precedent. In spite of these facts, however, the business was transacted with surprising ease. It is true that the primary operations were comparatively simple, but this simplicity was in large measure the result of the guarantees, the provisions for emergencies, and the care and foresight of those who were responsible.

In examining the reparation work of the B. I. S. it is well

^{*} President McGarrah, Speech before the American Club in Paris (Feb. 12, 1931).

⁴ There must always be some counterpart for payments but the way in which this arises differs so much that one can call such payments as Reparation "one-sided."

to divide it into two parts. There were, in the first place, the clearly defined and, therefore, routine functions of the Bank. There were, in the second place, the more general and banking functions which influenced the reparation problem indirectly. Then in addition to these two distinct separable aspects of the Bank's obligations, there were certain hopes and claims based on statements in the Young Plan, and on unofficial comments and announcements, but not to be found in the Statutes. Indeed these latter possible functions are in no sense a part of the actual work of the B. I. S., and so cannot be given consideration in this Chapter.

An important part of the accomplishments of the B. I. S. was the receipt and transfer of funds, the payment and accounting of deliveries in kind, the flotation and service of loans, the employment of special deposits, and, in case of emergency, certain actions in regard to postponement and the calling of the Special Advisory Committee. The second more general influence of the Bank on German payments can be mentioned only briefly here, since it is more properly a part of work in the interests of coöperation between different Central Banks and money markets.⁵

Although the main emphasis must be placed on the more technical aspects of reparation payments in this chapter, nevertheless the help which the B. I. S. granted Germany in 1930 and 1931 should not be overlooked. The support given was that which came with the short and long time investments in Germany,⁶ on the one hand, and the technical measures which eased the strains on the exchange markets, on the other. If these investments were small compared to the needs of Germany, they were nevertheless large compared with the resources of the Bank.

Even the technical facilitation of payments was inconspicuous, and it is impossible to estimate accurately the net results. There is, however, general agreement that the mark suffered less during the political disturbances in Germany

⁵ See *supra*, Chapters VII, VIII and XVI.

⁶ It was generally understood that most of the long term investments of the B. I. S. were in Germany.

than would have been the case without the clearing functions of the B. I. S. The significant aspect of the situation is that the help in both these ways, that is clearing and investment, was not peculiarly the outgrowth of the reparation functions of the Bank but was similar to assistance which the Bank would give to any of the participating countries in like circumstances. In other words, the support given was good banking and comes under the head of international banking coöperation.

Despite the assistance rendered, however, the limits to the Bank's activities, in certain directions, were rigidly set. Some of the more permanent limitations arose from the composition of the Board of Directors, and some from restrictive clauses in the Statutes, while others grew out of banking relations and policies. Some characteristics of the Bank which had a bearing on payments might change with the passage of time. More temporary limits were set by the general depression, by the small resources at its disposal, and special conditions in certain money markets. To these very real sources of difficulty must be added the slow development of the Bank's own policy and the necessity of reaching a complete understanding with the Central Banks before engaging on important new lines of action.

The general policy which crystallized these facts was one of strict neutrality, and although it has been much criticized in Germany, it was essential to the proper fulfillment of the Trust Agreement as well as the carrying on of sound banking business. Obviously the Bank was directed by men from the creditor as well as the debtor countries and must serve the interests of all concerned. Moreover, it was designed to be non-political. Those who were influential in the management of the Bank, with the exception of Dr. Luther,⁷ did not take an active part in the reparation controversy. Moreover, no act and no statement from the Bank showed direct preoccupation either with revision or with the maintenance of the payments prescribed under the Young Plan. For

⁷ It is obvious that no German could be neutral in this matter.

the Bank, the matter was a closed issue; its reparation functions were clearly defined and routine, and beyond these it would not go. It is, of course, likely that with the growth of long time resources, or even perhaps, with new capital issues, the Bank would find it good business to finance activities which might help create new outlets for German trade. Such a development was certainly not rejected by those managing the Bank, but was not an immediate possibility. In short, the extension of any functions with respect mainly to German payments was extremely unlikely.

Even the necessity for creating the B. I. S. has been questioned.* As far as its reparation work is concerned, it is obvious as one considers the operations, that some other organization might conceivably have acted as an accounting agency, as trustee of the bonds, and administrator of deliveries in kind and other minor and related tasks. While this may be true, there would be no gain in having such another organization perform these tasks. Moreover, the very fact that reparation funds with the B. I. S. become at once banking funds, and that the tasks which go with receiving and transfer bring about an easy clearing of balances between Central Banks, is a very great advantage to world economy.

It is essential to see clearly what happened to the reparation money, in order to understand the nature of the banking machinery that had been invented. In the analysis of this process the margin between the trustee functions and the more strictly business transactions is very fine, but the line can and must be drawn, and the funds which were at one moment government obligations, became in the next, fluid, generalized bank funds. Thus it is essential to the understanding of the second process that the first be definitely marked out and described.

* Gustav Cassel, "Is the International Bank Necessary?" *The Bankers' Magazine* (November, 1929).

THE HANDLING OF ANNUITIES

The first funds were received by the Bank on May 17, 1930. On that day the Agent General for Reparation Payments turned over his balance which was equivalent to 182,691,763.57 reichsmarks⁹ and immediately thereafter the account of the Agent General was closed. Part of this money was given to the B. I. S. in the form of cash, or more accurately sight balances with Central Banks, and the rest in the form of investments, bills of exchange, acceptances and so forth. Instantaneously these funds became assets of the B. I. S. against which were set liabilities to the creditor powers precisely equal in amount.¹⁰ In fact, all except about 47 million reichsmarks of this first money was already committed for payment, so that the remainder constituted only a part of the necessary deposit in the annuity trust account. This account was completed later. Therefore, there was, in May, no money in the account "Central Banks for Others," although this category appears in the statement of June 30 and shows where the money belonging to the treasuries was itemized. This arrangement was necessary since the B. I. S. held deposits only for Central Banks¹¹ and for the annuity trust account. The assets thus turned over to the Bank were held in the form of investments made at the discretion of the Management of the Bank.

The procedures adopted in the spring of 1930 were adhered to during the later months. The first balance sheet of the Bank¹² indicated under liabilities II, i and III, b, the receipt of these and other payments from Germany. On the assets side, on the other hand, the funds are at once merged with other resources and cannot be distinguished

⁹ *Report of the Agent General, op. cit.*, pp. 49, 360. See *supra*, Chapter III.

¹⁰ No commissions were paid to the B. I. S. on the handling of these first funds.

¹¹ See *supra*, Chapter VII.

¹² The Appendix.

in any way. The banking functions of the B. I. S., insofar as they grew out of Reparation, consisted in the use of the receipts during such a time as they remained on deposit, and the amount so available depended on the time lag between the original payment and the withdrawal by the governments through the intermediary of the Central Banks.¹³ This time interval was influenced both by the interest which the B. I. S. paid on deposits and, to a lesser extent, by the clearing functions which the Bank performed which made the payment for the war debts easily executed through their agency.

The detail of this process of transfer of funds is as follows: At least a month before each payment the B. I. S. handed the German government and the Reichsbank a schedule of currencies in which the monthly portion of the annuity was desired. This schedule was drawn up with a view to facilitating later "outpayments" for war debts. Under the Trust Agreement which prescribed this schedule,¹⁴ Germany could, if she preferred, make payments in the currencies of the countries "whose nationals were members of the Committee of Experts."¹⁵ In any case, the distribution of currencies requested was to be as nearly as possible according to the shares of the respective countries. This provision meant in practice that the payments would be in pounds, lire, dollars, belga, or french francs, but this alternative was not likely to be used. It was designed to furnish a safeguard in the case of a temporary maladjustment of some one or two exchange relationships.

Irrespective of this provision, however, the service of the Young Loan was to be made according to the schedule of currencies in the General Bond,¹⁶ drawn up in the proportions required for the payment of interest and amortization. Most of the reparation annuity was, of course, to be paid in

¹³ The Long Term Deposits will be discussed further, *infra*, pp. 371-4.

¹⁴ *The Trust Agreement*, Cmd. 3484, article No. III, p. 70.

¹⁵ These countries included Japan but its proportion of receipts was negligible. Germany was also such a country.

¹⁶ *General Bond*, Article VIII, p. 5.

dollars because the larger part of these payments flowed toward New York and eventually to the United States treasury. The sums turned over to the Bank always took the form of cash, except for the May 1930, payment by the Agent General, that is, sight balances with Central Banks.

The cash thus added to the assets of the Bank on the fifteenth of each month was transformed as soon as possible into investments. This further step was a banking matter pure and simple and was not directly related to the reparation problem. In fact the funds cannot be traced further on the assets side of the balance sheet. On the liability side, they can be followed fairly accurately by observing the item "Central Banks for the Account of Others," III, b.¹⁷ It is of course possible for non-reparation funds to be included under this heading but in practice such additions did not take place. On the contrary it will be seen that the average increment in this item in 1930 was 72 million swiss francs or approximately 58 million reichsmarks.¹⁸ This is less than half the monthly payment by Germany, the difference being accounted for in part by the deliveries in kind.

The decline of more than five hundred million swiss francs in "Central Banks for Others," apparent in the statement of the end of December 1930, indicates approximately the difference between the payments to the United States and the receipts from Germany during that month. Similar changes were to be expected each June and December as long as the 1929 schedule of payments was in force. It is of course possible that under different economic conditions the governments would choose to leave their money else-

¹⁷ See *infra*, Appendix, pp. 528-539.

¹⁸ The increments in 1930 are as follows:

July to August, 114 million swiss francs.

August to September, 68 million swiss francs.

September to October, 75 million swiss francs.

October to November, 33 million swiss francs.

June to July was not typical, nor was November to December, since these months include dates of war debt payments. The increment January to February in 1931 was 98 million.

where. So this item in the B. I. S. balance sheet might entirely disappear.¹⁹

In fulfillment of the Agreements German payments went first into the Annuity Trust account but were immediately transferred to the credit of the separate governments, through the agency of the Central Banks as described above. Although this process was indicated in the Trust Agreement,²⁰ it is carried out more specifically according to instructions from the respective governments. Since the B. I. S. does not pay interest on the Annuity Trust account only the required minimums are left there by the governments. The rest, that is, after the first two months, the whole amount, went at once to the interest bearing accounts in the names of the Central Banks, or was withdrawn from the Bank. The deposits in and withdrawals from the Annuity Trust account are not observable in the balance sheet since they take place instantaneously; in fact they had little more than a legal significance. Certain deductions from the Young Plan annuities were made to cover commissions. Deliveries in kind for the first ten years, and the service of the Young Loan and Dawes Loan were charges on the Annuity Trust account, and these were definitely prescribed and executed as a matter of routine.

All this was very simple in execution, moreover, since the B. I. S. in its specification of particular currencies desired, always anticipated the later requirements for war debts; further exchange operations were for the most part unnecessary. It is obvious that Germany still had to go into the exchange market, and that some one at the Reichsbank had to accumulate bills of exchange or other assets in the various countries indicated for the payment. In fact, some

. ¹⁹ However, the sum which remained under this heading at the end of December should be compared with the amount, 568 million, recorded in July 1930. This item declined after the "Hoover Debt Holiday" to 68 million swiss francs in 1932. The Bank for International Settlements, *Second Annual Report* (Basle, May 10, 1932), p. 39.

²⁰ *The Trust Agreement*, Cmd. 3484, pp. 71, 72.

of these purchases could be made more than a month ahead, since the distribution of the currencies specified did not vary greatly from month to month.

Thus the difference between the new and old procedures was more apparent than real. In fact the same person handled most of the exchange transactions before as after May 1930. The Agent General had purchased his exchange through the Reichsbank where it had been accumulated for him in anticipation of his requirements. It is possible that the changes would have been more striking in an emergency. The most significant change was that Germany bought more dollars and fewer pounds and francs, and as a result of the reduced purchases and sales in these two markets there was a net reduction in the volume of foreign exchange transactions for Reparation and war debts.

Nevertheless there were many important changes with the new régime as well as those which were nominally unimportant. There is no doubt that the B. I. S. was an instrument well fitted to clear reparation funds since it was constantly buying and selling in a number of money markets.²¹ This gave it a wide choice in its accumulation of exchange; it could go through many markets if one particular exchange was unfavorable. Further, the Reichsbank or other depositing Central Banks could surrender assets in one market for those in another without influencing the rates as much as might otherwise have been the case.²² In short, the variety of directions in which funds moved spread the pressure and in some cases canceled a portion through the offset of opposite movements.

Under the new régime a considerably larger part of the annuities was kept in marks, and the exchange rate benefited by this. There had been, formerly, considerable purchases of pounds with the reparation money, and these

²¹ The B. I. S. dealt in twenty-four currencies in the first year, but was active in some six or eight.

²² Transactions were made at the market rate.

purchases were balanced by later sales.²³ Such purchases were no longer necessary. In addition to this simplification, there was a further advantage in the more definite program on which the payments were carried out, making possible a better anticipation of exchange demands. This lessened the number of the transactions and speculative fluctuations.

There were many other changes that came with the Young Plan but these did not affect the Bank for International Settlements very directly. One of the most important aspects of the New Plan was the changed political nature of the problem and the new relation of Germany to the creditor countries. For instance, under the Dawes Plan the supervisory functions of the Agent General led quite naturally to the comprehensive reports which were issued each year. Under the new conditions only brief and formal statements covering the Young Loan were needed; in fact, it was no longer appropriate for an outside agency to publish analyses of German economic conditions or detailed reports of deliveries in kind and the cash transfers. Nothing more than the monthly statements and publication of the Trustee accounts were needed. Then other changes came in connection with deliveries in kind which the Commissioners in Paris handled,²⁴ but no great public interest was aroused by these transactions.

The new method of handling the funds was almost certainly less expensive than that under the Dawes Plan, but no exact comparison can be made. The expenses under the Dawes Plan²⁵ are indicated as being more than three and a half million reichsmarks a year in addition to the cost of the Reparation Commission, those charges connected with deliveries in kind, and certain indirect costs incurred by the German government. The cost of Reparation as administered by the B. I. S. cannot be exactly determined, although

²³ The "Balfour Note," August, 1922, indicated that Great Britain would attempt to balance out payments and receipts.

²⁴ Not all the work was done in Paris, see *infra*.

²⁵ *Report of the Agent General, op. cit.*, p. 19.

the commission of one per mille²⁶ on the funds handled would come to considerably less than the former figures given.²⁷ In many ways various items are not comparable but it is safe to assume a gain in this respect, particularly as the commissions earned by the Bank would represent in the main a net profit. The overhead cost in connection with the payment of annuities through the B. I. S. was small when allowance is made for its more general work as a center for Central Banks.

To the B. I. S. the most significant aspect of this complex cost situation was that the Bank earned interest on the deposits in the Annuity Trust account and the German government deposit, and this must be regarded as a loss to Germany, on the one hand, and to creditor countries, on the other.²⁸ The interest on these two deposits totaling between 230 and 240 million swiss francs would amount to several million a year. In fact, since it was clear gain this was one of the most important sources of income for the Bank. Although the sum given up through the loss of interest on this money is not large when compared with the budgets of the countries concerned, it is a considerable addition to the direct cost in commissions. The importance of interest should not be exaggerated, however, since the direct loss to the governments would be compensated by gains to Central Banks through the assistance of the B. I. S. There was a clear intention of strengthening the B. I. S. in creating these deposits.

It is possible to summarize the handling of the annuities under four headings. The first was the presentation of the request for special currencies. The second was the transfer to the B. I. S. of funds on deposit at various Central Banks on the fifteenth of each month. The third and simultaneous

²⁶ *The Trust Agreement*, Cmd. 3484, p. 79.

²⁷ The interest foregone on the minimum deposits left with the B. I. S. under the Hague Agreement should be counted in the cost. Also some allowance for participation in profits under Article 53 should be made.

²⁸ See *infra* this Chapter for discussion of the deposits.

act was the crediting of these payments to the governments in the Annuity Trust account of the Bank, and the final step was the moving of these funds, on standing instructions, to the accounts of Central Banks with the B. I. S. or to other banks or accounts. There was no variation in this procedure until July 1931, no place for discretion, no cause for uncertainty. Moreover, the method of handling the fraction of the payments which covered deliveries in kind under the Young Plan was almost as stereotyped as that of the larger portion which was received in cash.

DELIVERIES IN KIND

The Young Plan had prescribed the continuance of deliveries in kind for ten years. This was the only part of the reparation payments paid by the German government in reichsmarks.^{**} It was, therefore, the only part not covered in the foreign exchange requests, and which came to the B. I. S. in the form of a deposit with the Reichsbank. These amounts were to be at their maximum, 750 million reichsmarks in the first year of the Plan, and were to decline to 300 million in the tenth and last year. The installments were put at the disposal of the Bank on the fifteenth of each month and could be used then for investment purposes pending the withdrawal of funds for payments within Germany. In this respect they differed completely from the other part of the annuity which was never directly usable by the Bank. The importance to the Bank of this investment depended on the time lag between the receipt of funds and the cashing of checks upon the completion of the contracts. It is clear the steps involved in this part of reparation payment as well as the time intervals were different from those already described.

^{**} There was a technical complication in respect to the request for the currencies which led to the calling for a very small marginal sum in reichsmarks. It was not possible to know just what exchange rates would prevail on the day on which the payments made in other currencies were credited in reichsmarks. The amounts were therefore listed so as to come slightly below the required sum, and the very small remainder was paid in German currency.

Under the Dawes Plan the entire annuity payments had been paid into the Reichsbank to the account of the Agent General who had used the money either in German currency to pay for the deliveries in kind, or in other currencies for transfer to the creditor governments. The arrangements for the contracts were much the same under the Young Plan as before, but the relative importance of this means of payment changed very greatly. For instance, during the earlier period considerable portions of the payments had been made in goods and services. The demand for these had been stimulated in part by the need for supplies in the rebuilding of the towns of northern France. Moreover, in connection with indemnities to the French citizens, it had been possible to accept the *bons* in payment for German goods, although these *bons* could not be cashed at once by the peasants. Thus the French citizens had the benefit of the materials, while the government did not need to make direct outlays in cash to meet these claims.^{**} In addition to this specific advantage, the idea of direct transfers of goods had appealed to many. It seemed sensible to them to have the payments take the form of concrete wealth rather than the more abstract mediums of money and credit. Moreover, it is possible that some saw ways of arranging ahead for payments which would become a more permanent part of the industrial and financial arrangements of France and Germany and other countries, whereas the payments in cash might be more quickly altered for political reasons.

Very little attention was paid to these facts because deliveries in kind constituted a very small part of the total Young annuities and were to cease altogether in ten years. There were three main differences in the new régime; these were amounts, administration and methods. The reduction in amounts was the first, whereas under the former system there had been no maximum to the part of the annuities so usable. In the second place, there were some changes in

^{**} The French lost some of the value due under the annuities through price differences.

administration, though these were more nominal than real. To a considerable extent the same people supervised the deliveries as before the Young Plan. Although the *Sachlieferung* office in Paris was no longer directly under German control, the work of the Commissioners of the various governments went on in much the same way as previously. After the changes most of the Commissioners continued to stay in Paris, though this was not necessary, and some remained in their own countries or in Berlin.⁸¹ The office of the Agent General in Berlin was of course closed, and no comparable agency took its place. The third difference under the New Plan was the handling of the funds involved.

In 1930 the B. I. S. took over the accounting which had formerly been done by Mr. Gilbert's office. The other differences which appeared were, in the main, the result of the declining sums required for the deliveries. There were no further detailed reports published because the creditor governments had no longer the same interest in watching the contracts for future work. In fact, the fixing of an upper limit for such deliveries removed any incentive which there might have been formerly to arrange far ahead for work which could not be easily readjusted in case of a reduction of the total of Germany's payments. There was also some change in the nature of the commodities taken and a notable decline in the public works such as the harbor, river and electrification projects which France had undertaken.⁸²

The rôle the Bank played in this affair was comparatively small. There were, in fact, three different steps necessary to complete the deliveries in kind. In the first, the incurring of liability, the B. I. S. had no concern. The second, which was an indistinguishable part of the general "collection problem" within Germany, was the accumulation of funds in which, again, the Bank played no part. The third

⁸¹ The German Commissioner had to be in Paris. The Belgian Commissioner remained in Brussels, and some of the others were in Berlin.

⁸² *Report of the Agent General for Reparation Payments, op. cit.*, p. 71 and elsewhere.

aspect of these payments was the discharge of the liability, and this constituted one of the functions of the B. I. S. but the work was strictly routine business. In brief, it may be said that the first stage was made up of normal business arrangements, the second was a German budget problem, and the third was a technical and accounting arrangement of a very definite kind. It is true that there was one point in the handling of the money which led to certain banking operations.³³ Moreover, there were some links in the chain of events where government supervision may have altered in some degree the banking factors but these influences were of small importance both in nature and in amount.

The business arrangements referred to, which gave rise to the liability, were made directly between the buyers in the creditor countries and the German sellers. It is true that in the earlier period a considerable part of the deliveries were for public works, and in this case the government played an important part as purchaser, but this use of goods and services tended to decrease. Similarly the large part of the early payments for direct replacements in devastated territory diminished. Large sums were spent on roads, bridges, railroads, mines and electrification projects. Then, during the years just before the Young Plan, coal, coke, lignite, dye-stuffs, fertilizer, timber and sugar bulked large. Full descriptions of the projects and lists of the commodities are to be found in the reports of the Agent General.³⁴ Many of the same commodities continued to be taken under the Young Plan though the more comprehensive projects and the larger deliveries of coal ceased in 1930. An examination of what was done in this way indicates that business practices and economic needs set the limits and that the Bank had neither the right nor the ability to intervene.

After considering the planning and financing of the public works in connection with deliveries in kind, Professor

³³ See the discussion of the "lag" *infra*, this chapter.

³⁴ *Report of the Agent General for Reparation Payments, op. cit.*, pp. 9, 31, 67, 71, 332. (See Reports of other years.)

Gideonse has suggested that they might be taken as a model for other assisted schemes and coöperative adventures in finance.⁸⁵ He sees in the Bank for International Settlements an instrument to weld together "still broader interests"—the carrying out of worthwhile projects in South America, China, Russia, and elsewhere by methods similar to those of France, Belgium and Portugal in their use of the German commodities.⁸⁶ He was not alone in this view but actual developments have not gone in this direction. On the contrary, the whole tendency has been to lessen the importance of such special enterprises. Moreover, the Bank for International Settlements has not been able to take part in such schemes, nor to assume any responsibility for them under the reparation agreements. In fact, the importance of these deliveries was rapidly lessened and the scope of "assisted schemes" restricted.

As time went on, these operations began to lose their special significance. With the exception of public work contracts the arrangements were a part of the normal private business carried on between the citizens of the countries involved. A German and a Frenchman might agree to a purchase of goods, making all the specifications as to price and delivery in the usual manner. The currency for payment stipulated would depend on the usual practice in dealing with that commodity.⁸⁷ The contract would then be given to the French Commissioner⁸⁸ for approval. This formality would take some time, often as much as three to six months. Meanwhile, in many cases which seemed perfectly regular,

⁸⁵ Harry D. Gideonse, *The International Bank* (Rutgers, New Jersey, 1930), pp. 9-14.

⁸⁶ Sir Josiah Stamp, *Reparation Payments and Future International Trade* (Paris, 1925). This was a comprehensive report of possible "assisted schemes" for the International Chamber of Commerce.

⁸⁷ *The Trust Agreements*. Cmd. 3484, p. 91. In principle the payments were to be in reichsmarks, but it was possible to make them in other currencies. In this case the check would be changed at the average exchange rate on the day preceding that of payment. For instance the payment for sugar was in pounds sterling.

⁸⁸ In the case of each purchaser the Commissioner of his country would handle the contract.

the purchaser and the producer would take for granted the consent and continue their business as if the delivery was assured. In other cases, however, there might be a delay in production pending actual approval of the contract. Sometimes the Commissioner would request evidence of the delivery of the goods. When all such formalities had been fulfilled the Commissioner would draw a check on the Reichsbank³⁹ payable to the German who supplied the goods.

When these early steps were complete and the check was given to the purchaser by the Commissioner it might pass very quickly to the German or it might be held pending the final completion of the contract. The German who received it would present it at once to his bank which would collect from the Reichsbank. Despite its handling of the funds the B. I. S. was relieved of all responsibility with regard to the contracts.⁴⁰ Copies were sent to Basle and kept on file but the Management of the B. I. S. indicated that it did not take note of the nature of the contracts and merely served as a depository for them.

Meanwhile the accumulation of funds within Germany was the responsibility of that government alone. The collection of taxes and building up of the necessary sums was a matter in which neither the creditor governments nor the Bank for International Settlements had any part. Although it had been arranged in the Hague Agreements and the Young Plan that certain revenues be assigned as collateral guarantees, this was considered a mere formality. The revenues so assigned were calculated to yield about 150 per cent of the obligations to be met for the annuities.⁴¹ Certainly

³⁹ Because of certain laws the check was actually drawn on a French account at the Reichsbank, which might not show a credit balance at the moment, but which was credited immediately with the necessary sum. This sum was deducted from the account of the B. I. S. at the Reichsbank.

⁴⁰ *The Trust Agreements*, Cmd. 3484, p. 83. "The Creditor Governments concerned and the German Government remain responsible for the approval of contracts and entrust the management of the funds reserved for deliveries in kind to the Bank for International Settlements."

⁴¹ *The Trust Agreements*, Cmd. 3484, Annex VII, p. 67; *The Young Plan*, Cmd. 3343, p. 51.

these matters had no bearing on the work of the B. I. S. It is possible, even probable, that the sums which one government accumulated for the coming payments, left on deposit with the Reichsbank, were turned over to the B. I. S. which paid interest on them. The degree to which this occurred cannot be ascertained.

The final step in this process was the discharge of the liability. This was complete when the seller's bank, presenting the check drawn by the Commissioner, received funds from the Reichsbank. These funds were debited to the B. I. S. account. Thus the last step was simple and automatic; since the funds were in hand before the date when the money was to be paid, nothing was needed but a book transfer. The most interesting consequence of these transactions was the fact that funds accumulated several months sooner than they were drawn out; that is, there was a lag between German monthly payments and the presentation of the checks. This allowed the Bank the opportunity to use the funds for investment purposes, although this was not an essential part of the process. At this point all the obligation had been satisfied with respect to the transaction. Presumably the French government had been paid by the purchaser who had thus substituted himself for the German government, and the German government, through the B. I. S., had paid the German seller instead of the Creditor treasury. The buyer, for his part, in the creditor country had received the counterpart of his payment in German goods.

The lag between receipts and withdrawals had existed during all the deliveries in kind. Under the Dawes Plan this permitted a certain elasticity which made it easier to buy foreign exchange at favorable times or to refrain from buying, and gave a slight aid to transfers. With the Young Plan the responsibility for accumulating exchange was shifted entirely to the Germans, and the lag served a different purpose. That is, the money which remained on deposit increased the assets of the B. I. S. so that it was able to

make larger placements in bills of exchange, acceptances, and other investments in Germany. The part of the Bank's deposits with the Reichsbank which originated in the deliveries in kind was not of course distinguishable from the deposits derived from other sources⁴² which it held there. The B. I. S. had one account there, and against these it had to set the liabilities which were to be met in Germany. Banking prudence determined the form of the investments and the liquidity, but there was nothing to prevent earning a reasonable return for the time during which the funds were unclaimed.

It is not possible to know just how much money was left on deposit for this reason but it is indicated in the reports of the Agent General that the sums were considerable during the operation of the Dawes Plan. Some clue is given to this under the heading "funds committed under approved contracts."⁴³ It will be seen that in the fifth annuity year the funds payable and not taken amounted to approximately ten per cent of the total deliveries in kind for the year. There is, of course, no way of discovering whether the sums at the moment when the accounts were rendered were more or less than they had been at other times during the year, but in any case the figure stood at more than a 100 million reichsmarks in most of the cases given. Naturally some decrease would occur on account of the declining totals for payments in kind, and this would have a proportionate effect on the lag. Although a close estimate is not possible, it is known that the earnings on this sum ran to several million swiss francs a year in 1930 and 1931.

The reasons for this delay in withdrawing the money lay in the natural uncertainties and complexities of organizing a new system for the transfer of goods. The contracts which

⁴² The receipts for deliveries in kind would be included in "Central Banks for the account of others" on the liability side of the monthly statements of the B. I. S.; the investment of the "lag" would be included in bills, acceptances, and in deposits, on the assets side.

⁴³ *Report of the Agent General for Reparation Payments, op. cit.*, pp. 66, 311, 339, 351, 360. See also *Bank for International Settlements, Second Annual Report* (Basle, May 10, 1932), Annex XV, p. 67.

were turned in to the various Commissioners could not be approved automatically and a delay of several months might occur. It is also possible that the payment might not be made because of some factor which prevented the goods being delivered, and this might in certain cases account for another few months. Then again, although much of this work was carried on in the ordinary run of business, there was, in addition to the delays which may intervene in any transaction, the need for investigation, approval, and government oversight, at each step, multiplying several times the uncertainties and interruptions which might take place. The fact that the time interval did not become markedly less during the five years of the Dawes Plan indicates that there must have been very real obstacles in the way of prompt operation.

One explanation of the surprising persistence of the lag may have been that the loss of interest was distributed so widely that it was not recognized as a significant item. Insofar as the loss fell on the German it was merely one of the expenses which went with the administration of Reparation and one of the smaller items. Moreover, the major part of it must have been forfeited by the Allies, and here it was divided between all the governments and the individuals who had used this means to get goods from Germany.⁴⁴ Thus, if the buyer paid the government before he received the goods, there was a slight increase in the cost of the transactions. If the government did not receive the payment from the citizen before the check was cashed, it merely meant that the government was extending credit to that extent. Since it was spread over a number of countries and divided among hundreds of entrepreneurs the fact was almost lost sight of. On the other hand, the gains from this source were only of passing significance, and merit attention mainly because they emphasize the difference between such

⁴⁴ The French government did not receive the checks from French citizens as soon as money in Reichsbank was available.

artificial transactions and the more normal movements of goods.

Thus it is evident that the handling of funds, either for cash delivery or for payments in kind, did not undergo any great change with the coming into force of the Young Plan. Of course, the books were kept in Basle rather than in Berlin, the name in which accounts were listed was different, and some slight reallocation of tasks took place, but in general the procedure was the same as that which had been carried on for five years. Even the basic changes in responsibility, in guarantees, in the doing away of controls, affected the matter negatively, and these changes made the responsibility of the B. I. S. actually less in most respects than that of the Agent General. If the Bank is to play a significant part in the reparation problem, it must be by virtue of its general economic influence, or of special functions which might be delegated to it later. There is no doubt that more was expected in some quarters of this part of the Bank's activities than actually materialized.

THE YOUNG LOAN

Another instance of the inability of the Bank to alter the basic reparation factors is illustrated by the declining value of the German External 5½ per cent loan. Of course the Young Loan was offered at a very unfortunate time, and was too large an issue to be absorbed with ease. Furthermore the political atmosphere and the unusual division of responsibilities made it much weaker than financial conditions alone warranted. Thus the value of the loan on all the markets ⁴⁵ fell very low. There had been serious difficulties in 1930 in the way of distribution in some of the most important centers, and later events in Germany were such as to incite growing distrust. In 1929 it had been anticipated by some of the framers of the Young Plan, and certainly by some of the countries most interested, such as

⁴⁵ See Chapter XV for quotations.

France, that the first issue would be followed by others, and that this process of mobilization would spread the burden over time and space in such a way that the Reparation problem would be built solidly into the structure of commercial and private financial obligations. The actual turn of events, however, made it unlikely that any further loan would be undertaken.

It is probable that the loan issued by the B. I. S. in June, 1930, was the most complicated piece of international finance which had ever been arranged.⁴⁶ The issue was made on nine markets and in as many currencies. The proceeds were distributed among seven countries, not all included in the other nine. Moreover, the loan was served out of two separate sources,⁴⁷ and in all of the currencies of the original issue. There were financial agreements with the seven different governments who were to share in the proceeds, as well as with banks, lawyers, and commission houses in the nine countries who were taking portions of the loan. Moreover, all these transactions were handled by a financial institution which was just beginning to function, and the concept of Trustee, as here used, was practically unknown in Europe. There was, therefore, some uncertainty as to just what responsibilities were involved. To these difficulties must be added the fact that the loan ranks as one of the biggest international issues that was made during these years and that it was floated at a time when the bond markets were in the worst condition known for several decades.

The outcome of these efforts was a serious disappointment in the hope of mobilizing a part of the reparation payment, a hope which had been in the foreground for a number of years. It had been suggested quite seriously in 1928 ⁴⁸

⁴⁶ Bank for International Settlements, *Statement of Receipt and Distribution of the Proceeds of the Loan*, Basle, September 17, 1930 (auditors' statement).

⁴⁷ It should be noted the portion turned over to the German government, 100 million dollars, was served in addition to the Young Annuity.

⁴⁸ *The New York Times* (Feb. 14, 1928).

that an issue be floated with the German railroads as security. Figures as high as three billion dollars had been spoken of, which was a sum ten times the actual loan in 1930. As the discussion was carried further it was realized that such a large issue could not be made without a thorough consideration of the whole question, so when the proposal for a conference was finally made in Geneva in September 16, 1928, this was to be one of several matters, although not the most urgent reason, for reopening the question.

The motives for mobilization were three. There was, first, the desire in some countries to have cash for immediate disposal. There was, in the second place, the idea that the commercialization of the bonds would shift the burdens in such a way that the immediate payments, assisted temporarily by private investors, would no longer be a direct object of contention between governments. There was, however, a third motive, in that it was thought that it would be a more serious matter for Germany to default on obligations to the citizens of a number of countries than it would be to refuse to pay the creditor governments. In fact it was assumed that once the loans were commercialized, default or revision downward would mean credit suicide. The changed nature of the obligation to pay made it natural that Germany did not wish a large amount of commercialization, and that France, the main creditor, desired to push this transformation further, if it were practicable.

Thus, there is no doubt that the pressure for partial mobilization on the part of the Allies was of importance, although other factors were more influential in the calling together of the experts in 1929. It has been noted that one of the three main committees appointed in February studied the question of commercialization.⁴⁰ This committee, headed by the late Lord Revelstoke, found in the course of its deliberations that any large scale mobilizations would be best carried out by some sort of "international corporate

⁴⁰ *The New York Times* (Feb. 26, 1929), p. 3.

body.”⁵⁰ This point of view harmonized completely with the ideas developed by the other committees and led the way quite directly to the creation of the Bank.

At this time, however, the plans for commercialization were not carried far. In fact the Young Committee experts merely laid down a few general principles. The process was described as a phase of the “removal of the reparation obligation from the political to the financial sphere.” It indicated the right of Germany to prior redemption, the steps which should be taken to put such transactions into operation, and the matter of collateral guarantees. The amounts and dates were left to later agreements.⁵¹

A further step in the mobilization of a part of the unconditional annuities was defined by the Hague Conference in its agreements of January 20, 1930.⁵² Here for the first time the amount and approximate date of issue were decided.⁵³ The total amount of the effective proceeds was to be 300 million dollars, though only two-thirds of this was, strictly speaking, a mobilization of reparation payments, since 100 million dollars were entirely outside the annuities and were to go direct to Germany. This part was to be served by the Reich in addition to the other. Further, it was specified at the Hague that the issue was to take place before October first. It was also at this time that the nature of the “collateral guarantees” was defined, and the procedure for further mobilizations and also the nature of Germany’s exact responsibility were indicated.

Most of the further details as to the nature of the loan

⁵⁰ *The New York Times* (March 4, 1929), pp. 1, 24; *The Times* (London), (March 4, 1929), p. 15 *Le Temps* (March 5, 1929); *Frankfurter Zeitung* (March 5, 1929), p. 2; *Journal de Genève* (March 9); *Le Temps* (March 10); *The Times* (London), (March 10, 1929). See also *supra*, Chapter I.

⁵¹ *The Trust Agreements*, Cmd. 3484, pp. 76, 77, 134-137. *The Young Plan*, Cmd. 3343, pp. 28, 29, 50-54. Although the rate of interest was not indicated in the Plan, the rate at which Germany could redeem the loan was set at 5½ per cent, and this was later chosen as the nominal rate on the loan.

⁵² The matter was not taken up at The Hague in August, 1929.

⁵³ *The Young Plan*, Cmd. 3343, pp. 5, 6, 7, 74, 135.

were left to the Bank for International Settlements which was to act as Trustee, and administer the necessary payments. The Bank, in fact, attended to the distribution of the proceeds, rate of interest, and sinking fund. It decided on the date for the redemption of the loan. The date of maturity practically coincided with the expiration in 1966 of that part of the annuity coming from the Reichsbahn,⁵⁴ but the date, 1965, was chosen as a round number setting a 35-year period for the life of the loan. The further work in preparation for the flotation followed shortly on the determination of these conditions.

The plans were first taken up by the B. I. S. in the informal Board Meeting of April 22 and 23.⁵⁵ Meanwhile further steps had been taken to organize the new Bank and make possible the floating of a loan, such as the choosing of the Directors, election of officers, and measures to ratify the Young Plan introduced in the various countries. The German law was passed on March 13.⁵⁶ The French *Chambre des Députés* gave its approval on March 29. On April 5, it passed the French senate.⁵⁷

Then in May 1930, ratification by Great Britain and Italy⁵⁸ ended the legal formalities that stood between the Plan and its enforcement. Some progress was made on plans for the loan. Dr. Schacht resigned the presidency of the Reichsbank on March 7,⁵⁹ and the government was dissolved, partly because of internal issues, on March 27.⁶⁰ Nevertheless, opinion within and without Germany was still in the main favorable to the Young Plan.

A second step taken by the B. I. S. in May was the conference of bankers assembled in Brussels to discuss the Young Loan. It was called together and presided over by

⁵⁴ *The Trust Agreements*, Cmd. 3484, Annex IV, pp. 39, 40.

⁵⁵ *Frankfurter Zeitung* (April 25, 1931).

⁵⁶ *The New York Times* (March 11, 1930). *General Bond of Young Plan*, p. 2.

⁵⁷ *The New York Times* (April 6, 1930).

⁵⁸ *The New York Times* (May 6, 1930).

⁵⁹ *The New York Times* (March 8, 1930).

⁶⁰ *The New York Times* (March 28, 1930).

the officers of the Bank. President McGarrah, Monsieur Quesnay, Mr. Fraser represented the B. I. S. at this time. They could not wait longer if they were to complete the arrangements for the loan before the summer. The list of Bankers was most impressive; some of the most important houses of France, Germany, Sweden, Holland, Belgium, Italy, Switzerland, the United States, and Britain were represented, as well as some of the Central Banks.⁸¹ The discussions lasted several days and accomplished much work including such questions as the effective yield and the tax provisions which would affect its value. The French readiness to take the largest *tranche* made a favorable impression; ⁸² in respect to some of the conditions, however, the discussions revealed troublesome differences of opinion.

These preliminary conferences were followed by meetings of the representatives of the treasuries of the seven countries which were to participate in the proceeds of the loan.⁸³ Again a number of the questions to be decided proved difficult particularly that of the issue price.⁸⁴ For instance, the New York bankers had been reported as favoring a higher yield than the creditor governments wished. Then, the differences with regard to internal taxation in some countries complicated the matter further. As the conversations continued, it became increasingly evident that the bond market was in no condition to absorb a large loan of this character and that its course was not likely to be smooth. Moreover, a certain reluctance was evident in the offers made in regard to portions to be issued in different markets. These difficulties were partly psychological but this did not necessarily mean, as the *Deutsche Volkswirt* ⁸⁵

⁸¹ *Frankfurter Zeitung* (May 2, 1931).

⁸² The French share was slightly more than the issue made in the United States.

⁸³ The countries are France, Germany, British Empire, Italy, Japan, Yugoslavia, and Portugal. Bank for International Settlements, *Statement of Receipt and Distribution of the Proceeds of the Loan*, Basle (September 17, 1930).

⁸⁴ *Frankfurter Zeitung* (May 6, 1930); *The New York Times* (May 6, 1930).

⁸⁵ *Der Deutsche Volkswirt* (April 25, 1930).

prophesied rather hopefully, that they would disappear when all the conditions were known and the preparation for the issue complete.

During the meetings in Basle from May 14 to 18 the matter was not further considered, although at the end of the month a sub-committee of four, consisting of Messrs. Anderson, Luther, Masson, and Norman, meeting almost continuously from May 30 to June 3, arranged the final details.⁶⁶ These were submitted to the larger group of bankers representing the nine countries.⁶⁷ Thus, the loan agreement was ready just a year after the completion of the Young Plan and the General Bond was signed by Dr. Moldenhauer, the German Minister of Finance on June 10.⁶⁸

Finally on the eleventh of June and the days immediately following the loan was issued on the various markets.⁶⁹ It is interesting to observe that editorial opinion differed somewhat as to the success of the placement in the first few days. It was soon apparent, however, that any early gains had been lost and the course on the various markets was decidedly downward. Troubles in the process of distribution

⁶⁶ *The New York Times* (June 4, 1930).

⁶⁷ The countries are Belgium, France, Germany, Great Britain, Holland, Italy, Sweden, Switzerland, and the United States. *Statement of the Distribution of Proceeds* (Basle, September 17, 1930).

⁶⁸ *The General Bond*, German Government International 5½ per cent Loan, 1930.

⁶⁹ The dates of issue were:

June 11. New York, Berlin.

June 12. Amsterdam, Sweden, Switzerland, Italy.

June 13. Paris, London, Belgium.

The net yield in dollar equivalents was:

Belgium	\$ 4,225,548.69
France	84,735,091.79
Germany	7,498,518.75
Great Britain	49,334,181.55
Holland	25,096,501.81
Italy	4,915,782.58
Sweden	25,328,413.28
Switzerland	15,026,496.20
United States	85,956,172.44

Total\$302,116,707.09

The French portion should be adjusted to take into account the issue price.

were evident particularly in Amsterdam and New York but in general it was apparent that bankers found it impossible to get rid of their holdings on a profitable basis. The reason lay partly in chance circumstances such as the particular situation in which some of the banks found themselves in regard to the loan, but even more in the fact that the issue was too large to be absorbed readily at that time.

The unfavorable reception of the loan was variously interpreted in Germany. Some said that there had been sabotage in order to injure the Reich and spoke of the unwillingness to grant Germany credit as if it were deliberate and concerted action. Others took quite an opposite view and interpreted the reluctance to buy as a proof that the world did not want Germany to pay Reparation. At the same time more moderate opinions stressed the difficult combination of economic circumstances which were generally known to exist. In any case the spirit of optimism which had made possible the heavy borrowings after 1924 no longer existed either within or outside Germany.

Such were, then, the general characteristics and difficulties to be observed in connection with the Young loan. The particular form it took was probably not decisive as to the subsequent course.⁷⁰ Although many obstacles existed, the size alone was a condition which made success impossible in a time of political complication; even so, however, the amount actually mobilized was equivalent to only about one-tenth of the unconditional annuities, and was in approximately the same proportion to the sum first suggested. Moreover, it had been expected by some that other sections of the unconditional obligation would follow shortly, and that in three or four years, this part of the reparation payments would be on a commercial basis.⁷¹

The disappointment over the outcome was very real. It seemed probable even in 1930 that no further issues would be made, unless perhaps, some country, for special reasons,

⁷⁰ All the details are available in *The Young Plan, The Trust Agreements*, of January 20, 1930, and the *General Bond*.

⁷¹ *Neue Zürcher Zeitung* (Jan. 24, 1930).

should proceed to an internal issue, which was permitted under the agreements. In all this work, the rôle the B. I. S. had played had been clearly predetermined. It had neither the obligation nor the power to support the issue in the market, and its regular handling of interest and sinking fund did not in any way constitute an active support of the loan.

The B. I. S. applied the sinking fund so as to extinguish the total in 35 years, but there was little choice in the way this could be handled. It is true that when the bonds quoted below the price at which drawing was to take place, the Bank was in a position to purchase ahead certain amounts for the German government, but this was only possible to a limited extent because large funds were not available for purchases. Any savings effected were returned to the German government.

In the original plans it had been specified that one-third, or the part which was a direct loan to Germany, should be served *in addition* to the sums required for the Young Plan annuities, whereas two-thirds were served out of these sums. It is possible that this complication, along with the other features which were so hard for the public to understand, increased the general uncertainty regarding the loan. However this may be, queries were frequently addressed to the B. I. S. and to bankers who had a part in the flotation regarding the security, possibility of postponement or default, and source of interest and sinking fund for the loan.

The Young Loan differed from the Dawes Loan in a number of respects. First, it was larger by almost 100 million dollars.⁷² Second, the Dawes Loan was issued in order to make possible the financial and industrial recovery of Ger-

⁷² *Report of the Agent General for Reparation Payments*, May 30, 1925, *op. cit.*, pp. 11, 12.

The Dawes Loan was issued October 14, 1924, on nine markets, in five currencies, dollars, lire, pounds, swedish kronen, and swiss francs. The countries were the same as those in which the Young Loan was issued. The proceeds of the loan were approximately 800 million reichsmarks. These were deposited with the Reichsbank, and the power to draw on the account given to the Agent General. The issue price was between 80 and 90; in the different countries the interest paid a nominal seven per cent. The course of the loan on the security markets was at first upward,

many and, therefore, was more closely linked with real productive purposes. Third, the Young Loan was a more complicated piece of finance since it was issued in more different currencies, and distributed to more governments.⁷³ Finally, the guarantees and sources of interest and amortization were not identical. Thus, interest on the Dawes Loan was paid out of sums set for the Dawes annuities at first, but in 1930 was added to the later Young Plan annuities. Two-thirds of the Young Loan was served out of these annuities. The same revenues served as a guarantee for both.⁷⁴ The Dawes Loan was technically a prior charge as compared with the Young Loan, when this further issue was made. These latter differences were not of great practical consequence but they indicate to a certain degree the complexities of the arrangements made.

The more significant difference between the two loans, however, grew out of the general economic situation and the spirit which enveloped the proceedings. The Dawes Loan was issued in a moment of hopefulness and the Experts' Committee had succeeded in banishing much of the political hostility. Moreover, the German currency had reached a temporary stability which seemed likely to persist, and there was within the country a determination and will to work which impressed foreign lenders and made them consider that the high yields to be earned in Germany were more than was needed to cover the risk of investing there. The Young Loan, on the contrary, was issued in a moment of general disappointment and economic depression. Germany in particular was disturbed at this time. The criticisms made by Dr. Schacht, and his resignation from the Reichsbank, the overthrow of the government in March, were followed by weeks of unrest and heightened the distrust of the approaching loan. Added to these unfavorable events in Germany there were unhealthy signs in the bond

⁷³ The proceeds went to seven governments in 1930 and to one in 1924.

⁷⁴ The Dawes loan was backed by the "positive pledge" of five revenues and the Young loan by the "negative pledge" of four of these five, not including sugar revenues.

markets of the world. New York was unreceptive to foreign issues. Indeed, from the beginning the course of the two loans was different and although the Dawes Loan has declined at times, it has never fallen at so rapid a rate as the Young Loan.

Faced with this situation the Bank for International Settlements had no means with which to check the tide of selling. Moreover, it had no mandate to do so,⁷⁵ even if it could have used its resources for this purpose. Certainly its nominal responsibility as Trustee, and the activities which had been assigned to it, did not influence greatly the course of events. The only point at which discretionary powers were exercised was the arrangement of details preparatory to the flotation of the loan. In any case it is doubtful whether any of the arrangements which were within the scope of these conferences would have made a significant difference.

Of course it would have been possible to arrange for a higher rate of interest, but since the influences which bore so heavily on the loan were not purely economic but rather political and psychological, a higher yield might have been even less favorable.⁷⁶ In fact there is no clear ground for criticizing the adjustments of detail for difficulties were mainly those growing out of events which had occurred since the formulation of the Young Plan. The work of the Bank in this connection was easily and completely executed, but it is unfortunate, nevertheless, that its first activity should have been carried out in such circumstances.

Of course, bankers did not hold the B. I. S. responsible for the outcome of the loan and nothing in this experience lessens the future possibilities of the B. I. S. as a trustee. On the contrary it is mechanically well equipped for such

⁷⁵ *The Trust Agreement*, Cmd. 3484, p. 71.

"On the understanding that the obligations of the Trustee . . . shall be only those normally incumbent on a banker. . . ."

⁷⁶ E. L. Dulles, *The French Franc, 1914-1928* (New York, 1929), pp. 208-222. It has been found in times of crisis that a higher rate of discount often repels rather than attracts borrowers.

transactions, and stands in a good position for making international credit transfer. Moreover, it has proved itself financially sound even in time of crisis. Therefore there is little doubt that when funds begin to flow more freely between nations, the B. I. S. will be asked to take on further work of this nature. It has been noted that in addition to its clearing possibilities and the general soundness of its position, it has other advantages which assure it a special standing in case of war. On the other hand, there is no indication that it will have anything like a monopoly of such functions. Obviously the handling of international loans is a business to which a number of large banks are accustomed, and there is no reason why they should relinquish all such activities to a new institution. In fact it is probable that the B. I. S. loans in the immediate future will be either special Central Bank Credits, government loans of the smaller states, or others which are intended for sale on a large number of markets and which must be served in an unusual number of currencies.

This possible line of development was indicated by requests that came to the B. I. S. for its services as Trustee in the course of the first eighteen months of its existence. These came from private businesses and from municipalities and governments. The Bank was not inclined to extend its services rapidly in this direction though there was no general decision to refuse such types of business. The loans which came under its Trustee functions in the first year were limited to the Young Loan, and the Austrian, 1930, loan.⁷⁷ Moreover, it agreed to act as fiscal agent of the Trustees of the Dawes Loan.⁷⁸ Regular statements of the handling of the funds were issued by the Bank, the first was dated September 30, 1930, and others were issued on December 15, January 15, and on subsequent dates. Previous to 1930, loans of this general character had been floated and supervised several times by the League of Nations. As time went on, however, such loans might well be

⁷⁷ The Austrian loan was floated July 1, 1930. It was to mature in 1957.

⁷⁸ The trustees were Messrs. Jay, Gilbert and Ter Meulen.

under the Trusteeship of the Bank, which had wide financial contacts, and permanent machinery adapted to this end.

THE SPECIAL DEPOSITS

There were certain other functions which came to the Bank under the Trust Agreement. It had, for instance, the custody of certain special deposits. These funds served two purposes. On the one hand, two of these deposits were long time funds not drawing interest and so made a net increase in the investment possibilities and earning power of the Bank. On the other hand, the third deposit served as a partial guarantee of the non-interruption of payments to creditor countries in case of postponement. Thus it can be seen from the balance sheet that of the four types of deposits provided for, three were immediately put at the disposal of the Bank. They differ markedly from each other in the conditions under which they are held, but, subject to such special conditions," they increase the long term assets of the Bank by approximately 300 million swiss francs." Thus during 1930 they constituted from one-third to one-fifth of the total funds and almost three-fourths of the long run resources of the Bank.

The other long term deposit which was optional on the part of Germany was not made, but it has a certain theoretical interest. There is no doubt, for instance, that it was hoped by some of the men in Paris that the Bank would help the payment of Reparation not only through the technical facilities which it provided, and by means of certain aids to exports, but also by a share of the large earnings which might come with a rapid and successful development of a world organization. With this in view permission was given to the German government to make a long term deposit and to secure thereby a certain share of the surplus profits to help Germany pay the last twenty-two annuities

" See *infra*.

" The fluctuation in this amount which is observable in the monthly balance sheets is caused by the changing relation between the currencies in which the deposit is made, and in which the sum required is specified as compared with "swiss francs at par."

provided by the Young Plan.⁸¹ There is no date specified before which this deposit must be made.

The incentive for making this deposit was small; indeed a careful examination of Article 53 of the Statutes⁸² of the Bank which follows the provisions laid down in the Plan,⁸³ will show that participation in profits can only follow substantial additions to the reserve fund, and the payments of an extraordinary dividend. Thus the first charge on profits after the regular dividend was to be for the reserve fund, the next for the ordinary dividend, the third for an increase in dividends, and of a part of the possible residue, twenty-five per cent, would be paid to a fund to aid Germany in respect to Reparation during the final twenty-two years.

The possibility of a claim, thirty-seven years hence, to a fractional share of potential profits has not aroused any eagerness in Germany. In fact it is certain that attention there is focussed much more on the services which the Bank can render than on future profits. No one has ventured to forecast with any certainty what those profits are likely to be, but many changes will probably occur in the years to come.

The other deposits were of much more importance. The first of the long term and special deposits actually made was that in the Annuity Trust account and held in the names of the different creditor governments. As a result of this the equivalent of 125 million reichsmarks was held permanently without interest by the B. I. S. in the national subdivisions of this account.⁸⁴ Other sums could be so held, but since interest was paid on accounts not in this division, it was only during the first two weeks of the operation of the Bank that these deposits rose above the minimum.⁸⁵ This sum was in fact a subsidy by the governments to the

⁸¹ *The Trust Agreement*, Cmd. 3484, pp. 78, 126; *Statutes*, Article 53, e, ii.

⁸² See *infra*, Appendix.

⁸³ *The Young Plan*, Cmd. 3343, p. 48.

⁸⁴ *The Trust Agreement*, Cmd. 3484, p. 72.

⁸⁵ See financial statements in Appendix.

B. I. S. and added considerably to the net earnings of the Bank. It was not considered to be a guarantee and there are no provisions for the use of this deposit in the case of postponement by Germany of any part of the annuities. The sum was not actually held in reichsmarks, but in other currencies so that the equivalent always came to the specified value.

The second long term special deposit was the counterpart of the first made by the creditor governments. Thus, in pursuance of the Hague Agreement, the German government undertook to keep a non-interest bearing deposit with the Bank equal to half the other deposit in the Annuity Trust account, but not to exceed the value of 100 million reichsmarks.⁸⁶ The first annuity trust deposit on June 2, 1930, was at a higher figure⁸⁷ than was expected, because the amounts held in the national subdivisions of the account were larger than the minimum required. The figure was soon reduced, however, so that in August and thereafter it stood at the prescribed minimum. Once this deposit had been made it was of no great significance to the German government for the loss of interest was small compared with the total reparation annuity, approximately one per cent, and was partially offset by participation of the Reichsbank.

The third long term deposit, the French, had a different significance. It was established not to add to the working funds for the Bank for International Settlements, but to provide resources to readjust the payments to the creditors, in case the proportions should be altered by the postponement of part of the annuity.⁸⁸ To this end it was stated in the Plan that France should be ready to pay into the Bank on demand a deposit in the Trust fund not to exceed 500 million reichsmarks, a part of this deposit was to be made at the time of mobilization; the amount to equal a tenth of

⁸⁶ *The Trust Agreement*, Cmd. 3484, pp. 37, 74.

⁸⁷ The Bank Statement of June 30, 1930. In comparing figures it should be remembered that the Bank statement is in swiss francs at par whereas these specifications are in reichsmarks. *Frankfurter Zeitung* (June 3, 1930).

⁸⁸ *The Trust Agreement*, Cmd. 3484, p. 75, Article XI (4). *The Young Plan*, Annex VIII, Cmd. 3343, p. 65.

the proceeds of the share of mobilization going to France."⁹⁹ Therefore, as the result of the Young Loan, the deposit made was slightly more than 68 million swiss francs, or approximately a tenth of the maximum called for. This guarantee fund was established for the benefit of those creditors who had a smaller proportional claim to the unconditional annuity or mobilizable portion of the payments. The sum appears for the first time in the balance sheet of the Bank for July 1930, and remains unchanged in the following months. If there should be postponement of the entire conditional part, France would be asked to supply sums in addition to those first deposited.

The French deposit, unlike the other two, was to earn interest and so was not a source of net income to the Bank. Moreover, it could entitle the French government to participate in the profits if it were left for more than five years. The funds which might be deducted to readjust the annuities paid to the creditor nations in case of postponement were to be put back into the fund when the payments were resumed in the prescribed manner. It was further provided that the deposit should not be made in reichsmarks, but in any other currency, since it was obvious that in case of postponement the mark might suffer in comparison with other exchanges. It was understood that the larger part of the sum was held by the B. I. S. in dollars, the currency which would be in demand if the deposit were needed to supplement the German payments.

The concern of the Bank with this deposit was limited to its banking aspects. The funds were invested in such a way that they would earn the interest payable, and yet be liquid in case of need. Although this deposit is called a long term deposit, it does not seem to have the same claims to this classification as the other two, since calls might have been made on it, after the expiration of the ninety days notice required of Germany for postponement."¹⁰⁰

⁹⁹ The amount of the deposits actually made after mobilization was deducted from the amount which might be asked for. See Chapter XIV for discussion of the part the special deposits played in June 1931.

¹⁰⁰ *The Trust Agreement*, Cmd. 3484, p. 36.

CHAPTER XIV

THE CREDIT CRISIS AND THE BANK

THE main lines of influence of the Bank in 1931 were established through its deposit and investment business, its clearing facilities, its credit policies, and its Reparation and Trustee functions. All these have been analyzed in preceding chapters in the form which they took at the end of 1930 and in the early months of 1931.

The work for Central Bank coöperation which was still in its beginnings will be described later in Chapter XVI.

A new phase in the Bank's activity was precipitated by the crises in the spring of 1931 and by changes in reparation conditions. This new period will be discussed in the next two chapters.

The swift rush of events bore Europe to the verge of bankruptcy and threatened the solidity of the dollar and the franc in the latter part of 1931. Banking troubles in Austria spread, through the freezing of credits, to other eastern European countries, to Germany, England, France, and the United States. Political and economic questions, once believed settled, were opened again, and statesmen forced to consider sweeping measures of readjustment. The "Hoover Debt Holiday," "*Stillhaltung*" agreement, gold standard restriction, and general elections in England followed each other in quick succession.

Each month had its stirring event. May brought the Austrian collapse; June the Hoover proposal; July the French agreement and German banking crisis. In August the difficult negotiations of the Wiggin Committee were completed. September saw the suspension of the gold standard in England, and October the run on the dollar. The

B. I. S. was shaken by all these events in the short space of six months; Europe turned from a general and unconcentrated preoccupation with the depression to the more precise and peremptory demands to save the large banking institutions, to preserve monetary stability if possible, and to prevent panic. The emergency called forth every constructive force to fight for the safety of capital, both in its concrete manifestation as loaned wealth, and from another point of view, capital as the foundation stone of the system of credit and exchange.

In fact, established methods in the financial world were seriously threatened and, for the first time, perhaps, the entire Western world realized the gravity of the situation. The interconnections of the crises in the different countries had been known, but the gradual immobilizing of funds everywhere had not been given its due importance until 1931. Almost any losses at this time hastened the freezing of credit. The dangerous condition was a result in part of the many instances of the use of short term funds for purposes which did not lead to quick liquidation. Thus, the malady had spread until no country was free of it and, when the danger was recognized, efforts to save the world from catastrophic deflation were carried on with feverish intensity, and an honest willingness to compromise promised hope of recovery—if destructive tendencies did not move too fast.

This tying up of credits was due fundamentally to lack of confidence, and indirectly to political fears, high interest rates, and currency instability. In fact, there was a general unwillingness to enter into commitments for long, while Europe was in a state of unrest. In the dealings between countries, it was a logical outcome of the gold standard difficulties, because the building up of large short term funds in the sounder currencies interfered with the supplies going to the long term capital market. Within countries, it was due in part to the over-development of certain industries, the uncertainty of marketing possibilities and solvency, and

the unusual recourse to special kinds of loans, such as brokers' loans and Lombard credits.

All these factors bore with peculiar force on the Austrian economy, and finally upset the precarious equilibrium of the previous nine years. During these years the industrial situation had not been sound, markets had been dislocated, and all investment in manufacturing undertaking was highly speculative because of territorial changes and tariff barriers. Nevertheless, the importance of keeping production going, justified, to a certain extent, the banking support given to Austrian entrepreneurs. Unfortunately, no relief came on the side of tariffs, markets, or general economic recovery in the outside world. The insolvency of the *Credit Anstalt*, which threatened on May 11, proved to be unavoidable and dragged down a number of other Austrian banks. The destructive influence spread immediately to Germany, and elsewhere.

The alternating and yet constantly interconnecting influence of economic and political events in Europe makes it difficult sometimes to decide which was cause and which was effect. The Bank at Basle was hampered by both types of forces. It is evident that the rising wave of nationalism was a natural result of the economic discontent. This tendency is to be observed in particular in the swing to the right in France, Germany and England, culminating in the nationalist triumph—the crushing defeat of Labor in England on October 27. Earlier manifestations were observable in the gains of the National Socialists in the various district elections in Germany. Then, again, more significant from some points of view, the French election for the presidency resulted in the defeat of Briand, an event which indicated in part that the French questioned the policy of the foreign minister toward Germany, and had been unfavorably impressed by conversations on the Austro-German customs pact.¹

¹ See the discussion of the announcement made on March 22, 1931, and Hague court decision, September 5, 1931.

Thus in Germany, France, and England extremists of the right wing gained ground. As the result of tendencies in these three countries the issue was boldly set forth; there could be no further one-sided concessions; unless real coöperation were possible, the main nations of the industrial world preferred to work toward self-sufficiency, even at the risk of not maintaining their standard of living. There would have to be either a series of radical steps and inclusive agreements to insure coöperation, or, there would have to be rescue work to preserve what was left of foreign credits, as each nation attempted to reorganize on the basis of self-sufficiency.

The economic phenomenon which paralleled this spread of nationalism was the general freezing of credit which the Bank was powerless to help. This was caused by two powerful influences, one was the decline in prices piling up insolvencies, and the other was the loss of confidence, partly justified, partly hysterical. Both influences spread like a fatal paralysis throughout the economic system of the world. They moved from the more obviously distressed countries to those that had tried to help, or to exploit them, and then to other nations, comparatively sound in themselves. All of these nations had wide ramifications of investments, both short and long time. This situation called for artificial measures of a somewhat inflationary nature, and for the extension of credits, not because this action was sound in itself, but to check the destructive spread of a cumulative deflation.

So great was the danger that the desire for independence and a self-sufficient economy was hampered by the urgent need of mutual efforts to prevent general bankruptcy. The reparation obligations were part of this general problem, and, therefore, the whole question had to be opened up again. After the full force of the crisis struck in the summer of 1931, there was no general expectation anywhere in Europe that full Young Plan payments could be met for a number of years. The political obstacles to reduction were

real, but it was clear that in one form or another a new settlement had to be arranged before the expiration of the Hoover Moratorium. This "debt holiday" was a first step in the direction of many different protections for debtors.

The moratorium suggestion stirred up new political difficulties, and the delay which resulted hastened further banking troubles. Frozen credits growing out of bank failures hastened England's suspension of the gold standard and this led to a run on the dollar, which further demoralized confidence. During these months attention shifted from one center of trouble to another. The Bank was shaken by every new influence on credit, and called on for special services at the very time when its resources were diminished. It took an active part in the history of these momentous months, even though it was to be crippled in some respects by the difficulties which it attempted to ease.

HISTORY MADE IN 1931

The events of 1931 will be given a place of importance in the histories of the future. There was a shift in relative financial and political influence. Some existing tendencies were made plain, others were altered. There was, moreover, a redefining of what was desirable; in a number of countries economic self-sufficiency and independence temporarily took precedence, even over war tribute. The nature and importance of economic stability were seen more clearly than ever before. And the questions of the price level and right use of credit became the most urgent ones before the world, except perhaps, for the related problems of disarmament and security. The narrowing of purchasing power from a credit basis to something approximating barter, implied in the scramble for gold, was paralyzing Western civilization. The postwar catastrophe was faced squarely for the first time.

The difficulties of the *Credit Anstalt* which came to light in May 1931, had roots far back in the past, even reaching into prewar years.* The Austrian Bank had become very

* See *supra*, Chapter X, for the activities of the B. I. S. in May.

much involved in industrial life, both in the country and in neighboring states. Gradual pessimism over the tariff, the political relations of these countries, and the decline of agricultural values, reduced the value of its assets. The Austrian National Bank had to come to its rescue, and in its turn it had to secure help from outside.

The alarming news spread over Europe on Monday, May 11. On the twelfth, word from Paris indicated that adequate support would be given. This was immediately followed by rumors that the French had been bargaining with Austria for the renunciation of the Customs Pact with Germany. The next authentic news was that the immediate financial assistance had come from England and the inference was drawn that this help was rendered to prevent political pressure at a time of financial crisis.³

A Vienna correspondent describes this incident as the beginning of an economic war. Looking back to it in August, after the debt negotiation and the downward movement of sterling, he says: ⁴

It is believed that the fatal shot which loosed the present financial crisis was fired by the Bank of England last May when it lent £20,000,000 to Austria, thereby freeing her from having to submit to the humiliating political conditions that France was attaching to a loan, including the surrender of the customs union project. Austrian-German rejoicing over Britain having freed their hand was short-lived. To-day it is believed here that a France financial offensive was begun immediately "to teach England not to cross French political aims with French money." French attacks upon British credit brought in their train the German Danat Bank catastrophe, for England was then unable to come to Germany's rescue. Hungary was immediately affected. . . .

This comment is significant mainly in that it represents a

³ It is interesting to note that Great Britain was so prompt with assistance, and on May 14 the Bank of England lowered the rate from three to two and one half per cent. Almost at once thereafter the budget, unemployment, the exchanges, and the *stillstand* in Germany were to paralyze English financial power.

⁴ G. E. R. Gedy, *The New York Times* (Aug. 9, 1931). See also Paul Einzig, *Behind the Scenes of International Finance* (New York, 1931).

view widely held, rather than because of the exact validity of the statement.

In any case the urgent need for credit led the Bank for International Settlements to send Mr. Rodd and Dr. von Simon to Vienna immediately to confer with the officials of the National Bank. These men offered timely assistance, which was followed later by a credit. The B. I. S. did not take any direct part in the reorganization of the *Credit Anstalt*, which was carried on by a creditors' committee under the chairmanship of Mynheer Van Hengel. This work took many months to complete and offered troublesome questions leading to adjustments in all the surrounding countries. The presence of the B. I. S. experts in Vienna rendered assistance, because of the advice which they could give, and because they offered a means for coördinating the other efforts to prevent a breakdown in Austria.

It was first thought that these efforts had been successful. For instance, on May 18 *The Financial News* said that the work accomplished in Austria, the attempt to regulate the *Credit Anstalt* affair had "effectively restored confidence." A week later, however, new signs of distress were observed in other countries. German bonds fell sharply and information regarding other banks began to cause alarm. It was characteristic of these months that there were so many absorbing problems and unexpected events that attention shifted quickly, and a false optimism sometimes caused delays in rendering assistance.

Such a false hope centered on the Chequers conversations of Premiers Bruening and MacDonald. These took place over the week-end of June 7. Although every possible official attempt was made to indicate that they were merely an informal interchange of opinions, the fact that it was the first such visit of cabinet ministers to England since the war,⁵ and that so much was needed in the way of international coöperation, excited intense interest all over

⁵ German officials attended the London Conference in 1924 which arranged for the putting into operation of the Dawes Plan.

Europe. In some quarters it was rumored that the necessity of a reparation moratorium was urged at this time, and many people thought that the result of this German appeal was communicated directly to Washington. In any case, speculation anticipated favorable results by running up German security values on many markets, and then promptly registered a deflation of hopes by a sharp drop, especially the Young and Dawes loans.

The B. I. S. Directors' Meeting on June 8 was occupied mainly with Central European troubles. For one thing arrangements for the first credit of 100 million schillings were completed. And an additional loan was discussed. Then, further suggestions of help to both Rumania and Hungary were made, but these latter projects did not pass beyond the stage of general conversation at this time. This was the first Board Meeting with the newly elected Directors, and was important also in that it marked the beginning of a new phase of the Bank's development. For although the change was even more conspicuous when the "Hoover Debt Holiday" came into force, the real shift in emphasis came with the Austrian loan.

This change brought with it the new tasks of helping banks in distress, and of working over frozen credits, while moratoria created a new rôle for the B. I. S. in opening credits. This work characterized the third six months of the Bank. The Bank became in a sense an investment trust inasmuch as relief work of this nature essentially consisted of renewable credits.* As a result of this work it held high yield and non-liquid claims on countries which needed funds to tide them over emergencies. The granting of these credits enhanced the moral influence of the Bank in certain countries. Moreover, because the Bank acted as the head of a consortium in a number of cases, the work of international

* A financier in close touch with the Bank said that its new rôle must be that of receiver for frozen credits, a bankruptcy court and an agency for "saving face" and credit which was so badly demoralized.

coöperation took on a new form in Basle. This was all the more conspicuous later, as the Bank's resources for Reparation-Debt clearing disappeared, and it was left with only half the funds of the peak months, but greatly increased responsibilities and opportunities along certain other lines. Thus, for the last time in many months, on June 15, the debt payments due to the United States were made by debtor countries, using the Bank for shifting funds to their various agents in the United States. The result of these out-payments is reflected in the July balance sheet.

Meanwhile news from various sources informed Washington of the swift march of events. It is not necessary to suppose that any one bit of evidence was critical in bringing about the debt proposal. There is no doubt that Ambassador Sackett in Berlin sent word of his talks with President von Hindenburg, and that Ambassador Edge in Paris was aware of the uneasy feeling there. Moreover, it was known that Ambassador Gibson in Belgium was very thoroughly acquainted with the German situation and sent some impressive statements to the capital. In some quarters considerable stress was given to the fact that Ambassador Dawes was already in America and in a position to explain the nature of the emergency. Finally, whatever may have been the official communication regarding the Chequers conversations, there is little doubt that it indirectly hastened President Hoover's decision.

THE "HOOVER DEBT HOLIDAY"

During the week of June 14 President Hoover summoned a number of financiers and politicians to Washington. Several suggestions were laid before him and the political possibilities were canvassed by telephone and by personal conversations. The result was the rapid evolution of the Plan which came into force in July. The "Hoover Debt Holiday" announced on June 20 was a surprise to many and was hailed with great rejoicing in Europe and with almost universal

approval in the United States. Despite the financial sacrifice involved for America, it was considered to be a constructive measure to counter the depression. It was thought that it would operate in the interest of world peace, as well as for the recovery of commerce. There was for the first time, probably, general recognition that the receipts coming to the creditor country were of very small value in comparison with possible loss due to the disturbing effect they had on credit and prices.

The text of President Hoover's statement was in part as follows: ¹

The American Government proposes the postponement during one year of all payments on intergovernmental debts, reparations and relief debts, both principal and interest, of course, not including obligations of governments held by private parties. Subject to confirmation by Congress, the American Government will postpone all payments upon the debts of foreign governments to the American Government payable during the fiscal year beginning July 1, next, conditional on a like postponement for one year of all payments on intergovernmental debts owing the important creditor powers. . . .

Along with this proposal there were listed the names of prominent persons who approved this step, men in the Senate, in the House of Representatives, and others, for instance, Charles G. Dawes and Owen D. Young. The New York stock market had anticipated the recovery with a sharp rise, on Saturday, based on early rumors. This was referred to as "the biggest upswing for 19 months."

Although President Hoover's proposals were welcomed in almost all the capitals of the world, there was delay on the part of France, which had serious consequences. France had more to lose than any of the other creditors, except the United States. She was to receive about 199 million dollars from Germany and to pay out approximately 114 million dollars to her creditors. The sacrifices proposed were about as follows:

¹ *The New York Times* (June 21, 1931).

The United States	246 million dollars
France	86
Great Britain *	19
Belgium	17
Italy	9

Moreover, it is well known that France considered that the claims for the replacement of destroyed property had a moral if not a legal superiority over the payments for pensions and similar war costs.

In addition to this the French people had recently expressed their reluctance to make concessions, in the result of the election of the new President. They resented what they considered a threatening attitude in Germany, especially the *Stahlhelm* demonstrations, the "pocket battle-ships," and the Austro-German Customs plan. They had recognized the financial weakness in Central Europe, but in some ways this increased the consciousness of their own power. In view of these facts they asserted that the sudden adoption of a project which seemed to go outside the limits of the Young Plan was impossible. It was therefore politically inevitable that they should question the new move; and they submitted a counter proposal on June 24.

Meanwhile the B. I. S. credit to Germany was virtually used up over the month-end and a breakdown of the new debt plan was forecast by some. The United States sent a prompt reply to France, indicating that the alternatives to adopting the United States suggestion were becoming more and more threatening to European stability and costly to France. It was increasingly evident that the failure to reach an agreement would bring an immediate request for a moratorium under the Young Plan. In this connection the President pointed out that it would be necessary for France to deposit with the Bank for International Settlements

* See the *Financial News* (June 23, 1931). Great Britain had accepted the principle of equal receipts and out-payments but the different rates of increase made a disparity in certain years. Moreover the depreciation of the pound upset this balance. See *The Economist* (London, January 23, 1932).

about 106 million dollars.* If in addition to this, France were called on to pay more than 100 million dollars to the United States and Great Britain, she would be obligated for a sum of between 210 and 220 million dollars, whereas her receipts from unconditional annuities would be only a little over 100 million dollars when all deductions were made. Therefore recourse to the Young Plan protections would mean a greater sacrifice than the amount involved in the Hoover proposal.

For various reasons the political atmosphere improved on July 2 and 3. The Americans indicated a willingness to compromise on the question of the period of repayment and to allow adjustments which would fit the suggestion into the framework of the Young Plan and respect the continuity of the unconditional annuities. On the other hand, they rejected the suggestion in the French counter proposal that a part of the funds paid into the B. I. S. should be reloaned to Central European powers and insisted on the importance of quick action. Thus a "substantial agreement on all but a few minor points" was announced on July 4.

Very shortly thereafter, on July 6, full agreement was announced. It provided for the continuity of unconditional payments by turning them over to the B. I. S., which would reloan them to the German railroads. This arrangement was called for by the French, because of their thesis that Germany should continue to pay the unconditional annuities. In this transaction the Bank merely acted as agent; it received the German government's payment for the accounts of creditor countries and, acting as their agent, loaned these funds immediately to the German railroad which in turn put the money at the disposal of the Reich. These and other details of the arrangements were left to a

* France had already deposited about 14 million dollars as a part of this fund in virtue of the obligation incurred at the time of the mobilization of a part of the unconditional annuities—that is 10 per cent of her share. *The Commercial and Financial Chronicle* (New York, Jan. 16, 1932), p. 415.

conference of representatives of interested governments. Meanwhile, the payments due on inter-Allied debts to the United States were suspended, subject to the approval of Congress, from July 1, 1931, until June 30, 1932.

Unfortunately this announcement failed to bring the hoped-for relief. The German situation grew more desperate and President Luther of the Reichsbank began a campaign to secure a loan of 300 to 500 million dollars for the Reichsbank. German bonds and mark exchange were both weak, gold losses continued and rumors of Bank difficulties increased. Dr. Luther went to London July ninth and to Paris on the tenth, despite warnings as to the hopelessness of his errand. Having no success in these cities he returned to Berlin on the twelfth. There he found the *Darmstaedter und National Bank* in desperate straits and a threat of a general breakdown of the banking system. He took an airplane at once for Basle, where he described the desperate situation to the Directors of the B. I. S. assembled for their monthly meeting.

On July 13 the crisis in Germany was at its height. In the next few days banks were closed, special decrees were issued, the capital flight took on serious proportions, and signs of panic were evident in all directions. Individuals who remembered the days of inflation began to hoard food; dollar bills were accumulated, and foreign exchange was unobtainable. The Bank indicated both by its communiqués and its action as clearly as possible that a thorough reconstruction of Germany's capital position was called for. On the other hand, the Bank could not itself grant a new loan, unless a number of constructive measures were devised, since further loans would only pile up still higher the capital burdens of the Reich.

Some indication of foreign opinion as to German conditions is found in the erratic fluctuations of the Young Loan in New York. The low point in July 1931, was 56½ on the twenty-fifth. Other values are given below:

GERMAN EXTERNAL 5½ PER CENT LOAN

Dollar quotation in New York
(1931, first of each month)

January	69½	July	72
February	73½	August	56¾
March	78½	September	58¾
April	81	October	35
May	79½	November	40
June	69¾	December	31¾

The services of the Bank in bringing the moratorium into operation on July 15 have been vividly described by Mr. Streit in his article in the *New York Times*:

The competent officials of the World Bank gathered around the telephone in one room at Basle, while around the phone in Berlin gathered three officials, one each from the German treasury, the Reichsbank and the German Railway Corporation. The Reichsbank told the World Bank it had credited the account of the B. I. S. with the \$13,000,000. The B. I. S., acting under the instructions it had received from the creditors, told the Reichsbank official to invest immediately nearly all of this sum—representing the French share—with the Railway Corporation, and to lend practically all the rest—the British, Italian and Japanese shares—to the German treasury. Then the treasury and the railway officials took the phone in turn for their part in the deal. Then both Basle and Berlin exchanged telegrams confirming the spoken with the written word. The whole deal, of which the above details give only a few high spots, was finished by 10 P.M.¹⁰

FINANCIAL READJUSTMENTS

At the thirteenth meeting of the Board of Directors, on July 13, the following matters, according to the press communiqué, were included:

1. Reports on the situation in Austria and Hungary were examined.
2. The Board approved the proposal of the French government to complete the balance of the Guarantee Fund in monthly payments in the event of a moratorium.
3. After conferring with Dr. Luther on the situation in Germany, the Board agreed to renew its share of the Reichs-

¹⁰ Clarence K. Streit, "The World Bank Feels Europe's Pulse," *The New York Times* (Aug. 30, 1931).

bank credit and to collaborate in any further assistance given by Central Banks.

Immediately after these arrangements, The London Protocol was drawn up and the final draft was signed on August 13, 1931. The protocol covered four main points.¹¹ In the first place nothing in the agreements was to interfere in any way with the payment of the service of the Dawes and Young loans. Second, the unconditional part of the Young Plan annuity was to be paid into the Reichsbank account of the Bank for International Settlements, and to be repaid at once as a loan to the German railways. Interest was to be calculated at the rate of three per cent and the loan amortized by 1943.¹² The conditional annuities, on the other hand, were to be suspended for the year and to be repaid after the resumption of the Young Plan, at the rate of one-tenth of the total cash a year, in equal monthly instalments. These instalments were to be charged with an interest of three per cent. A further provision called for the regulation of deliveries in kind, according to the spirit of the agreement, allowing for the execution of existing contracts, and for the diminution of sums involved. These other details were worked out gradually by the Special Commissioners, and did not cause any serious disturbance either to Germany or to the receiving countries.

Although these negotiations required several weeks, the "Hoover Debt Holiday" really came into force before the agreements were complete.¹³ Thus the July 15 share of the annuity was treated according to the plan which was later made definite. The Reparation creditors at once ceased to accumulate funds for payment of their debts to the United States. The unconditional annuities were re-lent instantaneously to the railroads.

¹¹ *London Protocol, Report of the International Committee of Experts Respecting Suspension of Certain Inter-Governmental Debts* (London, Aug. 11 and 13, 1931), Cmd. 3947.

¹² The Commission of one per mille was paid to the B. I. S. as prescribed in the Trust Agreement.

¹³ Italy was the first nation to announce that she would not call for her share of reparation receipts in July.

In fact, the whole episode is remarkable for the speed with which the relief was granted and the ease with which the complicated agreements between more than seven countries were adjusted to the new emergency. Even though the achievement was notable, however, the decline of German credit was even faster than the rescue measures and the delays which occurred, although practically unavoidable in this type of negotiation were almost fatal to the economy of Europe.

Although this notable event did not in itself bring the solution of the difficulties, it looked like a turning point in both political and economic affairs. It was a recognition, implicit though not directly avowed, of two truths which had been contested for twelve years. One of these was the many interconnections of America with Europe in economic affairs.¹⁴ The other was the fact that it is disadvantageous for receiving countries to exact such a large tribute that the countries concerned will be brought to the verge of collapse, and credit and trade seriously disturbed. Both these facts affected the B. I. S. very nearly.

It is probable that some of the difficulties of these years could have been avoided if history had been more carefully interpreted. The lessons of 1870 had been regarded superficially and misinterpreted in many quarters. The disturbance to economic life after the Napoleonic Wars had been passed over as irrelevant. Both periods, however, furnished proof of the dangerous monetary disturbance that comes with war, of the destructive effect of abnormal capital flow due to hostilities or indemnities, and the need for constructive effort to repair damage in both the political and economic spheres. Analysis of these episodes had given a false

¹⁴ President Hoover's intervention in the Debt and Reparation situation was followed by Secretary Stimson's official participation in the London meetings in July 1931. During this year the Federal Reserve took part in credits supplied by the B. I. S. to certain Central Banks. Moreover, in the fall, Mr. Prentiss Gilbert participated in the meetings of the League Council. A further indication of American interest in international affairs was the visit of Dr. Burgess to Basle in October of this same year, see *infra*, Chapter XIV.

impression. Many have overlooked and underestimated the cost of the years of distress, because it showed that recovery came finally after collapse.

The backwash of these events shook many of the surrounding countries. There was a pronounced weakness of sterling leading to gold exports to France. This was attributed to a combination of external and internal causes. Britain had extended loans to Austria, Germany, and other countries at a time when she stood to lose both under the postponement of German payments and by giving up the claims on the dominions for their debt payments to her. Moreover, it was rumored that the French had not approved of British actions and that, fearing a further exchange risk and not wishing to support British authority in Central Europe, funds were being brought home to Paris. This action was obviously not taken by the French government, but was carried out by private individuals. The government was not in a position to instigate, nor to prevent such action. At the same time, the official attitude toward political differences, social insurance, the budget, and the tariff weakened the British position.

On July 20 the seven-power conference met in London to settle the details of the "Debt Holiday." Its actions took place against a background of spreading moratoria and uncertain exchange value. The willingness of France to make concessions was still in some doubt—the possibility of carrying on consultations in the larger question of the Reparation obligations of the future had been completely ruled out. With its scope thus restricted, the conference completed its work on July 23, and the adjournment was greeted with disappointment, because of the limited nature of its work at a time when a more comprehensive settlement was needed.

In brief, the recommendations of the London conference urged the advisability of renewing the Reichsbank credits, maintaining existing private short term funds in Germany, and the widespread recognition that the lack of confidence and withdrawal of capital from Germany were "not justified

by the economic and budgetary situation of the country." They said further that:¹⁵

. . . the Bank for International Settlements should be invited to set up without delay a committee of representatives nominated by the governors of the Central Banks interested to inquire into the immediate further credit needs of Germany and to study the possibilities of converting a portion of the short-time credits into long-term credits.

After this agreement on the general conditions of the arrangement, work on the details was resumed by a committee of experts on July 25. The United States was represented on this committee by Ambassador Hugh S. Gibson.

THE DIFFICULTIES ATTENDANT ON A YOUNG PLAN MORATORIUM

Many have wondered why Germany did not act under the Young Plan in June to secure relief. The answer was that this would have involved a fatal delay. Events moved too quickly in 1931. The Young Plan prescribed as a first step the announcement of transfer difficulties, and that the German government should give "at least 90 days prior notice of the right to suspend the transfer of the postponable part of the annuities"—this meant about two-thirds of sums required, 660 million reichsmarks were unconditional, and more than 1,000 million were conditional in certain circumstances.¹⁶ Even in case of such action the entire sum was to be paid into the Reichsbank to the account of the Bank for International Settlements and the larger part actually transferred.

Once these steps had been taken the right to postpone payment was only to arise after the right to withhold transfer had been in force for one year. Moreover, this was to apply to only "50 per cent of any sum the transfer of which shall then be susceptible of postponement under the condi-

¹⁵ See B. I. S. Communiqué of July 31, 1931.

¹⁶ *The Young Plan*, Cmd. 3343, annuities, pp. 16, 17; postponement, pp. 23, 24, 54, 55.

tions stated above.”¹⁷ This meant, therefore, a delay of one year and ninety days on the relief to the German budget, and then only partial reduction subject to investigation and approval by the creditor governments. This special period was limited to two years, after which payment with interest was to be resumed. These precautions were intended to¹⁸

protect Germany against the possible consequences of a *comparatively short*¹⁹ period of depression.

There was no provision made for a long or far-reaching economic dislocation.

In addition to this protection the German government was to ask the Bank to convene the Special Advisory Committee. This Committee was designed

neither to grant nor refuse a postponement. After making an enquiry, it shall report to the Governments and the Bank. . . .

It was “to act in a purely consultative capacity.” Moreover it was to “play no part in connection with the unconditional annuities accepted by Germany.” The Germans were obviously reluctant to call on this body.²⁰ Its terms of reference were limited; its right to investigate might, it was thought, prove politically objectionable to the nationalist parties. It was expected that it would seriously impair private credit without corresponding advantages to the Reich.

There were, thus, a number of reasons why Germany did not act in June 1931 along the lines suggested in the Plan. These may be summarized briefly.

1. Because it was provided that there should be a delay of three months before postponement of transfer be effective. This applied only to the postponable portion.
2. There was to be a delay of 15 months before payment could

¹⁷ *The Trust Agreement*, Cmd. 3484, p. 36.

¹⁸ *The Young Plan*, Cmd. 3343, p. 23.

¹⁹ *Italics mine.*

²⁰ *The Young Plan*, Cmd. 3343, *op. cit.*, pp. 24, 25; *The Trust Agreement*, Cmd. 3484, pp. 36-37.

- be postponed. This postponement did not apply to the entire annuity.
3. The Special Advisory Committee was restricted in scope and would, perhaps, inaugurate investigations objectionable to the extreme parties in Germany.
 4. The condition set for gaining this relief was inability to transfer, not inability to collect, and the creditors had not admitted the emergence of this difficulty at this time.
 5. The Young Plan had become extremely unpopular in Germany and any further official recognition of it, even to ask postponement, might lead to an overthrow of the government.

For these reasons Germany appealed instead through her ambassadors and high officials for more immediate and substantial relief.

In view of this delicate situation it was generally recognized that one of the great merits of the Hoover proposal was that it was simple and immediately applicable. Unfortunately even the three weeks' delay which intervened between the offer and the acquiescence of France were sufficient to bring about the failure of a number of important German companies and banks, the flight from the mark and the beginning of a series of difficulties for the Reichsbank. It was alleged that the German economy lost 500,000,000 dollars worth of capital, or considerably more than the Reparation payments for that year.²¹ In any case, figures from various sources showed that the Reichsbank lost heavily. In fact, from the end of May until June 23, the Reichsbank had been forced to give up approximately 250 million dollars.²²

Already the Reichsbank had been forced to raise its rate from five to seven per cent on June 13. The rate was to go to fifteen per cent in a few weeks. Bonds were weak, exchanges uneasy, and the flight of capital from Central Europe continued. Although the second credit to Austria

²¹ Dr. Max Winkler, *The New York Times* (July 15, 1931); Harold Candler, *The New York Times* (July 15, 1931).

²² *The Financial News* (July 20, 1931).

which was being arranged²³ made for better feeling, the Hoover proposal was the first really favorable event for some months. Berlin and London approved the Hoover plan at once, but news from France was less encouraging; the immediate report was circulated that France would call for the unconditional payments. The result was a reaction of sentiment and increased difficulties at the Reichsbank. These were met temporarily by the B. I. S. when it arranged for the granting of a two-weeks' credit of 100 million dollars on June 25.²⁴ The Bank of England, Bank of France, Federal Reserve, and the B. I. S. supplied equal shares. The details of the loan were administered by the B. I. S. It is interesting to note that the Federal Reserve had supplied a portion of the first credit to the Central Bank of Austria and that this was followed by a similar participation in the loan to the Central Bank of Hungary and the later one to the Reichsbank.

Thus the round of conferences began again. The Chequers conference in June was followed by the Hoover-Laval notes. The July London conference was to lead to the Wiggin Committee in August. The Wiggin Report was the preliminary to conversations in the autumn in Washington, Paris, and Berlin. The later meetings in the end of 1931 were to prepare the way for the Special Advisory Committee in December 1931, and the later Government Conference, 1932. There was hardly a week without an exchange of government notes or important meetings of premiers and finance ministers. Parallel with this, the movement was growing to demand the simplification and reduction of claims, in order to prepare the way for an expansion of capital movements originating in normal trade operations. Evidence of this was found in hundreds of newspapers, in speeches and resolutions, and in convincing documents published by research organizations and economic institutes.²⁵ The agreements

²³ See below for the facts regarding this second credit.

²⁴ *The Financial News* (June 26, 1931).

²⁵ One such was the Memorandum of Sir Henry Strakosch, *The Economist* (London, Jan. 9, 1932).

and meetings since 1919 had opened out of each other with wearying continuity, and the "definitely settled" problem was up for discussion anew in 1931.

SUDDEN GOLD AND CAPITAL MOVEMENTS

Many things disturbed economic relations, at this time. Gold continued to leave London throughout July. The accumulation in the United States reached a high point of \$4,951,000,000 on July 8.²⁶ The increase of the Bank of England rate on August 23 from 2½ to 3½ per cent made a differential of two per cent between London and New York. The German banks remained closed. Much English capital was frozen on the Continent and the list of bank failures in a number of countries grew. There were rumors of a Franco-American loan to the Bank of England. Meanwhile the Bank for International Settlements proceeded to arrange for the committee on credit. One of the few constructive events toward the end of the month was the organization of a new Acceptance Bank in Germany to help the other banks over their special difficulties.

Things looked better for a few days, but a slight improvement in the pound in August and statements here and there that the crisis was over were followed immediately by new declines. The situation was not so acute as earlier in the month, but nevertheless the Bank of England raised its rate a second time to 4 per cent. Rumors of the loan to the Bank of England were confirmed on August second, when the announcement appeared that the Federal Reserve and the Bank of France had each advanced 25 million pounds (125 million dollars) in francs and dollars. This was interpreted by some as the sign of a vigorous international coöperation which would end uncertainty and abnormal capital movements. Confidence in England was not to be so easily restored, however. The Macmillan report²⁷ had already

²⁶ This sum was not much greater than the amount in 1924, contrary to general opinion.

²⁷ *Report of Committee on Finance and Industry* (London, June, 1931), Cmd. 3897.

sounded a note of warning. Now, at the same time that the credit was secured, the Economy Committee came forward with the report that the budget should be cut approximately 500 million dollars.

The gravity of the situation is evidenced by the fact that during the thirteen days after July 12, the efflux of gold from England had been at the rate of several million pounds a day. The Bank's holdings were approximately 136 million pounds at this time. The total loss for the month was approximately 35 million pounds (180 million dollars). The reserves of the Bank were reduced to about 130 million pounds. That is, England had hardly more than 15 per cent as much gold as was accumulated in the United States. In any case the easing of the situation which came with these loans was not regarded as a sign of solid improvement. The treasury issued a minute on August first permitting the increase of the fiduciary circulation to 275, extending the limit 15 million pounds for a period of three weeks. Meanwhile the government bent every effort on the search for constructive solutions to meet the new emergency.

In the case of gold movements as large as this just described, the Bank for International Settlements found it impossible to take an aggressive position. It had not sufficient resources to offer a large credit. It was not in a strategic position to be the intermediary between the three countries principally concerned. It had performed some service in easing the pound through reparation clearing and through taking on what responsibility it could in Central Europe, but beyond this point it could not go. Of course it was concerned in all these happenings, and followed every detail, but its assistance in such emergencies was of necessity limited.

Meanwhile the regular work of the Bank went on. The fourteenth meeting of the Board of Directors was held on August 3.²² The Board acted on the following matters:

²² *Agence Économique et Financière* (Aug. 4, 1931). *Information Financière* (Aug. 3, 4, 1931).

1. Took note of the Declaration of the London Conference, and set a date for the first meeting of the Committee already appointed by the B. I. S. on July 31.
2. Authorized the renewal of the credit to the Reichsbank for a period of three months.
3. Examined the reports of the financial situation in Austria and Hungary.

The official communiqué issued at the time called attention to the decline in B. I. S. resources and indicated that it was due to two causes—the postponement of debt-reparation obligations, and attempts of Central Banks to protect exchange rates by bringing home funds. It was inevitable that the German situation should have occupied much of the Directors' attention, and reports on Austria and Hungary were also discussed.

THE WIGGIN COMMITTEE AND THE STANDSTILL AGREEMENT

The Wiggin Committee assembled on August 8. Speaking later of its discussions, Monsieur Francqui said that he had seldom known such stormy meetings nor such difficult discussions in his ten years' experience of postwar conferences. There is no doubt that the points at issue were complex and controversial. Only one favorable factor increased confidence during the sessions. This was the failure of the attempt of the extremists in Prussia to dissolve the Diet in the hope of gaining power. This made it seem evident that the Germans themselves had an ardent desire for stability. The opening of the banks under certain restrictions had been successfully carried out on August 6. There was no serious disturbance, despite the fact that it was generally known that many banks and companies had been kept going simply by the help of the new German Acceptance Corporation and easier credit conditions than were normal.

A distinguished group of experts came together for the Committee.²⁹ They carried on their deliberations for almost

²⁹ The members of the so-called Wiggin Committee which assembled on August 8, 1931, were as follows: Alberto Beneduce (Rome), R. G.

two weeks, and although they could not themselves draw up the final document which was to determine the status of the credits, they worked out the basis for this agreement, and left the technical details for adjustment by certain authorized bankers. In the course of their investigation, they called in a group of financiers from Germany who consulted with them for five days, and contributed largely to the final product. The problem was divided into the immediate question of the existing short term credits and the more extensive consideration of the need for long term credit, both extremely difficult.

Such matters as those before the Wiggin Committee are hard to regulate. It is generally recognized that capital cannot be imprisoned in centers to which it is not at the same time naturally attracted. The only way in which credits could be kept in Germany was by making it plain that the withdrawal of all the credits was impossible. It was in any case desirable to introduce a high degree of order and fairness into the proceedings, and, in the interest of European credit in general, to avoid any kind of stampede. Of course most of the credits which were actually frozen in Germany were not good risks from any normal banking point of view, either as long or short term loans.

The resulting *Stillhaltung*²⁰ agreement is an extremely complex and technical document. It was in essence an agreement between private bankers in Germany and outside, but was sanctioned in a general way by the Central Banks, and very indirectly, by the governments because of their part in calling the Committee and their interest in its achievement. It was not in its final form until the end of September, though it served as a guide for action before that date. The Wiggin Committee had, in fact, outlined the main clauses

Bindschedler (Zurich), P. Hofstede De Groot (Amsterdam, Émile Francqui (Brussels), Sir Walter Layton (London), Dr. Carl Melchior (Hamburg), Émile Moreau (Paris), Oscar Rydbeck (Stockholm), T. Tanaka (Representative in London of Bank of Japan), Albert H. Wiggin (New York).

²⁰ Usually referred to as *Standstill* or *Stillhalte* agreement.

of this document by the third week in August. They, then, called on a group of German bankers to assist them in this work. The result was a plan which at least served to restrain, if not to stop, the exodus of funds.

On September 9 the final text of the *Standstill* agreement was received by the Bank for International Settlements.⁸¹ This was substantially the document drawn up by the Wiggin Committee. It provided for the freezing of approximately 1,250 million dollars worth of short time credit. The agreement was signed by representatives of the Reichsbank, the Golddiskont Bank, and the Committee of private bankers. The period of immobility was to last from September 1 for six months, that is, until the end of February.⁸² Subsequent to this, necessary details were to be agreed on in letters between individual foreign creditors and individual debtors within Germany. The *Stillhaltung* was reinforced by special decrees within Germany, signed by President Hindenburg, giving it legal force.

Upon the conclusion of the agreement, 25 per cent of the balances due were withdrawable from Germany, subject to special conditions which might arise to endanger the Reichsmark.⁸³ Other portions were to be released under special conditions, and in varying amounts. Municipal and state short term notes were not included in these arrangements. The banks which took part in this agreement were those in the following countries:

Belgium	Holland
Czechoslovakia	Italy
Denmark	Norway
England	Sweden
France	Switzerland
Germany	The United States

⁸¹ *Stillhaltung* (Berlin, Sept. 17, 1931), pp. 3, 7, 8, 26. This agreement was renewed in 1932.

⁸² *The Times* (London, September 11, 1931). A new agreement to run for a year and to readjust this first arrangement was drawn up in January, 1932.

⁸³ In such circumstances, the Reichsbank was to appeal to the Bank for International Settlements for a one month delay.

The rates of interest to be paid on balances so frozen were to "be in line with the rates paid in Germany on bank deposits. . . ."

To offset this advantage Germany on her part guaranteed that no preferences should be granted to special creditors in violation of the spirit of the agreement. Further than this she undertook to make good any losses from exchange, and to take over through the Reichsbank or the Golddiskont Bank a certain fraction of the debts outstanding under special guarantees. Special loans such as those for financing crops or security transactions were excepted from the agreement, and the whole would be void in the case of a general moratorium. Further than this, every effort was made to secure the foreign creditor against loss, and to substitute reliable guarantees to take the place of the commercial transaction which might be completed before the end of the agreement. Moreover, the German banks agreed to keep their own foreign deposits at reasonable levels.³⁴

From this statement, it is clear that there were a number of exceptions to the freezing processes, and in addition, legal evasions and subterfuges made possible a steady drain of funds from Germany evident from the weakening of the Reichsbank position, at a time when the balance of visible trade was exceptionally favorable. It was well known that the persistent desire to repatriate funds was in many cases successful, but despite these facts large funds still remained under the agreement, either because of the desire of foreign creditors to be of assistance to their clients in Germany, or because the legal obstacles were insurmountable. This was true even though it is probable that sums approaching 700 or 800 million reichsmarks were withdrawn during September.³⁵

The net effect of this agreement on Germany was not so much to increase the capital at her disposal, as to make it

³⁴ See *Stillhaltung Agreement*, pp. 9, 10, 11, 14, 16, 19, 23, 24.

³⁵ See statements made to the Special Committee, December, 1931. *Report of the Special Advisory Committee* (Basle, Dec. 23, 1931).

easier for her to control the exchanges without disastrous effects to the mark, or to the relations between individual creditors and debtors. The very fact that the freezing was necessary was a warning signal to prevent any further supplies of short term credit coming from without. It is probable that such further credits were only arranged in close relation to export trade, and that a large part of such funds was kept abroad. Credit resists force, in every case, and the desire to withdraw money increased in direct relation to the difficulties involved. In contrast to these influences, one event led Germany to accelerate the pace of liquidation as much as was consistent with her promise not to give preferential treatment. This was the depreciation of the pound after September 19, which, for a time, made it profitable to pay off sterling debts and probably lessened to a considerable extent the total credits under the *stillstand*.

During the entire autumn of 1931 the mark tended to be weak, and the position of the Reichsbank became constantly worse. This led to anticipation of a renewal of the agreement at its expiration at the end of February. Some talked of refunding the short term obligations as long term credits, but it was obvious that none of the solutions suggested at this time were really attractive to the creditors. The more difficult the question became, the more urgent grew the need for Reparation revision. Furthermore, the existence of this *stillstand* agreement brought to the forefront again the troublesome disagreement as to the priority of commercial or political debts. On this stumbling block the early Franco-German conversations collapsed and the problem was not resolved for some months to come.

The work entailed in drawing up this credit agreement was necessary, even though not very constructive. Much assistance was rendered by the Bank for International Settlements in the negotiations of the Wiggin Committee. The secretariat was busy day and night. The officers of the Bank were able to supply certain advice and information as the result of their experience with the international move-

ment of funds. Then later, after the formulation of the terms, the Bank named a committee to handle any disputes that might arise as requested in the Standstill Agreement.³⁶ The Bank had been studying the ways and means of bridging the gap between long and short term credit during the winter. Two of the members of the middle term credit committee, Monsieur Francqui and Dr. Melchoir, were members of this latter group. There is no doubt that the work accomplished in these studies cleared the way for the more rapid progress of the conference in August.

Two main tasks had been put before the Wiggin Committee. One was to study the immediate credit needs of Germany and the second to study the "possibilities of converting a portion of the short term credits into long term credits." The result of the first part of the work was the Standstill Agreement; the result of the second was the recommendation to carry further the work of restoring confidence in Germany. These two problems were both covered in the Report in forceful arguments.³⁷

The Bank was called on to work through and with the new credit committee. On July 31, it announced that Mr. Albert H. Wiggin, President of the Chase National Bank, had been asked to serve on the Committee on Credit. This appointment was widely approved. He was later made the chairman by the Committee. Need for an early and workable decision was obvious. While the Committee was being arranged, credits were for the most part being held under the "Gentlemen's Agreement," and within Germany preparations for the reopening of the Banks included the increase of the Reichsbank rate from 10 to 15 per cent from the 31st of July to August 11.

THE LAYTON REPORT

The Layton Report was an impressive document. The Committee established the fact that an abnormal portion of

³⁶ *Communiqué* of October 5, 1931.

³⁷ *Report of the Committee appointed on the Recommendation of the London Conference, 1931* (Basle, Aug. 18, 1931).

Germany's indebtedness was held at short term. They indicated that the total volume of such credits could not be reduced without the dislocation of German economic life, export trade, foreign obligation, and a reasonable level of internal consumption. Finally, they indicated that the obstacles preventing the displacement of short term credits by long were twofold. On the one hand, there was the political risk in the relation of Germany to European powers; on the other hand, the external obligations which were increasing the burden of interest "in snowball fashion."

In fact, the relation of this abnormal situation in Germany to other difficulties was emphatically stated. One of the opening sentences of the Layton Report^{**} affirms that "until the situation in Germany improves there can be no general recovery from the existing state of depression." Moreover, it points out that the burden of short term credits would "leave her increasingly vulnerable to crises." It indicated that one of the fundamental troubles in the world at large was the lack of adequate long term investments which might bring about an increase in purchasing power. Certainly, Germany presented in this complex situation a striking example of the contradictions in the development of a world-wide financial system, and the subsequent erecting of barriers to the free flow of goods. In the name of world prosperity, as well as German recovery, therefore, the Report concluded by:

Urging most earnestly upon all Governments concerned that they lose no time in taking the necessary measures for bringing about such conditions as will allow financial operations to bring to Germany—and thereby to the world—sorely-needed assistance.

That is, it urged the necessity of the revision of reparation demands.

For political reasons, however, the word Reparation does not appear in the Layton Report. Here, as in the Statutes of the Bank, there was an attempt to get away from the

^{**} The Report of the Wiggin Committee was usually called the Layton Report because it was drafted mainly by Sir Walter Layton.

bitter feelings which this controversy had engendered and fix attention on the general economic disturbance which pointed to the need of whole-hearted coöperation. It was well known, at the time that the Report was drafted, that a majority of its members wished to make their appeal for revision even more emphatic, but they realized the importance of obtaining the approval of the entire group, and laying the foundation for immediate action. Certainly they would have failed in their purpose if Monsieur Moreau's signature had been lacking.³⁹ Therefore, they listed the facts and drew the general inference, without mentioning this particular problem by name.

B. I. S. CREDITS

During the summer, while these various conferences were under way, the B. I. S. participated in the granting of seven loans to Central Banks. The first two were to Austria on June 9, and, immediately thereafter, the third to Germany on June 26, the fourth and fifth to Hungary at the end of June, the sixth to Yugoslavia in July, and the seventh to Danzig on September 20, 1931. In each case the money was granted to the Bank of Issue, with the purpose of steadying the exchange rate in a time of unusual pressure. In making the arrangements the Bank placed itself at the head of a consortium of Central Banks, and supplied some of its own funds, while administering the entire loan. In two cases the loans were not actually used for special reasons; these were the second Austrian loan, and the credit to the Bank of Danzig.

Probably the most important of these was the first Austrian loan.⁴⁰ Negotiations for this credit and others which followed it began in May, and concerned not only the B. I. S. but the Bank of England, the Bank of France and

³⁹ Compare these discussions with an analogous situation in June, 1922, when the "Bankers' Committee" failed to reach an agreement. Carl Bergmann, *The Reparation Problem* (Boston, 1927), pp. 135-7.

⁴⁰ *The Financial News* (June 18, 19, 1931). The deficit of the Credit Anstalt was estimated at 300 million schillings and withdrawals at 350.

a number of other Central Banks. The part which the B. I. S. played was significant because of its prompt action. There is no doubt that the needs of the Austrian National Bank were very great and that the assistance granted it at this time was really effective in steadying conditions, even though it could not prevent all the consequences of this crisis. Subsequent to the arranging of the credits, the B. I. S. followed the Austrian situation very carefully. Dr. Bruins was appointed advisor to the National Bank and communicated frequently with the B. I. S. with regard to conditions and problems there. The details of the credit granted were somewhat complicated and frequently misstated in the Press.

The total funds thus put at the disposal of the National Bank of Austria in the spring of 1931 amounted to 250 million schillings. Of this sum 150 million was in the first instance granted by the Bank of England and the other 100 million was arranged by the B. I. S. with a group of associated banks, including the Bank of England and the Bank of France. The third credit of 100 million schillings was arranged in June by the B. I. S. and associated banks. This was, however, a blocked credit to be available only if Austrian treasury bonds should be issued. The Austrian Bank planned to use the proceeds of this loan to pay off a part of the Bank of England credit. This credit was never used because of difficulties which arose with regard to the placing of treasury bonds in France. It remained on the books for three months after it was opened and was finally closed in September.

These credits were changed in September because the Bank of England requested the repayment of 50 million schillings and the B. I. S. requested the repayment of 10 million schillings. As a result of these requests the credits which remained at the disposal of the Austrian National Bank were, therefore, a total of 190 million schillings. Of these, 90 million were owing to the B. I. S. and a 100 million to the Bank of England. Conditions were still difficult in

Austria, so the National Bank requested a new credit of 60 million from the B. I. S. The matter was not decided in 1931 but came up for decision in a Directors' Meeting in 1932. This further advance was favored by the Bank of France, but there was some doubt among the Directors as to whether it was a sound operation in view of the alleged opposition of the Bank of France to the flotation of treasury bonds and the rescue work carried out in May and June, 1931. It is important to observe that the Bank of France participated in the first B. I. S. loan to the Bank of Austria.

The Central Banks sharing in the first Austrian loan were:

Federal Reserve	Bank of Italy
Reichsbank	Bank of Poland
Bank of England	Bank of Greece
Bank of Belgium	Bank of Netherlands
Bank of Czechoslovakia	Bank of Switzerland
Bank of France	

The amount supplied by the B. I. S. was approximately one third. Some conditions of this loan which were typical of the others were that ten per cent of the total should be left on deposit with the B. I. S.; the credit was to run for three months but was renewed twice in 1931. A commission of $\frac{1}{4}$ per cent for three months was charged. The interest to be paid was to be at least $5\frac{1}{4}$ per cent and to vary with the Bank rate. The form which the loan took in the case of the B. I. S. was a money employed account; for the Federal Reserve it was bills purchased, and for the Banks of France and England it was advances against bills. The sums advanced were fully used.

The total credits *opened* for the Bank of Austria were thus 350 million schillings, of which 250 were actually used. It is worth noting that there was a slight difference in the conditions set by the B. I. S. in regard to the second credits which were opened on its books. These differences indicate the increasing uncertainty with regard to Central Euro-

pean exchange. For instance, the conversion rate for the repayment of the second credit, which was not actually used, was not set at the rate of the day for repayment as in the case of the first loan, but was to be at mint parity and, moreover, a sum of 3 million pounds was to be deposited with the B. I. S. In addition to this the Bank of Sweden as well as the other banks who were associated in the first agreed to participate in the second loan. It was anticipated that the first loan which ran to September 16 would be repaid on that date, but the collapse of the pound sterling unsettled all exchange rates and made such repayment impossible. The credit was therefore extended, although partial repayments, as indicated already, were made in the autumn, that is 10 million schillings were repaid to the B. I. S. on October 16 and 50 million schillings to the Bank of England on the same date.

Reference has been made already to the credit granted to the Reichsbank on June 26. This loan was at first intended to run for two weeks only as it was designed to offset the month-end money needs, and at that time the "Debt Holiday" proposal stimulated hopes of more substantial relief. The crisis of July 13, however, made renewal necessary, and it was carried forward into 1933. The amount loaned was 100 million dollars. The French and English Central Banks, the Federal Reserve and the B. I. S. each furnished 25 million. The rate of interest paid was the Bank rate, at first, but in October this charge was reduced to seven per cent.⁴¹ This return, plus the commission, made the business profitable for the B. I. S. at the same time that it supplied funds which were sorely needed. Moreover the credit was deposited with the B. I. S. with collateral in the form of secured bills amounting to five per cent more than the face value of the loan. This loan was renewed for the third time on November 6 and again for a

⁴¹ Conversion was to be at mint parity. The interest rate was further reduced in 1932.

month in January 1932, after considerable discussion and delay.

The loans to Hungary came shortly after the Reichsbank credit. The sums were 15 million dollars for the first and 10 million dollars for the second. On these two interest was to be paid at the bank rate, and conversion to be made at maturity at the mint parity. There was a deposit of one million pounds in gold with the B. I. S. as security against the first loan, in addition to the bills. As with the other loans 10 per cent of the amount granted was to be left on deposit with the B. I. S. In about two months, on September 18, five million dollars of this money was repaid, while 20 million dollars was extended for three months. There were eleven participants in the first,⁴² but, in the second, only the Banks of England, France and Italy joined the B. I. S.

As time went on the Hungarian situation became very difficult and the League of Nations again took part in reconstruction measures. Mr. Royal Tyler (American) was appointed as advisor to the government. The B. I. S. was asked to name an advisor for the National Bank and chose Mr. H. J. Bruce of London who assisted in the attempt to reorganize the financial situation.⁴³ The troubles had been precipitated by Austrian difficulties, and were made worse by the exchange difficulties in the autumn that followed the inconvertibility of the pound, and culminated in a general moratorium on December 23, 1931. In fact complete financial independence for Hungary seemed very far off.

Similarly, a number of other Balkan states were in trouble. To help prevent collapse, four million dollars was loaned by the B. I. S. to the Central Bank of Yugoslavia

⁴² Among the participating Central Banks were the Federal Reserve, the Central Banks of France, Italy, England, Belgium, Czechoslovakia, Poland, Netherlands, Lithuania, Bulgaria and the B. I. S. The Second Annual Report (p. 8) refers to twelve.

⁴³ *Communiqué of November 9, 1931.*

in July 1931. This was renewed when it fell due. Bulgaria and Rumania each sought loans but the Bank did not grant them in either case, although it did relieve Bulgaria of the 200,000 dollars which it had loaned to Hungary through its participation in a former B. I. S. loan.

The final B. I. S. credit, opened, but not used, was 150,000 pounds granted to the Bank of Danzig at the time when England went off the gold standard. At that time it was feared that there would be foreign exchange difficulties in Danzig but the readjustment was fairly easily made even though the free city had been on the gold exchange basis with the pound as the standard. The Central Bank was able to change immediately to a straight gold standard.

This work of credit extension was extremely important for the B. I. S., for it broadened its experience and increased its prestige. It gave the Bank undertakings which were profitable even though they were not liquid and united it in business undertakings with the most important banks of issue. Just at the time when the suspensions of reparation payments reduced its resources and cut down its activities as a clearing agency, it became extremely busy with these loans. They called for a general knowledge of conditions in a large number of countries, and also for considerable technical work, which kept the staff in Basle very busy. For instance thousands of bills of exchange were turned over to the Bank; these had to be examined as to their maturity, and nature, and all the technical characteristics, which affected their status as collateral.

CHANGES IN THE BANK'S WORK

In performing this rescue work the Bank was fulfilling the purposes for which it was designed, although in very different circumstances from those envisaged in 1929. It was certainly an agent for coöperation and a means of increasing the exchange stability in a number of countries. It was also a conference center in which the troubles of this year of crisis were discussed at length and measures

devised to lessen the damage. Certainly, the events of this year give striking evidence of the need of such a bank, and also of the obstacles with which it must contend. These were peculiarly difficult because of the fact that it would be most useful in times of crisis and it is just in these times that constructive work is most difficult. Without the Bank there would have been much more delay, and in some cases perhaps serious troubles in arranging the credits.

The significance of the Bank's work during this period has been stressed in the Second Annual Report.⁴⁴

"The extent of the emergency help granted during the year 1931 is not generally recognized. If there be added together the total amount of external advances granted by central banks, by the Bank for International Settlements, by the principal capital centers and by Treasuries, including the sums advanced to the British market, a figure of approximately 5 billion Swiss francs is reached, or about one-tenth of the total amount of short-term indebtedness outstanding at the beginning of 1931. These sums, supplemented by the large contributions made by the debtor markets themselves and by the diminution of their central bank reserves, permitted the liquidation in a single year of more than 30 billion Swiss francs of short-term indebtedness, a certain proportion of which represents, of course, not repatriation but transfers of funds from one foreign country to another. Of the balance of short-term credits still outstanding, a substantial part of the remainder has in fact become blocked as the result of restrictive measures referred to below. It is unnecessary to emphasize the havoc wrought by this vast movement of liquid funds, or to dwell upon the stagnation resulting from the magnitude of the sums immobilized. They have each contributed their part to the persistent fall of prices, and they have accentuated the deflationary forces which are oppressing world economy. The most remarkable thing is that the economic system has been able to withstand such dislocating forces—a fact that seems to indicate its inherent power of resistance."

The stress and strain made it inevitable that other carefully worked out plans and special projects had to be abandoned. The Bank transformed itself in a few weeks into

⁴⁴ *Second Annual Report*, April 1, 1931, to March 31, 1932 (Basle, May 10, 1932), p. 12.

a different type of organization. It had been a clearing house and a reparation agent, with large liquid funds. It became an advisory body and in a sense an investment trust, handling large loans for distressed Central Banks, which although liquid in form, could not be quickly realized. This work was of greater importance, however, than many of the projects which had been outlined in the earlier months. It was certainly entirely different.

Such was the destiny of the Bank. It could not have purposes and aims of its own. All of its strength must be turned to the service of the economic systems in ways that would fill the greatest need. It might seem for short periods to have an existence and purpose independent of other Central Banks, but this would be only a temporary occurrence. It must always hold itself in readiness and fill the need which might temporarily be uppermost. If on the contrary it should become crystallized, independent, and self-sufficient it would cease to serve the chief ends for which it was constructed, and there would be no other agency to fill the need which might threaten financial life with chaos.

Still further adjustments were to be asked of the Bank before the year was over. It had been affected in its business by the political changes all over Europe, by the sudden cessation of Reparation and debt payments, by the failures in Central Europe and widespread freezing of credit; it had taken on new lending functions and investigated the situation of several distressed countries. But all these episodes were to prove of minor importance in comparison with the culminating event which grew out of them, when, in September, England abandoned the gold standard.

This act shook the foundations of the Bank founded on the gold standard and designed to support and regularize the gold exchange standard. It is true that its funds tended to increase with the prevalence of this prestige among Central Banks. Its purpose was broader than this, however.

It was to meet financial emergencies of various kinds, including the recasting of the gold exchange standard if and when that should prove necessary. It would be more correct to say that, for the purposes of the Bank, the gold standard was a phase of coöperation and also the technical basis on which it was to carry on its business. From every point of view, therefore, the change in September was to make a vast difference to the Bank.

Even before this, however, large adjustment to currency systems and credit structure were called for by the events of 1931. Some of these had been foreseen, others came with amazing swiftness. The Bank was not unprepared for the events, but was powerless to achieve a comprehensive solution. It could work only in conjunction with Central Banks, and in the interest of security and order. It saw what might prove to be the end of a financial era and was prepared by the experience in these months to take an active part in the new developments to come.

CHAPTER XV

THE GOLD PROBLEM AND THE B. I. S.

THE crisis which began in Central Europe in the spring of 1931 and seemed to some to be confined to a small group of countries, spread rapidly through the summer to all regions of the world, and affected all important economic mechanisms.

The active concern of the B. I. S. in emergency measures has just been described, the increasing influence of these distressing events on its acts, resources, and policies must be further outlined.

The procedures in regard to deposits, investments, credit, and clearings which were brought to a fairly advanced stage by the beginning of 1931 were not fundamentally changed but their scope and meaning were temporarily limited.

New and pressing problems came to the foreground in the conferences of the B. I. S. These problems comprised the many-sided difficulties attendant on the establishment and maintenance of a stable standard of value. At the heart of all the discussions was the question of the influence of gold.

A description of the Bank's second year and an appraisal of its accomplishments must take due account of the interdependence of these debt, gold, credit, and price factors, and consider the Bank in the setting in which it carried on its work. The events of the autumn of 1931 challenge the attention of all monetary theorists.

GOLD

Early in October, twelve airplanes flew south across a wide sweep of Europe and landed at one minute intervals

at Le Bourget, Paris. From each airplane many thousands of dollars worth of gold were unloaded. Guarded trucks rushed the metal to the underground fortress of the Bank of France. Here large quantities of wealth were stored, an impressive symbol of economic power massed in various Central Banks which was destined to determine the fate of the gold standard, influence disarmament, political alliances, tariffs and prosperity in general. The gold standard had, in a few dramatic weeks, demonstrated, at the same time, the possibilities for harm latent in the system, and its vital importance to Western civilization. Thus, at the very moment when it was suspended in a number of countries, it became infinitely more important than it had been before. The abandonment of the gold standard by England showed all the crudities of the system, and yet made the hold of the gold standard fundamentally stronger.

Many visible signs of the abnormal gold situation can be observed in such sudden shipments and large accumulations. They were destined to multiply during the course of 1931. In fact the monetary situation became so complex that it is not always easy to distinguish the cause from the effect. This confusion accounts for the tendency in the Press to speak of gold hoarding, and to reason as if the drift of metal toward France and the United States were the cause of difficulties instead of a sign of the influence of certain basic forces on all economic conditions including gold.

In the course of public discussion much has been said that is unfair to France and the United States. It was absurd to insist, as some did, that there was a plot to accumulate gold. Indeed, there was no sufficient power in the hands of the politicians to bring about the colossal movements of metal unless there were existing sufficient economic causes. It is possible that some of those who found this economic power in their hand were not loath to use it, but the instances of this were very few. It is also true that officials might occasionally have acted so as to limit the flow of

metal, but no complete control was possible without going off the gold standard, since freedom of purchase and sale is an essential part of the system. In fact, rigid control would have injured many countries without giving much relief to those in whose interests it was exerted.

The difficulties of formulating a corrective policy were real, but in any case there are sufficient explanations in economic events to account for the movements of gold. In the case of France, for instance, there were three main causes. One was the repatriation of those funds which fled from the country during the depreciation of the franc.¹ The second was the stable conditions in the country which made it an attractive place to hold funds. The third was the surplus money available from Reparation after the payment of war debts.² This credit margin, at a time when investment abroad was extremely uncertain, was bound to move the franc to the gold import point very often. In the case of the United States the last two factors, that is relative stability, and a net surplus from war receipts, were decisive factors. A further influence was added during the stock market boom, for Europe participated in this upward movement and did not withdraw all of its funds with the crash. These are sufficient causes and the mechanism by which they operate is very familiar.³

It is true that theorists had urged two lines of action through the B. I. S. and otherwise which they hoped would spread gold more evenly. One was the inflation of the currency in these two countries, which might have led to an outflow by making the trade balance unfavorable with high prices. The other was the increase of investments abroad, which would, in effect, have put the metal at the disposal of the borrowing countries pending slower distribution

¹ Williams, J. H., "The Present Gold Standard Crisis," *Foreign Affairs* (New York, January, 1932), p. 180. Professor Williams lays most stress on this explanation.

² See *supra*, Chapter X.

³ Sir Henry Strakosch, *The Economist* (London, Jan. 9, 1932). Sir Henry Strakosch makes the third reason the predominating one.

through normal trade channels as the result of price changes. There is no doubt that either process might have been effective at one time in the postwar period but this moment was short. At the time of greatest need, neither measure was feasible. Moreover, it was not clear that either could have been carried out without bringing grave dangers. Certainly the stronger countries would have lost much of the advantage gained by the weak.

The obstacles to inflation and investment were more dramatic perhaps in the United States but they were somewhat similar in France. By 1930 the deflationary forces were so strong in America that even the unbalanced budget, government borrowing and the efforts to grant credits to distressed banks, farmers and special enterprisers did not bring about a rise in the price level, or an absolute inflation. Even before these special measures, the flotation of foreign loans became practically impossible. The French economic system was not so strongly affected by deflation as that in the United States but, on the other hand, the French were less tempted to imperil their stability by artificial efforts in this direction, surrounded as they were by political and economic distress. Moreover, they were hampered in lending abroad by cumbersome legislation, while a number of scandals in international companies frightened the bulk of investors. Undoubtedly, political considerations increased this reluctance to lend to some extent, but they were not the only factors.

As the depression continued it became constantly clearer that the gold problem was a result as well as a cause of the trouble. The inequality of distribution of gold and credit grew out of reparation payments, unwise speculation, political fears, rapid economic transition, changes in credit practices, and the reconstruction of postwar banking machinery. The problem was a basic one and was widely recognized at the beginning of 1930. Long before this, a few clear-sighted statesmen and financiers had pointed to the difficulties. The League of Nations' studies helped to develop

an understanding of the gold question. Then the widespread discussion of the B. I. S. and its possible functions stimulated thinking along these lines; in fact, various forces were working to repair the weak points in the system, but they were overtaken by the calamity before much progress was made.

THREE MAIN ASPECTS OF THE GOLD PROBLEM

There are vast differences in the urgency of different aspects of the gold problem. These aspects may be divided, broadly, into three classes. The first is production, the second is the distribution between nations, and the third is the use within each monetary system. While these questions are closely related they are quite distinct insofar as policy and actions are concerned. At the same time all three are reflected in prices. In fact, the fluctuations in the level of prices is the motivating force which focusses attention insistently on this matter. The gold standard and the gold exchange standard are the more technical aspects, or methods, rather than the ends.

In many investigations of the gold problem, ends were not clearly distinguished from means. Study was first directed in many quarters to the volume of production and its probable relation to demand. Eminent authorities such as Joseph Kitchin, Gustav Cassel and others, after examining the mining figures, and the long time trend of physical production decided that there was a discrepancy between supply and demand which would mean a lag of gold behind goods. They pointed out that if this should come about, prices would fail to maintain their stability, and depressing downward tendencies would be observed in a few years. It is clear that such a situation might conceivably arise, but long before this danger point was reached, and before it became a serious threat, the needs arising from the other two problems became compelling. For instance, the possible restraining effect of declining total production would be postponed for many years, as the price level fell very far

in 1932. The crisis of 1931 indicated that neither the international nor the domestic use of the existing gold supply was properly regulated to meet economic requirements.

The year 1931 was to emphasize, also, the fact that the manner of distributing gold between nations had become increasingly important after 1919. Changes spread quickly from country to country, whereas before, adjustments were made more slowly. Further than this, gold had moved to some extent according to the classical analysis, and there was a tendency for it to diffuse itself here and there, according to commerce and the price level. After the war conditions were very much changed. The existence of large one-sided obligations would have led to rapid and startling changes if they had worked themselves out according to the familiar theoretical assumptions; that is, all the gold would have been drained rapidly from Germany and those countries which had the largest debts, and would have accumulated in France and the United States. These countries, in turn, would have undergone a rapid inflation, balanced by deflation in the paying countries. For a considerable time imports would have flooded nations with low-priced wares, until finally the money flowed back and equilibrium was reestablished.

Fortunately the situation did not actually work out in this fashion for changes as rapid and far-reaching as those just indicated would clearly exert a disruptive force on economic organisms. This danger was recognized in part at the Peace Conference. On the one hand, an attempt was made to protect Germany's gold stocks, at least from the direct impact of the indemnities, and, on the other, the possibility of payments mainly in goods directly transferred to the creditors was rejected.

The disturbing pressure which caused this disequilibrium of prices, commerce and gold was not removed for many years, however. The acts accomplished at this time were mainly palliatives and for political reasons contradictory policies were often pursued. In fact, the fundamental ques-

tion was not faced until the distortion of the financial system brought the severe crisis of 1931. As months passed the distribution of gold between nations became increasingly unequal. The situation was bound to be unusual as long as war debts and Reparation called for non-compensated large payments and there was little hope of finding a solution in the free working of monetary forces according to classical description of the distribution of gold between countries.

The principles behind the distribution of gold *within* each country were less definite, even, than those governing distribution between countries. There was, in the United States, an attempt to "sterilize" gold, to divorce it from credit, to economize it, and to prevent its going abroad. Then again, the gold exchange standard had been devised to increase stability with a minimum of gold reserve, and various artificial measures inaugurated to protect the price level from the influence of the supplies available. There was comparatively little theory behind these actions, and this little varied from country to country. There was no doubt that a "managed" gold standard had gained ground over the traditional idea of a free flow in and out of circulation. The aims and methods of management, however, were not clearly formulated. It was generally said that stability was the goal of these efforts, but the concept had not been satisfactorily defined. Meanwhile, the former methods of controlling gold through the discount rate and bank policies seemed weaker, and the dangers from sudden changes were undoubtedly greater.

These three aspects of the problem of gold and its distribution concerned the Bank for International Settlements directly or indirectly. The conditions set in the Young Plan, the Statutes, and in unofficial statements, indicated its dependence on the gold standard. For example, participation was offered only to Central Banks of countries interested in Reparation or whose currency "satisfied the practical

requirements of the gold or gold exchange standard.”⁴ Then again, the operations of the Bank “shall only be carried out in currencies which in the opinion of the Board, satisfy the practical requirements of the gold or gold exchange standard.”⁵ Furthermore, there had been hopes that it would be an agency for economizing gold, that it could stimulate a more even distribution through the investment process, that it could save the price level from the more sudden impacts of gold movements, and that it could lessen the expense and loss involved in shipments. In addition to this, it was expected by many that it would help regulate the gold exchange standard in order to strengthen the policies of Central Banks, that it would make possible the universal adoption of the gold or gold exchange standard, and reduce the policies of different Central Banks to a more consistent code of procedure.

If the Bank should be able to work out some common meeting ground for divergent views, it would justify its existence many times over. This was extremely difficult to do. The abandonment of the gold standard by England⁶ merely brought to a climax forces already at work, and made more dramatic a need already acute. This fundamental change in the monetary situation limited the Bank in its actions in many directions, and at the same time created its most significant opportunity for future influence. It was well that it had the experience of a year and a half behind it when it came to these difficult months.

In describing the work of the Bank, there is no need to consider here the arguments for and against the gold standard. The existence of some form of gold standard will be assumed. Without it the dealings of an International Bank on lines familiar to the financial world would be impossible. There must be a common accounting unit between nations, a basis for exchange. Moreover, no index number has yet been devised to permit a general commodity stand-

⁴ *The Statutes*, Article 9. ⁵ *The Statutes*, Article 21. ⁶ See *infra*.

ard to serve as a means of equating values in different countries.

Between the two extremes, gold and index numbers, there exist two notable theoretical possibilities. One is the substitution of some other metal for gold, but this is irrelevant to the present situation, particularly since any other metal would have most of the faults, if some of the virtues, which gold has. The other main logical possibility is barter, that is some form of commodity standard, made up of goods separately or together. This has not been recently advocated as a practical working program, and cannot be contemplated as a mechanism for modern commerce. The more scientific form, that is a "composite commodity" is identical with an index number standard, and the future adoption of such a proposal is highly conjectural and not within the bounds of this study.⁷

Of course, those who guided the Bank recognized that different degrees of management of the gold standard are possible. In fact, there have been many controlling measures in recent years. As to a more comprehensive control, there is agreement neither as to the ends nor the means. There is little probability of a return to a system of complete *laissez faire* in gold, and there is some reason to doubt whether it has ever existed to any notable extent, for any length of time. The B. I. S. has itself been interested in an academic way in attempts to manage currency. Indeed, such attempts were implicit in modifications of the gold exchange standard and other recent developments. Even though some of these are still in the experimental stage, the Bank has been able to grant assistance to those Central Banks whose resources were small.

The rôle of the Bank for International Settlements is important to help in an understanding of these problems. In fact, its acts and decisions in the face of the most urgent

⁷ The only conditions which would make such a standard feasible call for a comprehensive control of the volume of production, commerce and prices. This is more or less the case in Russia.

needs in the last months of 1931 give a valuable composite picture of constructive and destructive forces.

It is not possible here to trace to their origin the forces which brought these changes in the gold standard. The general nature of the causes is well known—the stabilization of the pound at its prewar level, the depreciation of the franc which gave France its later power over gold, the collapse of the mark, the whole complex of Reparation and Debts as well as the persistent drift of funds to New York. Likewise an understanding of the reasons behind the evolution of the gold exchange standard is assumed as are the attempts to bring Central European countries back to stability by various artificial devices. The influence of monetary gold had been a visible thread running through all these various plans for financial reconstruction.

Large questions are opened by these complicated adjustments. Some were presented to the Bank in the course of daily business, others lay outside its scope. The early events of 1931^{*} brought the Bank into these gold and credit crises in an active way. For instance, its work in connection with the Wiggin Committee partook of this nature. The English experience affected it in almost all its business, in its investments, credits, clearings, profits and losses. For this reason the events in London in the autumn of 1931 must be briefly outlined below.

The late summer was dominated not so much by the fears about Germany, as by anxiety over England. To be sure after the opening of the German banks in August and the agreement of the Wiggin Committee, sentiment about the pound improved temporarily. Those who followed the rates carefully considered the quotations reassuring especially since they could not check them against the amount of foreign credits used by the Bank of England to support the pound. There was, in fact, a period of unwarranted confidence, but this did not deceive those who were convinced that a one-sided effort for stability was bound to

^{*} See Chapter XIV.

fail. There was, indeed, no real vigor in the short upward swings of the sterling quotations and no opportunity for the Bank of England to reconstitute the foreign funds which it had to use from time to time.

SEPTEMBER 1931

Meanwhile, in London, a new budget was being prepared and was presented to Parliament on September 9. It called for drastic cuts and large increases in taxation. A balance between expenditure and receipts was to be secured by means of heavy sacrifices and radical changes. The results of this earnest attempt to put finance on a sound basis led to confidence in some quarters, while in others it merely served to emphasize the difficult position in which England was placed. Despite the effort exerted, the new budget plan brought no real satisfaction in England—the Conservatives still insisted on the need of a protective tariff, and the Labor Party objected strenuously to the cuts in wages and unemployment insurance.

Immediately after the publication of the budget an unfortunate incident in the navy tended to increase general distrust. The wage cuts had included among others a considerable reduction for the naval force. The result was a strike on some of the ships, engaged in war manœuvres at this time. This audacious resistance, which came close to being a mutiny, had a very disturbing effect on public opinion. The government took a moderate attitude and modified its new wage schedules. At the same time the spirit of revolt was evidenced by riots in industrial centers. To the outside it seemed as if British patience had worn thin, and once this idea gained ground, confidence was profoundly shaken. The pound stood the immediate strain well, apparently, but the foreign credits of the Bank of England were melting away.

The week of September 14 opened in a spirit of relative calm; there was at first no widespread apprehension and even a feeling in some quarters that the crisis in sterling

was passed.* In a few days, however, the conditions became very much worse; there was an increased drain of gold, this time mainly to Holland. The stock markets in New York and Amsterdam were very weak and this increased the feeling of distrust. On Friday, September 18, according to Philip Snowden,¹⁰ the United States and France were consulted as to new credits—"in both cases the reply was friendly and sympathetic but afforded no prospect of the credits." On Saturday the condition continued to grow worse. A letter from the Bank of England to the Prime Minister and the Chancellor of the Exchequer stated that the credits obtained were practically exhausted and "urged that it was necessary to be relieved of its obligations under the Gold Standard Act."

The Bank of England's statement for September 16 indicated the weakened gold position. Its position compared with the three other large Central Banks during this week indicates the low level of reserve. The figures in round numbers are:

Bank of England	600 million dollars
Bank of France	2,320 million dollars
Federal Reserve	3,485 million dollars
Reichsbank	443 million dollars

A comparison of the gold coin and bullion for the past four years, shows that although the resources had not been high they had been well above the 1931 level. This was particularly ominous for it was well known that England had made an effort to attract gold from various sources, and had by this time exhausted most possibilities.¹¹

September 19, 1928	175.0 million pounds
September 18, 1929	136.9 million pounds
September 17, 1930	157.5 million pounds
September 16, 1931	136.8 million pounds

* *The Financial News* (September 14, 1931).

¹⁰ *The Financial News* (September 22, 1931), report of speech in the House of Commons, September 21, 1931.

¹¹ See *The Financial News* (September 18, 1931).

The news of suspension was not widely known until Sunday night and Monday morning. Some of the information is said to have leaked out in New York and was partly responsible for the heavy selling on the stock exchange there.¹² It was only on Sunday, however, that the decision was definite and was telephoned from London to bankers in many centers. The shock to public opinion was terrific. Many financial and political changes had shaken Europe but through all the troubled period after 1925, the pound had been held to be a fixed quantity on the exchanges.

Action followed swiftly on the heels of the Sunday decision. The Gold Standard (Amendment) Bill was introduced in the House of Commons by the Chancellor of the Exchequer, Snowden, on Monday, September 21. He stated that the credits obtained to strengthen the pound were insufficient, that "during the last two months we had lost in gold on the foreign exchanges a sum of more than 200 millions, apart from the fact that as a result of the London Conference 70 millions of our assets were locked up in Germany."¹³ The bill was passed through all the necessary stages on Monday on the urgent recommendation of the Ministry and became effective at once.

The bill itself was extremely simple. It suspended the second subsection of the Gold Standard Act of 1925. Furthermore, it stated that the Bank of England was discharged from all liabilities in respect of anything done by the Bank in contravention of this subsection at any time after the eighteenth of September. In addition to this it provided that the Treasury could make orders authorizing the taking of such measures in relation to the exchanges and otherwise as they may consider expedient in connection with difficulties arising out of the suspension of the Gold Standard. The obligation of which the Bank was relieved

¹² *The Financial News* (September 22, 1931).

¹³ *The Financial News* (September 22, 1931). In this speech Mr. Snowden points out that the French had maintained their balances, practically intact, and were therefore not to blame for this outflow of gold.

by this amendment of the 1925 Act was the requirement that it buy and sell gold. Thus, a very few lines enacted in short order by Parliament changed the course of finance over the entire world for many years to come.

Surprisingly few restrictions were added to this one legal adjustment. The treasury instituted a general measure at this time to the effect that only certain types of exchange purchases, that is, those to finance active transactions, not pure speculation, should be allowed. Dealings in foreign exchange were formally as free as ever, although banks were advised to use their discretion in complying with requests in order to prevent a rush of speculation in sterling. The Stock Market was closed for two days but after that business went on as usual. These were the only official changes, except the indirect acts of the government as the result of the demand for a general election, and the subsequent financial measures, changes in tariffs, and general economic acts. The repercussions in the financial world were many, however. For instance, the forward exchange market in London was disorganized. For a few days it was even difficult to get spot quotations. All contracts which had been drawn up in pounds in the course of international business were affected and certain international commodity markets such as coal, tin, wool and others in which the pound had been the unit of account were thrown out of gear.

Some thought the suspension of the gold standard was a step in the direction of a "managed" as opposed to a partially managed gold standard currency. Nothing could be further from the case. Although such theories and plans existed, and were held by a number of eminent economists and bankers, the actual events were the result of an unavoidable necessity, and were carried out only when no other way out could be discovered. The *Macmillan Report* indicated the fact that there were dissenting theories, but also insisted on the importance of holding to the existing

relation between the pound and gold.¹⁴ Moreover, in his speech Philip Snowden explained that help was asked at the last minute from the United States and France.¹⁵

Despite the gravity of the situation, however, there was a tremendous feeling of relief, and almost of exhilaration immediately after the suspension. This was, in some cases wrongly interpreted. There is, of course, a natural relaxation that comes with the renouncement of the attempt to combat an overwhelming force. Moreover, during the previous months, England had been suffering all the disadvantages of high gold prices, and a falling trade, which came with the gold standard, and yet had secured few of the advantages, in the way of prestige and influence. Then, in addition to this, those who had long felt the return to the prewar parity was a mistake became more articulate, once they found events turning toward devaluation. Undoubtedly many expected a quick recovery of industry, and a tremendous advantage to foreign commerce because of the decrease in the gold price of English wares. These views were shared, to a certain extent by people in other countries.

Others, most of whom took a pessimistic view of the new situation, were inclined to blame the Bank of England for a "cheap money" policy.¹⁶ It had been obvious for a number of months that the Bank had not used the discount rate in the traditional way to attract gold. There is no reason to assume that such a vigorous use would have failed to strengthen the reserves of the Bank. Guided by quite a different theory, however, the Bank rate had actually been reduced from three to two and a half on May 14, just at the time of the Austrian crisis. Then, it had been raised on July 23 to three and a half, and again on July 30, to four

¹⁴ *Report of Committee on Finance and Industry* (July 13, 1931), Cmd. 3897 (The Macmillan Report), p. 120. "The country shall continue to adhere to the international gold standard at the existing parity." See also minority reports.

¹⁵ *The Economist* (September 25, 1931, London).

¹⁶ Dr. Benjamin M. Anderson, "The Gold Standard and the American Tradition," *The Chase Economic Bulletin* (November 20, 1931), p. 11.

and a half. The rate was raised again on September 20 to six per cent.¹⁷

It was generally known that Governor Norman wanted to raise the rate to five per cent in July but that private bankers objected because they were anxious for cheap money. Moreover, it was traditional not to raise the rate more than one per cent at a time. A rare exception to this was the instance in September. It is possible that the lowering of the rate in May was a bluff to increase confidence, although it should be remembered that there was a corresponding decrease in America.

THE B. I. S. SHAKEN BY THE GOLD STANDARD SUSPENSE

Monday, September 21, proved to be one of the most dramatic days in the history of Central Banking. The atmosphere in Basle was charged with electricity. Telephone calls from a score of Central Banks brought alarmed questions, and threats of moratoria, and bank failures. The possibilities of a widespread suspension of the gold standard paralyzed financial activities, and left an impression of chaos in Europe. Some of the bankers in the B. I. S. were stirred by the possibility of new and exciting action, others saw the world on the brink of a general financial collapse, while every one agreed that a notable era in finance had closed.

The reasons for this feeling of a sharp break with the past are threefold. The first of these, although mainly psychological, was a powerful element in the situation. The traditional determination of the English to maintain the pound despite far-reaching sacrifices, and the fine tradition of banking reliability had given the impression that the English currency was almost the only fixed point in a world of fluctuating values. It is true that the pound varied in many of its relationships, but the feeling remained that it was stable while other things shifted. A second reason for profound

¹⁷ This act was a break in the usual tradition for changes in the Bank rates almost always occurred on the day of the regular statement, or regular meetings.

disturbance was that the prices of commodities on many international markets, such as cotton, tin, coal, were quoted in pounds. This was true even if, for example, Germany were drawing up a contract with some South American country, without passing directly through London in financing the operation. The third reason for disturbance was the gold exchange standard.

The widespread use of this modification of the straight gold standard was one of the most interesting financial developments since the war. It was designed before the war for silver using countries in the East and readapted after 1919 more or less deliberately to assist Central Banks to return to stability without building up large metallic reserves. It was made definite by various clauses inserted in the statutes of newly organized Central Banks. It was given careful consideration in various financial conferences, notably at Genoa in 1922, and was a matter of frequent discussion at the League. In all this development the Bank of England had stood solidly behind the system. Partly as the result of the Bank of England's interest in the gold exchange standard and partly because during the period of widespread depreciation the pound was surprisingly firm, a large part of the foreign exchange reserves behind the currencies in the smaller European countries had been kept in London. The suspension of the gold standard, therefore, shook their faith in the new financial methods on which they had relied, and threatened most of these Banks with intolerable losses through their exchange holdings.

Moreover, a serious blow had been dealt to Central Bank Coöperation, an idea fostered in London, and supported by interconnection of the gold exchange standard. It looked as if each Central Bank must stand on its own, or else fall before the overwhelming wave of deflation. The result was, on the one hand, the attempt on the part of many Central Banks to accumulate as much gold as possible; banks in Switzerland were especially active in adding to their gold supplies in October. And, on the other hand, there were

desperate appeals for help such as those from Hungary.

The widespread fears were reflected in the quotations of the B. I. S. shares on the Paris Exchange, although, because of the narrowness of the market and the irregularities of the quotations the values officially quoted are no absolute indication of the general estimates. Nevertheless they are interesting evidence of the distrust which prevailed in some quarters. The following quotations which are the first available in each month show a decline at the end of 1931 to less than a third of the value at the beginning of that year.

QUOTATIONS OF B. I. S. SHARES ¹⁸

on the Paris Bourse Jan.-Dec., 1931 (French francs)			
January	3,100	July	3,550
February	3,250	August	3,025
March	3,260	September	2,710
April	3,650	October	1,850
May	3,800	November	1,760
June	3,840	December	1,000
		(Unofficial)	

Unreasoned fears and conscious policy together precipitated the run on the dollar, in October. Attempts were made to strengthen the internal position by all possible methods, for the reversal of England's six-year policy shook confidence which was already distressingly low.

One of the immediate results of the changed situation was the modification of the monetary standards of a number of countries. For instance, Danzig and Greece, having currencies at a definite ratio to the pound, broke the link at once. Danzig went on a straight gold standard and Greece adopted the dollar exchange in the days immediately following England's announcement. Portugal also readjusted the basis on which her money was stabilized by connecting it with the dollar instead of the pound. The most important group of financial centers to be immediately

¹⁸ *Agence Économique et Financière* (Dec. 3, 1931).

¹⁹ Unpublished Statistics, Bank for International Settlements.

affected were the Scandinavian countries. They were forced to go off the gold standard before the end of the month. A number of countries avoided a definite departure from the gold basis but restricted the dealings in gold in many important ways. In short, suspensions and modifications meant that the gold standard was no longer functioning internationally while the United States and France were among the few countries giving out gold freely on demand.

Immediate changes affected nineteen European countries as well as a number of countries such as Russia and Turkey in which the gold standard had not been operative for some time. No description of this situation can be complete since, in a number of cases, the restrictions actually in force were not publicly announced in every case, but the following list (which does not include any of the Central and South American countries) gives an idea of the widespread modifications.

<i>Name of the Country Modifying Gold Standard in 1931²⁰</i>	<i>Date When Restrictions Were Put in Force</i>	<i>Date of Suspension of the Gold Standard</i>
Austria	Oct. 9	—
Bulgaria	Oct. 15	—
Canada	Oct. 19	—
Czechoslovakia	Oct. 3	—
Denmark	Sep. 22	Sep. 29
Estonia	Oct. 24	—
Finland	Oct. 5	Oct. 12
Germany	July 13	—
Great Britain		Sep. 21
Greece	Sep. 28	—
Hungary	July	—
Italy	Sep. 29	(actual but not legal re- strictions)
Japan	Dec. 14	Dec. 17
Latvia	Oct. 8	—
Norway		Sep. 28
Sweden		Sep. 28
Yugoslavia	Oct. 7	—
Portugal	(1924)	—
Spain	May 31	—

²⁰ This list comprises those with whom the Bank has business directly or indirectly, but does not include all possible countries, source—unpublished reports of the B. I. S.

FIVE WAYS IN WHICH THE B. I. S. WAS AFFECTED

There were five main ways in which the Bank was affected. There was, in the first place, the change necessary in the business of the Bank under the Statutes. These stipulated, under Article 21, that the operations of the Bank should be carried out in gold, or gold exchange currencies. This effectually prohibited new investments, or deposits, in the countries which had definitely abandoned the gold standard, although it did not call for the liquidation of positions already held in those countries.

The second main line of influence on the B. I. S. came through the Central Banks. These Banks were threatened with heavy losses, instability, and the breakdown of the banking structure within their money markets. The result was the sale of foreign exchange holdings, and the withdrawal of deposits from New York, Basle and other centers. The changed position of the B. I. S. was reflected in the balance sheets of the end of September and October. The total resources were in round numbers as follows: ²¹

TOTAL RESOURCES

July to November, 1931

July 30	1,631	millions	swiss	francs
August 31	1,605	"	"	"
September 30	1,273	"	"	"
October 31	1,093	"	"	"
November 30	1,107	"	"	"

Every transaction projected or undertaken in Basle was influenced by the bank failures, flights of capital, fluctuations in exchanges, and other disturbances which characterized this period.

The third type of difficulty, which the B. I. S. encountered in its attempt to improve monetary conditions, was the mass of restrictive ordinances and regulations, some of them limiting the exchange transactions directly and others indirectly. Such were tariff, tax, and exchange restriction

²¹ See *infra*, Appendix for the monthly statements.

laws. The net effect of all such economic barriers was to paralyze, for a time at least, commerce between certain countries, and to introduce speculative elements into many commodity markets. Against these factors, the Bank did what it could, in the way of advice, and information, notably in its organization of the Prague exchange conference. Very little could be accomplished in Basle, however, until such a time as the zones of currency fluctuations could be narrowed, and the political disturbances removed.

The effect of these restrictions was accentuated by the automatic disorganization of commodity markets and price agreements referred to above. Moreover, a large part of the short term financing of trade had been done in sterling bills, and both the drawer and drawee were forced to take into account the possibility of large risks of value changes, with the pound fluctuating widely. The attempt to avoid losses led to the drawing up of many contracts with a double provision, calling for payments in pounds or in gold. Such special conditions were complicating and time consuming, and acted in the same general way as the legal restrictions in slowing up business.

Then, in the fourth place, this sudden multiplication of hindrances, and the serious blow to confidence halted the new developments in the coöperation between Central Banks. Necessity forced each one to concentrate on domestic problems; moreover, the basis for common discussion and interchange had been severely shaken. The Bank found the need for its services greatly increased but the financial and moral prerequisites were seriously impaired. Once again it was an important clearing house for information, and advice, but, after the first crisis, its efforts had to be directed to the slow work of patching up shaken monetary foundations, and to preparing for the help which it might be called on to render when a return to some form of gold standard would be judged possible. The other functions which the Bank performed at this time will be described below.

Finally, in the fifth place, the Bank was faced with the whole complicated problem of the gold standard, within each country and internationally. Moreover, as an essential part of this problem, there was the gold exchange system, and the intricate question of attempts to control exchange rates or to influence price levels. This involved the fundamental aims of the Bank, its nature, functions, protections, contacts, technical adjustment, and every other phase of its activity. The concrete question around which most of the general discussion centered in the autumn of 1931 was the significance of a suggested gold clause designed to protect the Bank and strengthen its influence.

These discussions are made more significant if one distinguishes sharply between two different aspects of the gold question. One may be called the monetary problem, as distinguished from the broader or price control problem.

THE MONETARY ASPECTS A DIRECT CONCERN

The narrower or monetary aspect of the problem presents difficulties, but does not depend on sweeping political and economic changes as a prerequisite to its solution. It is this monetary question with which the B. I. S. is definitely asked to deal. It calls for further progress along lines already indicated by the Central Bank. It depends for its meaning on fixing some one or more relationships in the field of purchasing power. The traditional relationship is that between a nominal currency unit and a weight of gold. The gold exchange standard is a modification which calls for a fixed ratio between two currencies, one of which is related to gold. Some further suggested modifications include more complicated relations to commodities or exchanges, as well as a consideration of the connections which money has with other phases of economic life. Central Banking practice has always considered that the first step of this all-important task is to assure the reliability of the simpler relations, leaving the larger tasks until this should be assured.

The B. I. S. followed in this tradition. It is, of course, pos-

sible, that the scope of the Bank and the resources which are given to it will, at some future date, make possible an attack on the wider aspects of the gold problem.

There were, in fact, many tasks which were to be carried out in 1931, even within the limits of the narrower problem which has been indicated. These involved careful decisions and wise planning. They may be listed briefly as a preliminary to further comment on the most important ones. For instance, the Bank was called on to:

1. Decide in what currencies it could operate and what Banks could participate in conformity with the Statutes.
2. Modify and improve the workings of the gold exchange standard.
3. Encourage confidence in various currencies and prevent runs or large scale withdrawals of gold as far as possible.
4. Limit or avoid losses arising out of depreciation of currencies.
5. Rearrange its business in view of reduced resources.
6. Consider the possibility of a gold clause, or some special protection for its holdings in each Central Bank.
7. Arrange for meetings of the exchange restriction conference, in Prague.
8. Be ready to help in case conditions became opportune for a return to the gold standard.

These practical and theoretical matters occupied the Management during the troubled weeks that followed September 21.

ACTIVITY INCREASED

Meanwhile, the ordinary work went on much as before although the available funds diminished rapidly. It is often true that dealings with small sums mean approximately as much work as the same kind of transactions in larger amounts. There was an increase in the general activity in Basle, for as the investment of deposits became less important, the new problems mentioned above took up a great deal of time on the part of the Management and Staff. The routine was practically unchanged, even though most of the thought and attention was turned toward new aspects of monetary questions.

During the gold standard crisis it was a disappointment to some that the B. I. S. went on its way as usual for they hoped to see a sudden assertion of leadership, and an attempt to guide the financial world through the period of chaos. At first there were frequent rumors that a Board meeting would be called to organize concerted effort to maintain stable relations between currencies. These rumors were denied, and no special action was taken in Basle along the lines suggested. There were a number of reasons for this. One of these was the small resources. Another was the lack of any basis for predicting the political changes which would determine economic trends. A third was that England did not wish any artificial measures to interfere with the adjustment of the pound sterling to its "natural value."

For these reasons the date of the fifteenth Directors' Meeting was not advanced but was held as had been planned on October 12. The Governors assembled as usual on Saturday. In the course of their conversations Montagu Norman discussed the suspension of the gold standard in England, but in the regular Board meeting the matter was not directly mentioned. The business reported in the official communiqué included nine general topics. There were: ²²

1. The resignation of Dr. Vissering from the Board of Directors was noted with regret, and at the request of the Board he agreed to serve until the end of 1931.
2. The Wiggin report was received, and the appointment of the arbitration committee which had been made by the President in conformity with the report was approved.²³
3. Note was taken of the protocols of August 11 and 13 and "the suspension of certain intergovernmental debts."
4. The statement of accounts was approved.
5. The B. I. S. share of the Reichsbank Credit was renewed for three months from November 4.
6. The 40 million schilling credit to Austria which was a part

²² See official *Communiqué* of October 12.

²³ See *Communiqué* of October 5. The Wiggin Report is usually referred to as the Layton Report.

of a joint credit of 190 million was renewed for three months.

7. The one million B. I. S. share in the three million dollar credit to the Bank of Yugoslavia was renewed.
8. It was agreed to appoint a member of the Board of Directors of the proposed International Agricultural Mortgage Credit Company. (The League Agricultural Bank.)
9. Note was taken of the preparation to pay the Young Loan coupons on a gold basis.

It is interesting that none of these topics of discussion was directly connected with the gold standard crisis except the arrangement to pay the interest on the Young Loan on a gold basis. This was called for by the General Bond of June 11, 1930. The details of the arrangement were announced in the communiqués issued on November 26 and 27, and December 1. These adjustments applied to the portions issued in pounds sterling and in swedish crowns. None of the other parts of the loan were affected at this time since the currencies concerned continued to be on a gold basis.

One unusual event which grew out of the gold standard difficulties was the visit of Dr. W. Randolph Burgess, Deputy Governor of the New York Federal Reserve, to the Bank at the time of this meeting. He came to Basle to confer with the Governors of the Central Banks who were assembled there. He did not, of course, attend the Board Meeting, but merely used this opportunity to discuss the crisis with the financiers who were there.²⁴ His explanation of the gold and currency situation of the United States did much to dispel the exaggerated fears which were circulating in Europe at this time, and which were causing a panic of withdrawals of credits from New York. Special conversations on the subject of French funds in America were held in New York,²⁵ but it was important to have other countries understand the true situation, since the rapid liquida-

²⁴ *Agence Économique et Financière* (October 13, 1931).

²⁵ Paul Einzig, *Behind the Scenes in International Finance* (London, 1931). It was said that the French deposits were a subject of conversation during the Hoover-Laval conference, October 22, 1931. A Bank of France official also went to New York to arrange certain aspects of this matter.

tion of the holdings of even the smaller Central Banks accentuated the general lack of confidence, without materially improving the position of these Banks.

There is no doubt that many of these Banks were in real difficulties. In addition to the losses which they themselves sustained, the private credit institutions in each country were seriously impaired, and foreign exchange restrictions hampered trade on all sides. This was so disturbing that the League Finance Committee in connection with its work with government finance in Hungary urged that the B. I. S. take the leadership in an attempt to establish more order in the exchange relationships in the Central European countries. The subject of these exchange restrictions had already been discussed in Basle. The result of talks in Basle and Geneva led to the conference called in Prague on November 3.²⁶ Here the attempt was made to develop means of compensation and offset through a clearing house so that the currency situation would not limit commerce, but the arrangements were made difficult because of the extensive interference of governments in financial matters and the universal desire for a favorable balance of trade. In fact, it was found that very little could be done to improve the situation technically, unless these disturbing influences were lessened.

MONETARY CONFUSION CONTINUES

The November Meeting considered, among other things, the report of the Prague conference of Central Bank Experts.²⁷ It recognized the importance of non-economic forces in handling these matters, and in general, preserved

²⁶ See official *Communiqué* of October 27, 1931; also *The Manchester Guardian* (Nov. 10, 1931). Mr. Porters and Dr. Blessing went from the B. I. S. to this meeting.

²⁷ See *Communiqué* of November 9, 1931; also *The Manchester Guardian* (Nov. 10, 1931). "Typical of the post-war nationalistic financial policy is the failure of the Prague conference which the B. I. S. called last week to discuss the problems arising out of foreign exchange restrictions imposed by the Danubian countries. The governing body was obliged to record the failure of this conference."

the attitude which was desired by the member Central Bank in not attempting to hurry the adjustments which were bound to be greatly influenced by later government action. Dr. Bruin's report on the Austrian situation was considered at length, but it was decided to postpone the matter of a further credit.²⁸ This act was variously commented upon in the Press, some claiming that it was an indication of the reduced resources, and "frozen position" of the Bank,²⁹ while others said that in any case a reorganization of Austrian banking affairs was a prerequisite to further credit. The resignation of Mr. Francis Rodd was noted with regret, and the appointment of Mr. R. H. Porters as a Manager of the Bank was confirmed.

Other business taken up at this meeting included the confirmation of the appointment of Mr. Henry J. Bruce as advisor to the National Bank of Hungary. This appointment was another indication of the parallelism of the work of the Bank and the League. The B. I. S. acted in the selection of the Bank advisor while the League appointed Mr. Royal Tyler as financial advisor to the government. The arrangements with regard to the payment of Young Loan coupons on a gold basis were noted by the Board. Moreover, a sub-committee appointed to consider the "principles to be observed in the investment and banking policy of the bank" was of necessity concerned with the gold standard question,³⁰ and the possibility of a gold clause.³¹

It is clear that there was a marked difference between the various phases of the Bank's work at this time. On the one hand, it was called on to make a multitude of arrangements in connection with the catastrophic events in the

²⁸ *Agence Économique et Financière* (Dec. 1, 1931).

²⁹ Jacques de Bainville, *La Liberté* (November 11, 1931).

³⁰ *Agence Économique et Financière* (Oct. 30, 1931). "The Board Meeting of November 9 will discuss the gold clause. The question at stake is the guarantee of gold parity for the assets in all circumstances—without having to modify in any respect the monetary policy of the various countries—by a confirmation applicable only to international operations."

³¹ The subsequent Board Meeting, scheduled for December 14, 1931, was later postponed until January 11, 1931.

financial world. These were concrete and immediate tasks. On the other hand, much consideration was devoted to questions in connection with the gold standard, and the ultimate adjustments which would make for stability of value and Central Bank coöperation. None of these larger questions could be definitely settled because of their complexity. It is evident that these cannot receive comprehensive treatment here. It is merely possible to outline the principle questions so that the position of the Bank as it entered the new phase of its existence in 1931 may be more clearly understood.

The more definite work of the Bank consisted of three main lines of activities during the last weeks of 1931. There were those banking accounting functions which grew out of the handling of the unconditional annuities and the deposits of Central Banks and others. This work was conducted much as before, even though the volume of business was greatly reduced. Then, the Bank was called on to make special arrangements, such as those already indicated in connection with the financial reconstruction of Hungary, and the Prague conference, and other adjustments to the gold standard suspension. Finally, in November, it was asked by Germany to convoke the Special Committee under the Young Plan.

The relation of the B. I. S. to the Special Committee was clearly outlined and definite, and involved no direct concern with the negotiations to be carried on. The request for the calling of the Committee was presented to the Bank on November 20. The Bank immediately notified the seven interested Central Banks, asking each one to appoint a member to this Committee. On November 25 ²² the following nominations were announced:

Professor Alberto Beneduce..... President, Consorzio di Credito; Rome
 M. Émile Francqui..... Vice-Governor, Société Générale de Belgique; Brussels
 Sir Walter Layton..... Editor, *The Economist*; London

²² See *Communiqué* of November 25, 1931.

Dr. Carl Melchior.....	Partner, M. M. Warburg & Company; Hamburg
D. Nohara, Esq.....	Manager, Yokohama Specie Bank, Ltd.; London
Professor Charles Rist.....	Professor of the Faculty of Law; Paris
Dr. Walter W. Stewart.....	Chairman of the Board, Case, Pomeroy & Company; New York

The Committee was convoked for December 7, and the seven men already assembled in Basle then chose the four other advisors called for under the Plan. They were Messrs. Bindschedler, Colijn, Diouritch, and Rydbeck.

The Bank carried through its prescribed functions of convoking the Committee, and in addition, made arrangements for it to meet in its offices. Beyond these services, it had little direct connection with the Committee. The Managers and Directors of the Bank took no part in the deliberations by virtue of their connections with the Bank, although Dr. Melchior, Monsieur Francqui, and Professor Beneduce were actually members of the B. I. S. Board. The Bank appointed a small secretariat, under Signor Pilotti, Dr. Blessing, Monsieur Rodenbach, and Mr. Pollen to assist the Committee, and to act as a liaison group between it and the Bank. Once these arrangements were made, the two groups functioned independently, even though the personal contacts were, naturally, very close, because of frequent association between these financiers at other conferences.

The Board of the B. I. S. did not meet in December, and no new business came to the front. One had the impression that despite the official aloofness, the business of the Bank was very much overshadowed by the difficult negotiations going on in its assembly rooms. No one could escape the feeling of pessimism, and of potential change which grew out of reparation uncertainties. Although the Management of the Bank was far from inactive, no efforts to enlarge the scope of its work in the immediate future were contemplated. In many respects the Bank was marking time, because it was realized that the negotiations of the next few months might modify the nature of the new institution.

Meanwhile, the final balance sheet of the year shows that the Bank's resources had been considerably reduced during the last months. They stood at approximately one billion swiss francs for the next six months.

GOLD EXCHANGE STANDARD

The other phase of the Bank's activity referred to above was the consideration of the part it should play in the gold standard adjustments to come.³³ Conferences on this question were concerned chiefly with two main questions. The first was the adjustments which might be made in the gold exchange standard; this had already been the subject of study in Basle for many months. The other was the possibility of a "gold clause." These are both far-reaching and difficult questions. It is merely possible to present the problem here. The answers must be found at some future date after more study and experience has contributed to the formulation of feasible plans. There were a number of conflicting views and hopes, which called for reconciliation, and both matters were destined to be before the Bank for consideration for some time to come.

A large number of countries had adopted the gold exchange standard after the war. The system had been known before the war, and received its first masterly exposition by Professor Keynes in his study of the Indian currency.³⁴ The main European countries which could include foreign exchange as part of their reserve against notes in 1931 were:

Albania	Hungary
Austria	Italy
Czechoslovakia	Latvia
Danzig	Poland
Esthonia	Rumania
Germany	Yugoslavia
Greece	

The requirements governing foreign exchange as a reserve

³³ The Gold problem in relation to clearing has been discussed in Chapter XI.

³⁴ J. M. Keynes, *Indian Currency and Finance* (London, 1913).

against notes varied widely from Central Bank to Central Bank.

The two questions were closely interrelated. The importance of the Gold Clause was derived in large measure from the prevalence of the Gold Exchange Standard. The adoption of this standard by Central Banks in the postwar period is evidence of the need of introducing into monetary systems greater flexibility than that afforded by the straight gold standard. This modification consisted of using foreign exchange assets as reserves against currency under conditions which varied from instance to instance. The question was very naturally raised, whether these foreign exchange reserves should be considered equivalent to gold, and if they did not serve exactly the same purpose, to what extent and in what ways they differed. It is clear that the soundness of this development depended to a considerable degree on this fact, and yet the true situation was not definitely known. In any case this state of affairs led to uncertainties and risks.

THE GOLD CLAUSE

The desire for a "gold clause" originated in the attempt to eliminate some of this uncertainty. It covered only one aspect of the problem of the gold exchange standard, but it was this aspect which was brought forcibly to the front in 1931 by the suspension of the gold standard. It was concerned mainly with the possibility of liquidating foreign exchange holdings without an exchange loss, and did not cover the wider question of the use of these holdings, and their relation to money market control. The "gold clause" presents a definite and clear-cut issue even though it rests on a complicated and uncertain economic and legal basis. It requires long and careful consideration, and falls outside the scope of the present study. Moreover, in view of the early discussions it seems unlikely that any decision on the matter will be acceptable to the Central Banks and the B. I. S. for many months to come.²⁵

²⁵ *Berliner Boersen Zeitung* (Nov. 13, 1931).

The term "gold clause," as used in the Bank for International Settlements, meant the granting of a special guarantee that the holdings of the B. I. S. with the Central Banks of various countries would be paid in value equivalent to the gold value of the currency at the time when the deposit in that Bank was made by the B. I. S. It would, of course, be paralleled by full repayment by the B. I. S. to its depositors, and would, if successful, reduce the incentive for sudden withdrawals of funds, and increase confidence. By virtue of these characteristics it would introduce a new element of stability into the foreign exchange relations of the countries concerned.

Although it could not be quickly arranged this project was not a matter to be considered by the Management mainly because of the future developments of international coöperation, but was, rather, a very practical question. It had to receive some kind of answer in the course of the regular investment and repaying of funds. Thus, as soon as the pound sterling began to depreciate the Bank was faced with the decisions as to what it should do with regard to sterling assets and liabilities. It was not faced with a direct loss from the depreciation of the pound for, as the result of its policy to shift money to the countries which needed it most, it was short sterling. Thus the Bank could have made a profit if it had been willing to pay its creditors in depreciated sterling, covering its commitments at rates which were lower than those which prevailed when the original transaction was made.

On the other hand, it would be impractical and useless for the B. I. S. to repay full value if Central Banks in which the B. I. S. had deposits did not agree to repay these deposits on the basis of their former gold value. The Bank could not wisely incur the loss which would grow out of receiving depreciated currencies and paying out full value. In short, a gold clause, to have any significance, must be reciprocal, and an early decision was desirable for the B. I. S. Pending such a decision, the Central Banks which had sight deposits with the B. I. S. labeled in depreciated

currencies, for the most part kept their funds intact, whereas the B. I. S. did not withdraw its deposits from the Central Banks which had suspended the gold standard.³⁶

The motives for establishing such a special guarantee were, thus, as has been indicated, the immediate problem of paying and receiving gold value for deposits with and for the Central Banks, the desire to strengthen the relations of Central Banks in the interests of monetary stability, and the improved working of the gold exchange standard. There is no doubt that such a protection, if feasible, would fortify the position of the B. I. S. It was not essential to coöperation or to stable exchange relationships but it would make a great difference, in that it would make the B. I. S. the corner stone in such a new structure, and it would increase many-fold the incentive to move funds through the B. I. S. If such an arrangement should prove to be fundamentally unsound, however, its hasty adoption would harm the Bank, as well as the participating Central Banks, because it would engender a false sense of security, and because of the limits which it would set on the action of Central Banks in certain cases.

A basis for this special value guarantee was alleged to exist on two grounds, one legal and the other economic. The legal aspect of the matter rested on Article X of the Hague Agreement.³⁷ This clause was incorporated also in the Charter and reads as follows: ³⁸

The Bank, its property and assets and all deposits and other funds entrusted to it shall be immune in time of peace and in time of war from any measure such as expropriation, requisition, seizure, confiscation, prohibition or restriction of gold or currency export or import, and all other similar measures.

In addition to this the acceptance of the Statutes by a Central Bank is implied by the ownership of shares.³⁹ Thus, it

³⁶ Some deposits were withdrawn after a few months.

³⁷ *The Trust Agreement*, Cmd. 3848, p. 22.

³⁸ This is the English text; compare the French which takes precedence.

³⁹ Article 18, *The Statutes*.

can be argued, that depreciation is tantamount to partial confiscation, and that the export of the full value of funds, introduced with the approval of Central Banks, is a right implicit in the normal operations of the B. I. S.

Although the legal question is not easy to decide, the economic arguments brought forward in support of a gold clause are even less easy to accept or reject. They are concerned mainly with the desirability of recognizing certain value relationships as fixed, and attempting to maintain them even through difficult times. In short, the gold ratios of the currencies of the countries participating in this kind of arrangement would be tied to each other, and although they might vary, this variation would be restricted because it would be possible to avoid fluctuations of one currency in terms of another by using the B. I. S. as an intermediary, as long as the gold clause applied. This consolidation of a system of exchange rates would rest for its validity on the development of a sound coöperation between Central Banks. Without such a constructive collaboration, the Central Banks would sacrifice some freedom of action for which they would gain an uncertain advantage.

It is conceivable, of course, that to obtain this guarantee, some compromise might be effected which would permit special arrangements between the B. I. S. and Central Banks, but which would also limit the amount of funds to which this guarantee would apply. This limitation could be placed on the Bank through the exercise of the veto clause or by other means. It is evident, however, that such a development would not make possible the free movement of funds, and the unquestioning confidence, which the advocates of the gold clause would like to see realized. The attainment of these aims would automatically result in a kind of international money in the form of B. I. S. funds; it would furnish a means of payment which would put no strain on the metallic resources. There is no doubt that such a prospect is most attractive, if economic and political considerations should make it a workable arrangement.

Doubts which have been raised in opposition to this device so urgently brought forward in 1931 were to the effect that the clause was not needed in good times, and could not be fulfilled in bad. The regular agreement of Central Banks to give gold for notes was in itself a "gold clause" similar to that suggested by the B. I. S. The fact that certain countries were forced to give up this agreement, despite earnest efforts to maintain it, indicates that circumstances sometimes bring about the inability to meet the most solemn engagements. How can a special guarantee given to the B. I. S. prove different from the normal promise to buy and sell gold, ask the sceptics. The answer is one which lies outside the limits of abstract reasoning in the field of actual economic experience. For this reason, all conclusions on this question must be tentative and subject to revision.

In any case, the practical measures necessary for the adoption of such a gold clause are dependent on the will and power of Central Banks and, indirectly, on governments. For this reason alone, irrespective of the natural difficulties which may be involved, progress toward this end is apt to be fairly slow, even if the investigations by the B. I. S. make the desirability of this protection very clear. Certainly, the adjustments required in monetary standards, when the time for reconstruction arrives, require long study and negotiation. Fortunately many lessons have been learned from the experience in the twelve years that passed from the end of the war to the suspension of the gold standard in England in 1931, and in addition, certain new mechanisms have been developed.

Meanwhile, because of the practical problems which have been indicated, the Bank at once took steps, in 1931, to prepare the way for a gold clause. They wrote a letter in October to their participating Central Banks asking if they would be willing to give a special guarantee to assure the permanent gold value of the deposits which the B. I. S. might make with them. By March 1932 answers were received from thirteen of the smaller Central Banks who

agreed to do this. The larger Central Banks, on the other hand, either hesitated or expressed serious doubts as to the practicability of such an arrangement. The reason for this difference in attitude was obvious. The smaller banks had much to gain by the stability of the foreign exchange deposits which they might hold through the intermediary of the B. I. S., and moreover, they had very little to lose, because the B. I. S. was not likely to leave large sums in their markets, and as holders of foreign exchange themselves, they could be sure of making good their engagements if these exchange deposits were safe from depreciation. The larger Central Banks, on the other hand, might have considerable funds of the B. I. S. in their markets, and would gain comparatively little by holding their own exchange deposits with the B. I. S.

CONCLUSION

The result of all these events and investigations was to make it more and more clear that the gold problem could not be adjusted to economic needs unless basic, industrial, commercial and political conditions attained some measure of balance.⁴⁰ Gold reserves could not be adequate if there were threats of war or of arbitrary interference in the movement of funds and of goods. Neither the gold standard nor the gold exchange standard could regulate credit in the face of panic and a badly coördinated productive life. No agreement such as a gold clause, and no technical modification of monetary practices could suffice. On the other hand, various monetary improvements could be made once a reasonable sense of security developed on the basis of a well-balanced production and political good will, and without this condition all efforts would prove unavailing.

The work and experimentation at the B. I. S. did much to indicate what could be done to stabilize the weaker currencies and draw together the stronger banks. The fact that their work was interrupted by events over which they had

⁴⁰ *Second Annual Report* (Basle, May 10, 1930), p. 10.

no control, such for instance, as the suspension of the gold standard and the reparation crises, does not lessen the value of the findings which they made, although it must be admitted that the setback which the Bank suffered in 1931 indicates the relative weakness of the institution in the face of such powerful forces. That it could survive these happenings indicates a high degree of vitality, and that it brought to light a number of definite conclusions with regard to the gold question points to its future usefulness.

A number of aspects of the problem which were illuminated by the activity of the B. I. S. have been outlined. The most instructive findings were on the subject of the workings of the gold exchange standard, the conditions which must be met before assets abroad can be counted as reserves, the importance of having such foreign exchange investment under the supervision of the Central Banks, and the necessity of introducing order and regularity into the exchange, gold, and investment practices of various countries in their international dealings. Some of the studies made in Basle, as well as some of the specific undertakings, require further testing, and elaboration, but the beginnings made should help in the re-ordering of international monetary relations.

CHAPTER XVI

CENTRAL BANK COÖPERATION

HOPES for effective Central Bank Coöperation through the B. I. S. or otherwise were considerably diminished in 1931 just at the time when the urgent need increased. The effects of monetary instability and of conflicting bank policies were evident on every hand. They became real in bankruptcies and poverty in every country, and left their impress on the laws and customs, as well as on the international relations and social structure of every nation. The Bank for International Settlements was a concrete manifestation of the hope for coöperation. It was bound to suffer from the events of 1931, from the collapse of prices and credit, and the breakdown of most manifestations of economic internationalism. Despite the growing difficulties, however, it kept this primary aim constantly before it.

Thus, even though the more ambitious plans were postponed for a long time, the Bank was in its first two years an agent of collaboration. It was a meeting place for Central Bank governors, and an exchange for financial information. It was the agency for opening joint credits, and an intermediary for many requests and arrangements. Moreover, every step in the direction of mutual adjustment or concession could be worked out through Basle if this were desirable. Even at the moment of least activity it was a link between different money markets.

The main intention behind "Central Bank Coöperation" is to provide international commerce with a reliable means of payment and prevent monetary fluctuations which will disturb price structure and cause financial crises. The need for coöperation lies in the fact that credit can retain its

value only if it expands or contracts at a fairly even pace in different countries. Obviously, in a world where there is active trade between countries, a sudden upward or downward movement of prices in any major country will disturb conditions of competition—that is the terms of trade¹—and this disturbance will harm the losing countries more than it will profit those which gain temporarily. This being the case, it is only reasonable to look for some orderly way of coördinating policy as a substitute for chance agreement, or occasional meetings.

This need for collaboration is made more urgent by the actual shortage of gold as a means of international payment unless, as is usual, it is supplemented by a liberal use of credit. The dependence on credit, therefore, makes it important to have the conditions of granting credit, as well as the real wealth behind the credit, sound and to have the rules governing the creation of purchasing power well understood in all the trading countries. Obviously the task is not easy, and unless some international agent is found, reliance will be placed on some one or two Central Banks, with the political limitations which come from such alliances and predominating influences. A neutral organization, with the common interest in view, is therefore a much desired instrument.

Until recent years financial coördination between countries was less important because the economic links between nations were less close. Transportation was slower, industrial expansion and changes in technique less rapid. Formerly the possibility of mass production, which would now permit even the smaller countries to fill the world needs in certain commodities, did not present the same threat and promise as at present. Moreover, credit had not been developed to such a high point, nor was the velocity of circulation subject to so many sudden changes. In the past a well-developed nation could manage to get on, comparatively free from outside influences by relying on certain es-

¹ F. W. Taussig, *International Trade* (New York, 1927), pp. 8, 9.

established relationships in internal and external trade; now swift changes and technical progress make this impossible. The choice is, therefore, between reasonable coöperation, or a straight nationalism in economic policies which would mean a decline in the standard of living everywhere.

Even before the war, however, the need for some kind of international adjustment became fairly evident. Study of business cycles indicated that price and credit changes in one country could cause serious disturbance in others. Moreover, the volume of international trade and the speed of production were increasing rapidly. The result was that sporadic and occasional efforts were made to reach coördinated policies in credit and banking matters and to mitigate international differences in economic affairs. In addition to this international interdependence was acknowledged on rare occasions in the granting of loans to strengthen the banking system of a neighboring country.

These attempts at financial coöperation before the B. I. S. took various forms but the one outstanding characteristic was that each effort was short-lived. The cordial relationships which were developed between the financial experts of certain countries would vanish when these particular men resigned from their positions of importance in the financial world. The loans which one Central Bank might arrange for another would not be followed by a consistent policy of support in later difficulties. The conferences which met to discuss uniformity of practice and coördination of principles ended with academic suggestions which were not carried out. It would be unwise to minimize these beginnings but the immediate practical results were few. In fact, it was not until after the World War that efforts in the direction of financial coöperation were in any significant degree continuous and interconnected.

The subject of financial coöperation is large, and related to all the more important economic facts and principles. Even the history of early efforts in this direction requires a careful scrutiny of the development of central banking,

of international trade, and credit relations between nations. The significance of these early attempts can be alluded to here only in the briefest manner.

The Bank, the new instrument of coöperation, began its work in 1930, when almost everywhere politicians were increasing barriers between nations, and when the mistakes of financiers and statesmen were tearing down the intricate structure of world-wide economic relationships. This meant the new plans were developed under insurmountable difficulties. It meant that the basis of payments between nations was so thrown out of gear that no central agency could bring it into proper working order. It meant that the conferences which the Bank could organize reached a working agreement only under the greatest handicaps, and only if the project were of the most cautious nature.

Thus, the new effort, though sound in principle, could achieve little in view of the world chaos in finance. Indeed, to the sceptics, it seemed as if coöperation were diminishing as new agencies, notably the League and the Bank, were developed. This appraisal of the early work and the new methods leaves certain essential conditions out of account. The new project would eventually bear fruit when the desire and the vision of many people should prepare the necessary conditions.

CENTRAL BANK AIMS

Central Bank Coöperation implies certain ends which the Banks of Issue wish to attain. These ends are not always clearly seen, and the roads by which they may be reached differ greatly according to different opinions. The more generally admitted aims may be indicated here, even though the other related objectives are the occasion for much doubt and controversy. These are in the main two, first *confidence*, and second *stability*. Confidence implies the general expectation that the banks, and in particular the Central Banks, will be able to fulfill the letter of their contracts. Stability implies that the values paid and received in the

respective monetary systems will remain substantially the same.

The officers of the Bank found both of these conditions lacking in 1931; credit systems all over the world were crumbling. Moratoria and the suspensions of obligations to give out gold made it clear that no contracts could be relied on. The dangers in such a situation had been foreseen, but the rapidity with which the difficulties would overtake efforts to reorganize European finances astonished even the most apprehensive.

Although the meaning of confidence and stability varied somewhat when referred to in different connections, they were not merely abstract ideas, but were general expressions for concrete conditions governing credit and money. For instance, confidence rested on the acceptance of some generally recognized monetary standard, and the ability and determination to fulfill the normal legal and economic conditions. This, in turn, called for the liquidity and solvency of Central Banks, a large measure of freedom in the money, metal, and foreign exchange markets, and the avoidance of deliberate inflation and government interference in Central Bank policies. It is clear that the maintenance of such conditions in one market would be greatly facilitated by a similar policy in neighboring centers. In fact, regular or occasional coöperation was an essential.

It is surprising in view of its fundamental importance to credit that the maintenance of *confidence* in the international field had been left largely to chance until Genoa, 1922. Political barriers and intangible factors had of course placed serious difficulties in the way of conscious efforts, but it was not reasonable to reject the possibility of coöperation or of some orderly adjustment of common problems without a trial. Unfortunately, when the time came for the ambitious experiment in Basle, the forces had become so powerful that the B. I. S. could exert no decisive influence to stop the landslide as credit and confidence collapsed.

Stability, on the other hand, had received increasing at-

tention in the early years of the twentieth century. It was closely related to confidence but went further into the economic bases of the monetary system in that it pointed to the dangers of the fluctuation of real values, and not merely to the non-fulfillment of technical obligations. The idea was more complex and more controversial in some ways than the maintenance of money and credit in accord with existing agreements, for it implied the desire to go beyond contracts and to achieve a new justice based on utility, or cost, or a composite commodity standard. The idea was not new but the execution of the idea on an international basis called for some new methods of coöperation.

The way to stability was generally conceived to be a control of the volume of money and credit, but so far no international agency to guide or restrain international means of payment had been devised. Thus, whatever progress was made in the domestic field was threatened constantly from without by the possibility of conflicting movements in other countries. The contagious sweep of price declines from country to country in successive industrial depressions had already indicated the close connection between countries and this connection became closer in the years that followed the war although the means of international control of purchasing power seemed to become less effective as the usual mechanisms of the world distribution of gold failed.

To some economists the idea of Coöperation held out hopes more brilliant than those referred to above. In fact, there is no doubt that many looked on achievements in these directions as minor steps toward the ultimate goals of an ever expanding trade. They saw technical achievements which would increase opportunity for all men, and lessen the political pressure which led so often to destructive competition and war. In looking to these more distant ends, some financiers thought of confidence as a subsidiary to the proper management of currency and desired a slowly rising price level as a stimulus to production. Most bankers,

however, emphasized the more immediately attainable ends and considered that if regularity, order, trust, and the avoidance of sudden changes could be secured, the other economic problems could be handled by non-banking agencies.

EARLY COLLABORATION

Previous to 1930 financial coöperation had taken four main forms. These were, in the first place, those unofficial conferences concerned mainly with methods and information, such as the meeting of Central Bank statisticians in Paris, 1928.² Then, in the second place, there were the official conferences which were arranged to consider specific actions in financial matters which might be agreed on collectively by governments or Central Banks such as the Genoa Conference and wartime collaboration of bankers and treasury officials. In the third place, there were the occasional meetings of Central Bank governors to discuss common problems. Finally, there were loans granted by one Central Bank to another to assist it in time of emergency.

Three of these forms of coöperation had taken place at some time under the auspices of the League of Nations. The exception was, obviously, the meetings of Bank governors which were never arranged by Geneva. On the other hand, the granting of loans, conferences, and committees to arrange for banking reconstruction and various forms of investigation and assistance were initiated at one time or another by the economic and financial section of the League.

It was characteristic of most of the early efforts at coöperation, though not of the part the League played, that the attempts were episodic and in the main disconnected. There was, thus, little possibility of accumulating knowledge, or benefiting by past experience. When the conferences dissolved, the groups based partly on personal knowledge and

² See confidential reports of these meetings.

friendship ceased to exist. Even the loans led to no permanent connections on which principles and methods could be worked out in the common interest. Moreover, since the reasons for the conferences and assistance differed from instance to instance, and the basis was not commonly understood, public opinion was often misled by false hope or unwarranted cynicism as inaccurate unofficial reports were circulated.

The work of the League, admirable though it was, suffered under certain other handicaps. These did not lessen the effectiveness of the efforts actually exerted, but did limit somewhat the further extension of its activities in the direction of banking coöperation. The importance which is placed on these limitations differs somewhat according to assumptions made as to the degree of government interference likely to prevail in the economic life of the future, and any assumption in this direction is highly uncertain. In any case, however, it is clear that the League was essentially political, and that all the tasks which it executed were under the direct or indirect control of governments. In addition to this its first financial work had been assisting certain countries which were in a state of complete collapse and, as a result, it was usually taken for granted that a country appealing to the League did so because of a desperate need of assistance.

The Bank for International Settlements was not subject by nature to these particular handicaps. It was limited rather by the general economic conditions prevailing and by the lack of political good will rather than by structural difficulties. For instance, its work was continuous and cumulative. The basis for its activities was fairly clearly understood. It was a non-political organization, and the Central Bankers who attended its conference were, as far as could be possible anywhere, on a plane of equality. In short the Bank was admirably planned to become an agent of coöperation, although circumstances made its work along those lines extremely difficult in 1930 and 1931.

Some further consideration of the early steps in the direction of financial collaboration is called for in order to show the fragmentary nature of past experience. Some acknowledgment should be made of the efforts of those who first saw the need for harmonizing the banking policies of different countries for there is no doubt that even those aspects of the Bank which appear to be new and original were, in a measure, a recombination of former suggestions.

It is sometimes forgotten that the financial coöperation which was carried on during the war laid a basis for the future developments which brought the Bank into existence. In connection with foreign purchases, certain countries had sent abroad representatives to confer with treasury and Central Bank officials. Moreover, the measures taken to peg some currencies led to conferences and arrangements which drew the Central Bankers together. It was natural that the interchange of visits and the discussion of currency and credit problems should continue in peace time, and also that these should be extended to include the former belligerent countries. These contacts were not centralized in any way but they were, nevertheless, important beginnings of mutual adjustment of Central Bank policies.

The first clearly expressed plan for Central Bank collaboration was made at the Genoa Conference in 1922. It grew out of the discussion of the restoration of the gold standard and was based to a considerable extent on a memorandum prepared by H. A. Siepmann in consultation with his associates at the Bank of England. This memorandum has never been published but is known to have outlined plans for regular consultation and methods of arriving at harmonious policies in money and credit through the more important Central Banks.^a Not only at Genoa, but elsewhere, the return to a common unit of payment based on gold was recognized as a prerequisite to smooth working international finance, but the difficulties involved in the

^a See *supra*, Chapter I, pp. 10, 11.

redistribution of the metal were so great that it was clear that some special adjustments would be necessary.

The permanent legacy of the Conference was the body of resolutions which indicated the essentials of financial reconstruction.⁴ The indirect results were, on the one hand, the extension of the gold exchange standard, and on the other, the Bank for International Settlements. Unfortunately, the particular steps recommended at the time, for instance, the calling of a conference by the Bank of England, to handle certain aspects of the gold question, were not carried out. In fact, it almost seemed as if the conclusions were forgotten, but the influence was to be felt here and there in the years to come, even though the disturbing political rivalries and economic fears prevented any swift development.

It is certain that this conference presented the most impressive statement of the need and the most helpful outline of the possibilities so far formulated. The discussions were in their turn somewhat affected by suggestions made in earlier monetary conferences, such as that held in Brussels in 1920 and at Cannes in 1922.

In any case the dissolution of the Genoa Conference meant the scattering of the ideas expressed there and the end, for the time being, of the constructive discussion of international coöperation in finance. Economic and political difficulties arose in 1923 which prevented the carrying out of plans for a further conference, and the indirect effects through the evolution of the gold exchange standard worked themselves out without centralized international guidance.

The meetings of Central Bank governors had much the same episodic character as the Genoa Conference. These informal conferences have taken place at various times and are a normal development of financial life. They reached a high point during the years when Governors Norman, Strong, Moreau and Schacht came to a close and cordial understanding of their mutual problems, and talked on several occasions about the matters of policy of such urgent

⁴ Genoa Conference resolutions Nos. 1 to 12, Cmd. 1667.

concern to them all.⁵ In this case, as in that of other financial conferences, however, the results, though of great value in the development of Central Banking, led directly to no permanent or continuous development of policy. Governor Strong died in 1928; Dr. Schacht resigned from the Reichsbank in 1930; Governor Moreau resigned from the Bank of France in 1931. Thus, the group who had come to understand each other in the preceding years was completely dissolved, and Governor Norman was the only one of this particular group left in Central Banking in 1931.

It was inevitable that Central Bank governors should occasionally meet to discuss their problems. It was only on rare occasions that these meetings included more than two or three heads of Central Banks, and not until the founding of the B. I. S. did a considerable number come together for conference. The largest gathering held up to the present was the General Meeting in May 1931. Despite the close relationship of their interests many of them had never met before. Moreover, their meetings occasioned much surmise as to their purposes. It was even alleged on several occasions that one Governor was trying to secure concessions disadvantageous to the domestic interests of the other banking systems. In fact, these conferences often assumed an unwarranted importance in the eyes of some, whereas they could not accumulate any momentum because they were largely dependent on personal acquaintanceship, and various factors which governed the tenure of office of the Governors of the Banks.

Then again the work done in connection with occasional international loans either between governments or between Central Banks was even less the basis for permanent coöperation than the conferences which have been discussed above. These loans were an indication of the growing financial interconnection between various banking systems, but they

⁵ The four Governors were ably assisted in these conferences by others in Central Banking circles, notably Dr. Rist, Monsieur Quesnay, Mr. Siepmann, Walter Stewart and others.

took place mainly in times of emergency and were generally forgotten as soon as the immediate crisis was over. The result of this type of collaboration was to emphasize the advantages of mutual support in time of need. Since no permanent organizations or practices grew out of these rare instances they had comparatively little influence on long-run developments in finance. The outstanding example of this type of collaboration was the loan by the Bank of France to the Bank of England in 1890.⁶ His case is frequently referred to but, it must be admitted, there are few other clear-cut examples of Central Banking coöperation during these years.⁷

Finally, the accomplishments of the League of Nations in its financial work take on a much greater importance than the early episodes referred to. For the first time in the history of the world there existed a permanent organization which could deal with financial matters on a really international basis. It is true that the League was not formed to deal primarily with problems of this type, but, to the extent that financial stability and political harmony were interrelated, it was both proper and practicable for it to fulfill certain functions in the field of international finance. In some ways the nature of the League fitted it for this work. It had considerable power and prestige and wide connections among nations. Moreover, it was in a position to enlist the services of financial experts of the highest calibre.

The most serious of handicaps for the League was its political nature which interfered with Central Banking traditions; another was the tradition that help was granted mainly to Central Banks in desperate straits; both increased in importance as time went on and the different national economic systems attempted, often in vain, to get away from wartime government control in financial affairs.

⁶ A. E. Janssen, *Note on the Plan for an International Clearing House*, League of Nations, Provisional Economic and Financial Committee, E. F. S. 270, A. 158 (Geneva, April 8, 1922), pp. 3, 4.

⁷ The Belgian stabilization loan is a case in point.

Even though the League was not, perhaps, an ideal center for banking coöperation it played a very large part in the financial reconstruction of Europe from 1920 to 1930. Its achievements may be listed under three main headings. The first financial contribution was perhaps the more generally recognized and given a foremost position; this was the arranging of international loans to aid financial recovery. The second type of work in this field was more technical and less generally understood, that is, the assistance granted in monetary stabilization and in the reorganization of a number of Central Banks. The third kind of assistance was the carrying on of investigations, the calling together of experts, the assembling of data, and the publication of reports, which would help to develop a common understanding of international financial problems.

The fruit of these efforts can be seen in the surprisingly quick return to normal conditions in Austria, Hungary, Greece, and other countries which came to the League for guidance. In addition there was a *rapprochement* between financial experts which was to assist the B. I. S. when it came into existence later. There was, furthermore, a wider understanding of the possibilities of research, investigation, and conference than had existed before. The many direct and indirect results are hard to appraise. The more concrete benefits derived by Austria, Bulgaria, Danzig, Esthonia, Greece, and other countries are certainly but a small part of the widespread economic advantages through the constructive work in Geneva.

When the history of these efforts is finally written it will reveal a surprising degree of success. The League was working without precedent and in a difficult time. In fact, it was only by virtue of a real desire on the part of most of the member nations to bring about financial stability, and the ingenuous devices worked out by League experts, that it was able to attain its ends. Beyond the field of its activities, however, lay wide regions of banking policy and monetary questions with which the League made no attempt to

deal. For this reason there was more than room for the creation of an international banking institution to assume some of the functions which lay beyond its scope.

Thus events proved that loans, conferences, investigations, and technical assistance were all possible under the auspices of the League. Only the less formal meetings of Central Bank governors lay outside its sphere of influence. The Bank for International Settlements on the other hand could assist in all these phases of coöperation and in addition could bring together the heads of the leading Banks of Issue at the time of its monthly meetings. Moreover, in addition to these services it was designed to develop many new channels and methods of coöperation not hitherto known to the financial world.

Of course it was desirable that the work of the League should continue, and it was to be expected that Central Bank governors would visit each other from time to time in addition to their meetings in Basle. It was likely that loans and conferences would be arranged irrespective of the work of the B. I. S. Nevertheless an institution had been created in Basle which could assemble and perpetuate the results of its own work for financial collaboration and of achievements elsewhere.

REQUISITES OF COÖPERATION

Observation of past experience shows that two things were essential to the development of financial coöperation. These were a permanent organization devoted to this purpose and a formulation of policies and aims on which the various Central Banks might unite. The first requisite was achieved with surprising facility when the B. I. S. was organized in 1930. The second was much more difficult and was bound to require years of slow, painful development. The degree of success which might be expected by a suitable institution which developed constructive financial policies would of course depend very much on underlying political and economic conditions.

For instance, just as in a time of war no lasting achievements could be expected, so during years of narrow and destructive mercantilism, comparatively little could be done to coördinate the financial relationships of the economic world. These general and political circumstances would lie outside the control of any international bank and while their importance is undeniably great they cannot be taken into consideration here.

As an organization the B. I. S. was well suited for purposes of coöperation. It was founded on a broad international basis. Central Banks participated in it on an equal plane; it had wide contacts and an international personnel; it was legally constructed so as to withstand most political or economic fluctuation. On the other hand, some argued that the close connection of the Bank with the reparation settlements was a handicap. This might in theory have been the case;—actually the predominant influence given to countries interested in reparation payments corresponded fairly well with the banking influences which could be brought together on a practical working basis. Moreover, the Board was increased in 1931 by the inclusion of Directors from non-reparation countries, Holland, Sweden and Switzerland. It is probable that a much larger number would have been unwieldy and a smaller group too narrow in its interests. In any case the development of its policies and business did not indicate that the reparation question was dominant during the first two years.

Although the reparation question did not interfere directly with the Bank's efforts in the direction of coöperation, there were a number of hindrances, some connected with the one-sided payments growing out of the war, and others of independent origin. These difficulties were brought to light by the actual experience of the B. I. S., and may be referred to under seven headings. There were, first, the movements of capital which tended to increase interest rate differences and the disparity between gold holdings, and which therefore made for wide differences in policies. There

were, in the second place, those political factors which although not the direct concern of the Bank, nevertheless made the financial collaboration difficult.

A third difficulty grew out of the natural habit of independence and the habit of ignoring contemporaneous events in other money markets. This made the progress of consultation slower and less productive in the early years but need not be considered a permanent hindrance to constructive work. Closely allied to this was a fourth difficulty which grew out of the question of prestige. It was obvious that the adjustment of policies and the inquiries and conferences implied a willingness to compromise in details, and a growing consideration of the importance of other money centers which would lessen the prestige of individual Central Banks. This idea like the other mentioned above was not one which would continue to be as powerful as it was in the early months of the Bank's endeavors. Then again, in the fifth place, coöperation was to some extent inconsistent with the active competition of certain money markets for business and influence.

Two other general difficulties lay in the way of rapid development of Central Bank coöperation. These were, in the sixth place, the differences between the nature and methods of the various Central Banks, and, seven, the lack of policies on the part of these Banks which would have served as a basis for the development of common aims and methods. These two difficulties are of more serious importance perhaps than the others mentioned, since they affect the future even more than the immediate present. These obstacles together and separately delayed the putting into effect of plans which might have been of real service to the financial world.

Some of these difficulties have been overlooked. For instance, it is frequently the custom to speak of Central Banks as if there were one type about which one can generalize, whereas these Banks are in reality very different both in their nature and in their functions. The differences

consist mainly, on the one hand, in the degree of independence and power which each Bank possesses and, on the other hand, in the scope of its activities. There are many possible combinations of these differences but in practice one can distinguish three major types.

The most powerful type of Central Bank is that which has been developed as a private bank and functions independently of the government. The outstanding example of this is the Bank of England. This first kind of Central Bank is concerned with both money and credit problems. A second type which exists in many countries is the Central Bank which is in many respects little more than an agent of governments. As a general rule it has little direct control over credit, but is responsible for meeting currency needs and guarding gold reserves. This type is familiar in certain Balkan countries.

There is a further type which is quite distinct from the other two—it is like the first in being relatively free from government interference, but is like the second in that it does not regulate credit conditions. The Bank of Greece is an example in point. It would be possible to make further groups, for in many respects each Central Bank has distinct peculiarities, but the threefold division serves as an indication of the varied aims and functions of the Banks which the B. I. S. was trying to link together in a coherent system. When it comes to a careful analysis of the operations of these Banks in their respective money markets, or on the exchanges, it becomes clear that differences in resources, experience, tradition, spending habits, political position, and capital resources raise an infinite number of complications.

Unfortunately, however, the development of a strong policy to guide financial coöperation was practically impossible because the primary essentials were non-existent. The B. I. S. was in a certain sense a Super-central Bank, although it lacked certain of the instruments of Central Banks. In any case its strength must come through its ability to synthesize or make effective the more constructive

aims of certain of these banks. It could not hope to lead them in entirely new paths but must depend on the member banks. This was true—both because of its statutory limitations and because of the fact that its resources were derived from the Banks of Issue.

It is generally admitted, however, that the Central Banks themselves have few policies and that these policies are formulated for the most part to protect the national monetary system from sudden disturbance and do not look to the long run of international adjustments that the world so much needs. This lack of policy is in part characteristic of Central Banks and is in part the result of the elementary state of the development of monetary and banking theory. The B. I. S. was limited in both these directions and was, moreover, subject to the checks and cautions imposed by the Board of Directors. There were, inevitably, compromise and delay which would have been discouraging to observers if it were not for knowledge of the extreme difficulty of the task involved.

Many bankers realized that the very slow development of the principles behind Central Banking should be taken as an indication of the caution with which the B. I. S. was forced to develop. At the same time it is clear that the bank could learn something from two hundred years of financial experience. The result of these years of development which may be considered to begin with the founding of the Bank of England in 1694 was the development of one or two simple principles and mechanism. Unfortunately the experience in one country was not entirely adaptable to the needs of another and so the growth of Central Banking was irregular and spasmodic. Certainly no generally acceptable rules had been worked out by the date of founding of the B. I. S.

A FEW ADMITTED PRINCIPLES

Although an investigation of Central Banking history would thus reveal many interesting principles and practices it may be said by way of summary that the outstanding

developments of this long period of banking history were two general aims and three major instruments. The two goals which were set before every Central Bank were, first, the supplying of the currency and credit needs of the country so as to avoid monetary panics or sudden fluctuations and, second, the maintenance of the gold value of the monetary unit. This second objective meant usually a strong effort to sustain the value of the national money on the foreign exchanges since this index of its value was often considered more significant than the premium on gold on the domestic markets. In many respects, however, these two purposes were essentially one and constituted the outstanding and indispensable condition of a healthy financial life.

In supplying this necessary basis for economic life the guides to action which the Central Banks watched were usually the gold reserve, and the foreign exchange value of the currency. In addition to this, of course, the level of interest rates prevailing was always important both as a sign and an influence on all other important economic factors. In fact, although there was a sudden development of a wealth of statistical data Central Banks continued to be directed more by these simple outstanding facts than by the more complicated curves and indices which became available to them in recent years.

When the careful observation of these signs indicated that the Central Bank should intervene to check some exaggerated tendency it had recourse to one or more of its three main instruments. These three were: changes in the discount rates, open market operations, and warnings and cautions usually issued through the main banking institutions which came to it in the course of rediscounting or deposit business. Although the way in which these mechanisms operated changed slightly from time to time and varied from place to place they constituted the outstanding developments of Central Banking during this long period of years.

Other methods of operation were available of course. For

instance, in certain cases the Central Bank exercised its influence in conjunction with that of the government to accelerate inflation or deflation. In other cases it acted through subsidiary corporations to exert an influence on industrial life. Then again special practices developed in recent years which aimed to sterilize gold or to make the transfer of funds easier through earmarking the precious metal. Many other things might be pointed out to show the variety and complexity of operations of Central Banks but a more complete description would indicate that all these procedures were dependent for their effectiveness on the concomitant use of three basic instruments which have been mentioned above.

This brief indication of certain outstanding principles in Central Banking applies almost exclusively to the control of national money and credit because there had been little development of principles and policies in the international field. Indeed, the control within a country had been based largely on the assumption that international dealings would bear a very small proportion to domestic finance. Once this situation began to change as it did before and after the war, traditional policies showed serious weaknesses which had not been realized and there was considerable question in the minds of many as to whether the relationships which had been taken for granted would continue to exist as the financial connections between nations became closer. For example, if a Central Bank wished to restrict credit within its home market by raising its discount rates, its policy was frequently nullified by the inflow of foreign funds attracted by the high interest which could be earned.

This dilemma was one of the most urgent unsolved problems facing Central Bankers after the war. In addition to it, however, there were, as was widely recognized, scores of other questions which would have to be answered before a comprehensive and reliable control of financial life could be possible. It was not known, for instance, at what point and under what conditions the effect of an increase in the

discount rate changed completely and worked in a direction quite different from that usually expected. Moreover, practically nothing was known about the velocity of circulation of money, the effect of confidence on credit, and of psychological factors on demand. Comparatively little was known in regard to the relation of the money market to the capital market. Then again, despite a great deal of research and theoretical analysis the relation of the quantities of gold, money, and credit, to prices could not be definitely formulated. These were large problems requiring years of study, and suggest the wide unexplored realms of finance into which the Central Banker must venture.

A list of unsolved questions is discouraging but should not paralyze effort. Moreover, it is the more rapid development of industrial technique and international relationships which have made the development of a well-coördinated science of Central Banking difficult and yet a fundamental necessity to the continuance of modern social and industrial institutions.

The B. I. S. was created at a time of urgent need and yet before there had been a clear-cut formulation of either the desires or aims for coördinating Central Banking policies internationally. This uncertainty gave rise to a number of exaggerated hopes and false expectations. The management of the Bank had to ignore these expectations in 1930 and 1931 and at the same time struggle with a financial situation in which confusions and rivalries were increasing very rapidly. Its task was far from easy. Those who viewed its problems in the light of the slow development of Central Banking in the separate countries and the many unsolved problems which have been referred to felt a large measure of satisfaction that the Bank was able to survive in face of these difficulties.

It is clear that at this time coöperation meant very different things to different people. Some thought of it as a program which involved the generous supply of resources by the strong nations to the weak. To them coöperation meant

a sort of leveling of financial conditions which might have been for the general good but which would certainly have been costly to some of the stronger financial nations. Others thought of coöperation mainly as the general adoption of the traditional English banking principles and methods. This was natural because England had gone further in the clarification of banking procedure than most other nations, but it was an idea unacceptable in many money markets. Further than this, some thought of coöperation as a means of the development of clearing facilities so as to postpone fluctuations in the value of their currencies and carry over unpaid balances on their international account for longer periods than would otherwise be possible. A fourth idea which was held by many, particularly at the time when the Bank was founded, was that coöperation would mean a joint international inflation.

The wide discrepancy between these views is in itself an indication that no one of them could be taken by the Bank as a basis for action. For instance, the B. I. S. would undoubtedly offer assistance to weaker countries in many cases and it would attempt to accept the best in the banking traditions of highly developed financial centers in order to make them understood as widely as possible. Moreover, in certain cases it might prevent seasonal fluctuations of value although it could hardly postpone more significant changes without accentuating the difficulties of the ultimate adjustment which must be made. It was in no position to stimulate a general inflation or deflation of value. Its idea of coöperation was therefore based, on the one hand, on the duties indicated in the Statutes, and, on the other hand, on the desires expressed by the directors and representatives of Central Banks.

In order to understand the ideas of coöperation held at the Bank, one must examine first the statements given out, second, the documents that guided the Bank, and third, its actions.

Some of the more general statements regarding the future

work of the Bank were not entirely consistent with the possibilities which existed when the Bank was actually put into operation. It is clear, however, that all those who had a real knowledge of what could be done looked upon the B. I. S. as a link between Central Banks, and as a means of increasing the effectiveness of each unit in the monetary system by help, advice, and the interchange of information. It is true that some talked of price control, of joint inflation, and of the absorption of unpaid balances in a clearing system. No such visions, however, could be taken as any indication of the immediate prospects of the Bank.

More exact indications of the Bank's program can be found in the functions and limitations outlined in the Statutes. In the first place, Article 3 states quite clearly that "the objects of the Bank are to promote the coöperation of Central Banks and to provide additional facilities for international financial operations. . . ." The Statutes then proceed to make it plain by manifold statements that two general principles should guide the Bank in this direction. The first of these was that the B. I. S. should in no way compete with or infringe upon the power of Central Banks but should act so as to strengthen each Central Bank and to formulate its own policies as a result of the joint, and practically unanimous, will of the participating banks. The second major guiding principle in coöperation was to be the maintenance and more satisfactory adjustment of the gold and gold exchange standards. These principles are expressed and implied in Articles 3, 20, 22, 23, 25, 28, 32.

The policy of the B. I. S. in working through, and with, Central Banks has already been outlined in Chapter IX as well as in the analysis of its deposit and investment methods in Chapters VII and VIII. It has been pointed out that insistence on the consent of each Central Bank to operations in its money market or its currency makes it essential that the B. I. S. shall work in close harmony with these institutions. On the other hand, the veto clause led the Bank to carry out all its business in close collaboration with Cen-

tral Banks.* On the other hand, the controlling influence of the Board of Directors made it inevitable that the Bank should act only in those directions which were agreeable to the Governors of the main Central Banks.

As a natural corollary of the part to be played by the Directors in the development of the Bank it is clear that the founders were most anxious that the institution in Basle should become a center for conference and consultation. With this in mind it was provided that Directors' Meetings should occur at least ten times a year and there should be a General Meeting once a year to bring together the representatives of Central Banks. In addition to this, other indications are given of the possibility of special committees working together for the improvement of financial relations. These gatherings were not necessarily to be confined to the representatives of Central Banks but could be arranged in connection with other banks, corporations, or individuals as the B. I. S. might see fit.

Additional evidence of the nature of coöperation is found in Articles 9, 21 and 24 of the Statutes which indicated the importance of the maintenance of the gold standard to financial collaboration through Basle. Although it was explicitly stated that the operations of the Bank should be carried out in gold currencies, this would have proved to be a necessary working principle even if it had not been included in the Statutes. It is obvious that the Bank could not carry on business in a large number of currencies without having an accounting unit in which to relate each transaction to every other. Under the conditions existing in 1930 and 1931 gold was the only such unit available.

Even though the breakdown of the gold standard in many countries in 1931 severely handicapped the Bank there was no choice except that of continuing to coöperate on the basis of gold within the limited field for its activities which remained. And furthermore, at the very time its influence was temporarily circumscribed it could look forward to the

* See the actual procedure analyzed in Chapter VII.

possibility of a very great contribution to the reestablishment of financial stability through efforts to restore a reliable standard of value.

Article 24 is particularly interesting in that it pointed to new developments in connection with the gold and gold exchange standard, clearing, and the transfer of funds between nations. It constituted one of the more definite indications of those "new facilities" which the Bank had been called on to further. It is possible that the B. I. S. would have been able to work out certain systems under this Article, systems which would have lessened seasonal exchange fluctuations and minimized the physical transport of gold and at the same time brought about a more orderly working of the gold exchange standard. Certainly this would have been a valuable achievement in the direction of coöperation.

Although the Statutes and the Young Plan yield many important indications of possible developments by setting rules and limits, more significant signs are to be found in the actual accomplishments of the B. I. S. in the direction of coöperation. These accomplishments must be analyzed briefly in the light of the early plans and expectations. It has been indicated that the Bank very soon met with unexpected hindrances. The growing depression, the collapse of credit and the suspension of the gold standard limited its action more and more as the crisis grew worse. Even in spite of many insurmountable difficulties, however, the Bank did carry through acts which furnished evidence of a prospect of larger achievements in more normal times, or later during crises when it would have increased power and added experience.

Every concrete attempt by the Bank to further coöperation was aimed to increase confidence and stability. Furthermore it may be said that these acts fell under the four main classifications of earlier efforts at coöperation. For example the Bank arranged for official and unofficial conferences. It brought together Central Bank Governors. It arranged for loans to Central Banks. It can, therefore, be said that its

work was a continuation of existing traditions in new and promising directions. It was a center and laboratory in which the continuous efforts at collaboration could be recorded and examined.

There were some beginnings made, on the other hand, which were rudely interrupted by outside events. For instance, one potential phase of coöperation in which the Bank took considerable interest was monetary stabilization. Unfortunately, various circumstances prevented the successful consummation of the Bank's efforts in this field. The assistance given to the Bank of Spain has already been described as well as the events which interfered with actual stabilization.⁹ It is clear, however, that this incident does not limit, in any way, the future of the Bank as an agent of currency stabilization. The difficulties in this case were special and political and do not cast doubt on its ability to act in other circumstances.

Another possible aspect of coöperation which was discussed at great length in Basle and elsewhere, but which did not result in a large number of transactions through the B. I. S. was the clearing of international funds. The beginnings which were made and the difficulties encountered as discussed in Chapter XI showed that the progress of the Bank in this direction was apt to be slow.

A considerable measure of progress, on the other hand, was made in the various conferences which the Bank called. Since the disturbing events were to a considerable extent political, they could not be modified by the Bank, and, further than this, the development of a science of Central Banking must of necessity be long and difficult. When viewed against the background of long years of gradual development in the field of currency and credit, the conclusions and plans which developed in Basle take on a very real importance.

Discussion in these meetings was concerned with various difficult matters. Some were, for instance, the effectiveness

⁹ See *supra*, Chapter X.

of gold, the way in which it could be bought, sold and transferred to the best advantage of all concerned; the legitimate aims and practical possibilities of international clearing of funds; the systematization of the gold exchange standard; the more even distribution of credit between nations; ways of transforming short term credit into long; and the detail of various international financial procedures. In respect to each one of these subjects and others which were discussed from time to time, certain courses of action were eliminated as unwise, other lines of activity were emphasized as desirable, and the common understanding of the general welfare greatly advanced.

The official conferences which met under the auspices of the Bank were quite different from the first type which has just been described. Two such meetings were called in Basle in 1931; the first of these was the Wiggin Committee and the second the Special Advisory Committee under the Young Plan which met in December.¹⁰ In both cases the Bank offered many facilities which greatly accelerated the work which had to be done. The Secretariat which was at the disposal of these committees was experienced and well fitted to give assistance in this work. The Bank proved to be an excellent place for these meetings. It afforded the incidental advantages that the members of the committees met together frequently for informal conversation and did not scatter quickly after their more formal discussions, as was often the case in the larger cities. Moreover, the spirit of internationalism which prevailed at the Bank had some influence in bringing together the divergent views which were often expressed in the meetings. Even though the connection between the management of the Bank and the experts who assembled to consider specific questions was not officially close, there was inevitably an interchange of views which was an advantage on both sides. There was a general agreement that the Bank had performed a real service in aiding these committees.

¹⁰ See *supra*, Chapters XIV and XV.

In fact the inconspicuousness of these conferences was one of their important characteristics. It was never known, for instance, just what conversations took place in Basle between Governor Norman and Governor Moret in December 1930, on the question of French gold purchases and the drain of capital from London to Paris. There was no public comment on Dr. Luther's tentative inquiries early in 1931 as to the possibility of easing the burdens which rested on Germany. Then again public curiosity was not greatly aroused by the visit of Dr. Burgess to Basle, nor was there any general speculation as to whether there had been criticism of the action of Central Banks in withdrawing funds from New York in unprecedented volume.

Certainly it was only on the basis of a natural and long standing acquaintanceship that financiers could hope to arrive at an understanding of the difficulties with which they are faced and appreciate the differences in the problems of the various money markets. Before the Basle meetings many of the Central Bank governors had never met. Moreover the differences in the resources and traditions of the various Banks tended to build up barriers between them and to prevent discussion on a basis of equality. The situation in Basle differed considerably because of the joint participation in most enterprises. It was often said that a Governor of a Central Bank could be an autocrat in his own sphere. In Basle, however, he had to take account of the desires and theories of all the other governors. This may have led to compromise and delay, but it resulted in a clearer understanding of the many powerful forces which influenced international finance.

The fourth outstanding contribution of the Bank for International Settlements to Central Bank Coöperation was the quick and efficient arrangement of credits to aid the Reichsbank, the Bank of Austria, the Bank of Hungary, and of Yugoslavia in 1931.¹¹ The work which the Bank accomplished in arranging the participation in these credits

¹¹ See *supra*, Chapter XIV.

and in attending to the practical details was generally recognized as of the highest importance. The fact that the Bank Governors were meeting regularly greatly speeded up the arrangements; indeed the first Austrian credit was agreed upon in the Directors' Meeting in May and many of the necessary conditions were arranged over the telephone while the Governors were still in session. From the point of view of both organization and management the B. I. S. was well designed to help Central Banks in time of need and whatever limits may have hedged about its usefulness on this score came either from a lack of resources or general economic difficulties which made credits of any kind almost impossible.

The actual accomplishments of the B. I. S. in the field of coöperation were thus mainly the carrying on of various investigations in the principles and practices of international finance, assistance rendered to other conferences, the development of cordial acquaintanceship between Central Bank Governors, and the granting of credits in conjunction with other Central Banks. The work which it accomplished in the direction of clearing and currency stabilization belongs rather to the theoretical part of its activities than to its more practical business achievements. On the other hand, it might be said that all its work in handling deposits and investments was a phase of coöperation. It has been explained, for instance, in Chapters VII and VIII that the policy of the uniform rate of interest and the attempt to shift its funds to countries which were short of capital were motivated by the desire to encourage normal international collaboration and a healthy readjustment of values.

The ideas which are embodied in the word coöperation are the most far-reaching and important which lie back of the organization and early years of the Bank. For this very reason, however, it is impossible to expect the most definite early achievement in this realm. Every basic question of money and credit was in some measure involved. All former mistakes, fears and prejudices had to be taken into account.

The inflexibility of laws and the threats of political disturbance all played a part; sluggishness of the public mind in accepting new financial ideas was bound to interfere with any rapid development of harmonious policies and plans.

Those men who balanced the accomplishments of the Bank against the early hopes and expectations admitted a wide discrepancy. Even though they granted a certain disappointment in the results of the B. I. S. they were practically unanimous in saying that a valuable beginning had been made and that these gains should be preserved even at considerable cost. A highly efficient mechanism had been constructed which should be infused with more power to meet new and greater needs in the future. An atmosphere had been created which could be of great assistance to international understanding. Moreover, as a clearing house of information and advice the B. I. S. was unique and indispensable.

One thing is certain, some form of international adjustment will be necessary for the world of credit and money. If the Bank for International Settlements is not given the power and the facilities to work at this problem the result will be the successive emergence of financial rivalries. One Central Bank after another will gain a predominating influence and as this Central Bank is threatened from time to time by rival financial influences, the stability of the economic system will be strained to the breaking point again as it has been in 1931. It is to avoid such catastrophies that the B. I. S. should be strengthened to meet the urgent needs which lie before it.

CHAPTER XVII

CONCLUSIONS

IN less than two short years the Bank for International Settlements completed a cycle of activities which brought it in the spring of 1932 to the threshold of a new phase. From its foundation in 1930 to the beginning of its third year in April 1932, it had lived through many critical experiences. There were the early months of organization, the first decisions as to tentative policies and procedures, a further stage when large plans were considered and resources grew rapidly. Then followed the difficult months when it fought the collapse of credit and saw its own resources reduced to a billion swiss francs.

The first highly significant chapter in its history was complete in 1932. An uncertain future lay before it, and yet a future full of stimulating possibilities and varied opportunity. During these two years the outstanding facts were an impressive power of growth, even during the difficult times of depression, and the ability to survive the terrific shocks which brought many Central Banks to the verge of bankruptcy and threatened to overthrow the entire structure of financial life.

Only the general characteristics of these years of the Bank's existence can be mentioned here; the facts and details have been presented in earlier chapters.

The rapid expansion, followed by contraction, is graphically illustrated by the curve of its resources. In its first month it had funds equaling about 1,000 million swiss francs. These increased until they passed 2,000 million swiss francs in 1931.¹ Then it lost deposits rapidly in the autumn

¹ This figure was actually reached in December, 1930, but was first seen in the month-end statement of May, 1931. See also Chart I, p. 40.

of the year so that the December balance showed again about 1,000 million swiss francs, or a sum, in the eighteenth month of operation, about equal to that held in the second. The rising and falling curve represented by the total resources was broken by smaller changes ascribable mainly to the shifting of reparation and debt funds through the Bank but the significant comparison is between the original figures, the peak of May 1931, and the reduced funds in January 1932.

Although these rapid changes in the resources of the Bank give a picture of its growth and the effect upon it of general financial conditions, the balance sheet does not tell the whole story. On the contrary, one aspect of the Bank's usefulness was becoming more important at just the moment when the funds at its disposal began to melt away.^a It was at this time, for instance, that the Bank intervened so efficiently in a number of cases to extend help to distressed Banks. Moreover, during these months it was accumulating experience of a very valuable nature, and exerting an indirect influence on the financial world through the meetings that were held in Basle.

In any case the position of the Bank was transformed in the latter half of 1931, so that the nature of its activities and its line of future development could not be accurately foretold. There were a number of logical possibilities from which one could choose the more likely, but any definite prophecy was of course impossible. At the one extreme it was suggested occasionally that the readjustments of the reparation question might lead to changes in the Young Plan and the early liquidation of the Bank. This prospect was judged to be entirely unlikely by those who were in close touch with either the Bank or the reparation question. At the other extreme there were a few who still considered the possibility of the Bank being transformed quickly into a powerful instrument for credit expansion and currency

^a The cessation of the accumulation of funds for war debt payments was the cause of the first declines in deposits with the B. I. S. in July, 1931. See *supra*, Chapter XIV.

control. This idea, like the other extreme view, was not entertained by those who had followed the situation closely from the beginning.

A brief examination of the position of the Bank on the first of January 1932, indicates why neither of these two views was widely held—why the Bank was expected to survive, and yet not expected to grow rapidly in power in the immediate future. The funds at its disposal had been reduced to about 1,000 million swiss francs, and the liquidity of these resources had been impaired by the credits granted in Central Europe and elsewhere. Thus, although the Bank was earning good profits, it had very few funds which it could use freely. In fact, it could make large new investments only with the collaboration of one or more of the powerful Central Banks, such as the Bank of France. Its direct financial influence on the economic situation was thus temporarily reduced, and it could hope for no change for many months, unless there should be some sudden transformation in the conditions and desires of the participating Central Banks.

Beneath this reduction of the Bank's resources lay the basic causes of disturbance, which limited its action. The more objective of these hindrances was the widespread suspension of the gold standard in 1931. This circumscribed the action of the Bank both because of the statutory conditions under which it was to do business and because the new state of affairs introduced a large degree of risk into most of its investments. The position of the B. I. S. was unique in that, as has been pointed out in Chapter III, the Bank had no home currency, but always incurred a potential exchange risk, a risk limited by the gold standard while that was in force. Moreover, its situation differed from that of the Central Banks which could either use their credit-creating possibilities to offset losses, or could call on the government for help, as did the Bank of France in December 1931.* The business of the Bank was thus more

* See the Report of the Bank of France for 1931.

and more restricted since it was limited in many respects to dealings in gold standard countries and in 1932 this meant, generally speaking, these countries with an uncertain financial position or those where interest rates were extremely low.

Furthermore, the suspension of the gold standard had brought with it a revulsion of feeling and a distrust of financial collaboration in most of the participating countries. For instance, it was said in London that the Bank of England had worked for coöperation ever since the war, and, in trying to help the rest of Europe, brought about the collapse of the pound. At the same time it was said in France that French banks had left deposits in England to avoid upsetting the financial stability of Europe, and the result had been the loss of billions of francs. Moreover, Central European Bankers were very much disillusioned, for they considered that the suggestions made to them at various international conferences in the name of the common welfare and the more effective use of gold had dragged them into tremendous exchange losses. Other financiers made similar complaints, and, reasoning *post hoc ergo propter hoc*, turned temporarily away from common efforts in order to work for shortsighted, short run measures aimed to save their positions by efforts of limited national scope.

Then there came as a natural consequence of reversals in banking positions, the shrinkage of credit and the decline of values which threatened the security of any new undertaking in finance, whether in Basle or elsewhere. From the psychological point of view this characteristic of the financial world was reflected in the loss of confidence; on the more material side it was evidenced in the decline of prices. The two aspects together meant that direct or indirect financing of a new investment was a perilous thing, and that it was safer for the time being to refrain from almost any kind of economic activity. The result was a paralysis which spread through economic life, and affected the Bank

for International Settlements along with other older and more experienced institutions.

Thus it is evident that certain new limiting factors, along with all the difficulties so familiar during the years of depression had made aggressive financial action on the part of the B. I. S. impossible at the beginning of 1932. What the future may hold is another matter. It is entirely possible, of course, that the state of mind of the public will change suddenly, that political calm will emerge, and that the expansion of credit and prices will set in motion an upward swing of values and cause Central Banks to direct a larger part of their funds through B. I. S. channels. Such quick changes have been known to take place in the past, but no clear prospect of improvement could be seen in 1932, at the beginning of the third year.

In contrast to the discouraging picture of the financial and political difficulties must be set the gratifying demonstration of vitality on the part of the new Bank. It is reassuring that during this time when a comparatively small blunder might have involved it in fatal losses, or brought upon it a political animosity which it could not have survived, it managed to hold its friends and well-wishers, and to receive the approval and support of the member Banks. All this indicates a power to survive. Its weakness was appraised in the light of overwhelming circumstances. Moreover, its ready assistance had been highly valued, and it was eagerly looked to, especially by the smaller banks, with the hope that it could help them when the time for monetary reconstruction might arrive.

The services which it had rendered and which stimulated these hopes for the future and a certain amount of approval of the past have already been described; hence they can only be summarized briefly here. For instance, (1) it had acted as an efficient clearing house for debt and reparation funds, and (2) had shown itself able to assume other clearing functions if and when these were needed by Central

Banks. It had been (3) an important agency for bringing about the acquaintance and collaboration of Central Bank Governors. It had been (4) a laboratory and a council room for the study of urgent financial problems. It was (5) a clearing house for international information,⁴ and a source of advice for those Banks which called on it for assistance. It had helped in some instances to bring about (6) a uniformity of technique or at least an understanding of differences in financial procedure. It had arranged (7) for international loans furnished by groups of Central Banks and had itself supplied credits to certain countries where the shortage of funds was acute. It had (8) executed its work as Trustee in a highly satisfactory manner. It had brought to light (9) a number of important principles and problems to guide later efforts in international finance. Finally, (10) it had assembled an internationally minded staff equipped with wide knowledge and many contacts and, thus, well fitted for the work which had been so boldly sketched out.

Although the practical results of these efforts were sometimes swallowed up in the disasters which followed each other in quick succession, they were not the less important as an indication of the potentialities of the Bank. The B. I. S. could not hope to withstand movements of the force of the price decline which broke over the world as the result of wartime mistakes and losses. On the other hand, it could hope to grow gradually during more normal times until it should have the power and the experience to halt a later collapse of confidence and a downward rush of values. To do so, of course, it must be in a position to act before such a movement gathers momentum. This reasonable hope was held by those who followed the development of the Bank while it was still in its infancy and who saw that it could gain its full strength only after a number of decades. There is little doubt that the expectation of continuous progress in international affairs, either under the capitalistic sys-

⁴ At the time of the gold drain from the United States in the early months of 1932, it had been able to advise the Federal Reserve of impending withdrawals.

tem, or under any other system of production and distribution, must depend on such a possibility.

The attempt to make any appraisal of the first two years leads naturally to the tentative listing of the conditions which can facilitate the growth of the Bank and make it a useful instrument of finance. Some of these conditions seem to be essential to the very existence of the Bank, others to limit its broader development. In any case the economic and political changes essential to the development of the Bank are at the same time necessary foundations of the world's prosperity. These conditions may be outlined briefly.

In the first place, the Bank must have some accounting unit bearing a constant relation to the main currencies in which it deals. This unit is under normal conditions a weight in gold, and was in fact the basis on which the Bank's accounts were drawn up during these months. This accounting unit is of little value, however, if it does not bear some predictable relation to the main currencies dealt in by the Bank. If these relations are upset, the B. I. S. may find it impossible to make any reasonable calculation of profit and loss, to make prudent arrangements for its future investments, or to judge where it may safely be of assistance to other banks. It is probable that if the moneys of the world were "managed"—and not by the Bank itself—it would be forced to reinvest its resources so that it would, to a considerable extent, "match" liabilities and assets in the different currencies rather than risk many uncovered positions. This would tend to nullify the influence of its credit activities, and would also reduce opportunities for earning a profit. In fact, the Bank would be caught between the two possibilities of a meaningless set of operations, on the one hand, and the risk of absolutely ruinous loss on the other. The satisfactory solution of this problem leads back to the international gold standard or some equivalent system.

In practice the accounting method which the Bank used

was like the adoption of the *grammor*, suggested by M. Quesnay, although it was not so designated.⁵ In fact, the suggestion for this unit which had been rejected in Baden-Baden was not revived again in the following months. Actually, however, the Bank was bound to link its operations with something definitely measurable and familiar, and so chose the weight of gold prescribed for the monetary unit of the Swiss currency. This meant that the Bank's accounting was based on a quantity of gold of a definite fineness. This quantity might have been designated as a special international monetary unit, but in order to avoid the appearance of adopting revolutionary or unsound practices, the more familiar term was chosen in order to bring it into the realm of the known weights and units. Nevertheless, unavoidable difficulties arose when a large number of the participating Banks abandoned the gold standard, and the accounting unit of the Bank ceased to have any definite relation to deposits in their money markets. This type of difficulty facing the B. I. S. became, in 1931, for the first time, very conspicuous and the urgent need of a common international unit was once more thrust into the foreground.

The Bank first attacked this problem by attempting to claim full gold value for its deposits,⁶ in order to give a similar advantage of security of value to those who had claims on it. This proposed arrangement, usually referred to as a "gold clause," was one which concerned the Bank in all its dealings but which could not be put into operation during these months of financial chaos. Clearly the questions involved were many and intricate. They included such difficult matters as, for instance, whether the Bank should be allowed to have a privileged position in comparison with other creditors of Central Banks; again, whether there should be an attempt to set up a system of international values by tying certain monetary units together in definite ratios through agreements with the Bank for International Settlements, and whether it was desirable to con-

⁵ See *supra*, Chapter II.

⁶ See Chapter XV.

tinue and extend the use of the gold exchange standard by making the Bank the intermediary and depository for a large part of the foreign funds of the Central Banks.

If these various questions were answered in the affirmative, that is, if the Bank were given a privileged position, if definite ratios of value were tied together by making B. I. S. claims on each, and the claims of each on the B. I. S. always, and under all conditions, stable in terms of gold,⁷ and if the gold exchange standard were extended in scope, the Bank would undoubtedly become a very powerful institution. It is true that halfway measures are possible, and in fact are most probable, for although there is a possibility that the Bank will become a tremendous force, political hesitations make this unlikely. There are clearly a number of possibilities for currency reconstruction. These include:

1. An attempt to return at once to a straight gold standard.
2. Some form of gold exchange standard.
3. The combination of silver and gold as reserve behind currency (dilution of reserves).
4. The general recognition of some kind of international credit, originating in the B. I. S. or otherwise, as a part of currency reserves.
5. Some form of "gold clause" to make the gold exchange standard or the straight gold standard more effective.
6. "Managed currencies" with some provision for "international credit" relations and little dependence on metallic reserves.

The form of new arrangement adopted will, of course, affect the B. I. S. very much and any one of them will depend, for its successful inauguration and operation, on help from the Bank.

In any case, this readjustment of financial relations cannot come about suddenly. It would always be possible for the principal Central Banks to curb the power of the B. I. S. through the use of the veto clause as well as by the with-

⁷ The ability of Central Banks to maintain such a many-sided set of relationships is very much to be doubted.

drawal of deposits. An increasing flow of funds toward Basle was a prospect which many looked forward to as a favorable development, while others feared it as a possible menace to general stability or to the welfare of certain countries. There is no doubt that the attempt to introduce any special protections, bringing with them some of the rigidity in exchange values, held two dangers—one, sudden failure of the schemes, and two, the unwise use of this increased power.

Granted the dangers implicit in a "gold clause," some people thought that such an arrangement might prove the key to unlock the financial riddle which was distressing the world, while others thought that this idea was an impractical hope not solidly founded on possibilities. In any case, the matter was one of great importance and calling for painstaking consideration. During all the distressing months that followed the suspension of the gold standard in England the question was hotly debated in Basle and in the member Central Banks and the outcome was in no way sure as the Bank faced the beginning of 1932. One thing was demonstrated, however, both by abstract studies and by events which moved with relentless force, that is, that in carrying out large financial transactions, the Bank must have either the reasonable assurance of the regular working of the gold standard or some special guarantee or unit of value which might be devised. The far-flung interests cannot wisely be limited to the narrow confines set by national currency conditions.

In addition to this type of protection, both events and theories have indicated that the Bank must have the whole-hearted coöperation of the major Central Banks in order to accomplish anything of consequence. Despite political factors that interfered with such support on various occasions, this participation manifested itself in the form of deposits left with the B. I. S. and also the willingness to aid the Bank in the investment of funds. The business of managing Central Bank funds was important, and increased both

the financial influences and experience of the Bank. Moreover, the placing of funds with the B. I. S. is an indication of more than a passive interest on the part of Central Banks and leads to many coöperative acts. There is, for instance, the choosing of commercial bills or acceptances, the help given by Central Banks in making B. I. S. investment and, also, the granting of guarantees which protect the Bank against credit risks. In addition to this the Central Banks willingly carry out business transactions such as foreign exchange purchases, and keep the Management in Basle informed about local market conditions. Thus the B. I. S. functions both as a separate business enterprise and as an intermediary and agent of the Banks of Issue.

This assistance and these guarantees had been available during the early years of its development. In fact the clarification of deposit and investment procedures which has been described in Chapters VII and VIII was one of the outstanding contributions which the Bank made to financial science. Therefore, even if in some unlikely event the Bank should be liquidated, the technique which it developed and the principles which it brought to light are bound to influence economic methods elsewhere. This development will be dependent to a considerable extent on the generous help from the Central Banks. There is no doubt that the B. I. S. enlisted the interest and the coöperation of bankers everywhere during its most active period, and there is every reason to suppose that it will continue to do so in its later years. In general it can be assumed that the sympathetic aid of Central Bankers is not a problem although there is some concern as to the quantitative importance of their financial support.

There were other conditions of B. I. S. development which were more difficult to control, and yet fully as important as the active support of Central Banks. These were the price and credit relations which were so profoundly disturbed by the loss of confidence in 1931. In order to achieve sound banking conditions, it was evident that confidence

must be restored. This was the most essential requirement. Once men felt that effort would be rewarded by reasonable profit, the initiation of various forms of enterprise would of itself increase the demand for goods, and, since purchasers would no longer stay out of the market in anticipation of abnormal price declines, commodity and security prices would remain reasonably steady or would in some cases rise.

This optimistic state of mind could not be created by any purely artificial effort, nor could it be divorced from many other complicating and uncertain factors. Some of those who distrusted the future thought in terms of monetary policy but more looked to the troubled political conditions, and knew, without being able to analyze all the reasons, that the main causes of disturbance lay in this direction.

Unfortunately the Bank had no power to act in the political world. It had neither the resources nor the moral influence to prevent the disastrous interference with financial life which grew out of governmental strife and ill-advised commercial restrictions in 1930-1932. Moreover, it was evident that the calamitous deflation might continue for a considerable period; certainly until the public was reassured. These psychological and political problems were of a character and a magnitude that placed them beyond the scope of the Bank's activities. Nevertheless it is clear both from an analysis of abstract possibilities, and from a study of the Bank's early history that it will be limited in its business if the necessary foundation of confidence is lacking. In fact, if there is no political stability and if values decline rapidly it will probably exert its influence as a kind of international "receiver" rather than as a reservoir of funds.

In the preceding pages, an attempt has been made to do three things. In the first place, the main facts with regard to the origin and first two years of the Bank's history have been outlined—facts which might be forgotten if they were not recorded in the immediate present. In the second place, procedures and policies of the Bank have been analyzed to

throw light on problems which would necessarily confront any international bank, and to furnish data bearing on various questions of international finance. In the third place, there has been some attempt to indicate the lines already marked out for future development. The result of the three aspects of this study is the conclusion that it is of the highest importance to economic welfare and international finance that the Bank should continue to exist. A brief summary of some outstanding facts throws further light on this conclusion.

It has been seen, for example, that the Bank originated not only in the reparation discussions and the need for an international body to help in the execution of German payments, but also in a generally expressed demand for an organization which could regulate the gold exchange standard, ease credit strain, and bring Bank Governors into closer collaboration. These desires were stimulated in some slight degree by the academic studies and conferences of an earlier date, but in the main the idea originated in Paris. The result of this attempt to fill an increasing need was an organization, unique in international law, but not having a separate sovereignty, despite certain privileges and immunities. The successful planning of the framework was the result of long and trying sessions at Baden-Baden, and, although some compromises were necessary, the final result was that the Bank was legally sheltered from sudden changes, and protected from the dangers of active competition with existing organizations.

Then within a very short time, the treaties were ratified and the Bank became an active efficient business unit, handling millions of francs, holding important meetings and carrying on as a part of its daily routine a fairly large deposit and investment business. It is notable that within a few weeks it developed procedures for handling deposits in a score of currencies, investing its funds with due regard to exchange and credit risks, and with a hope of earning a normal profit. Thus, events moved swiftly in the first six

months. The paper plans of Paris, the Hague, and Baden-Baden became solid realities while many people were still only vaguely aware that a new and adventurous step had been taken.

This rapid development in the first six months led many to think that the power of the Bank would keep pace with its broadening experience. On the basis of such hopes in 1930 some urged plans for a world clearing to develop new procedures and instruments of credit, and attempts to connect various money markets more closely with each other. Some of these more optimistic ideas were not abandoned until the crises which followed each other in the spring and summer of 1931 led to a sober realization that the world was facing a financial decline of unprecedented violence.

Only the future can tell what the ultimate development of the Bank will be.* The final months of the second fiscal year brought it in 1932 to the end of one phase and the beginning of a new stage. Despite all the discouragement and difficulties, the B. I. S. had stood the strain and had proved itself a sound instrument of Central Banking coöperation.

A number of questions of policy were still unsettled in 1932 or might be reopened in the months to come. Ten of the more concrete of these issues were the following difficult problems.

1. Should the Bank receive deposits from private banks, or only, as at first, from Central Banks?
2. What form of *gold clause*, or value protection should the Bank secure, and along what lines should it strengthen and reëstablish the gold exchange standard?
3. Should the Bank continue to pay a uniform rate of interest or vary it according to the currency in which the deposit was received?
4. Should it make an active effort to develop new clearing facilities and to narrow the gold points?
5. Should the Bank take a more active part in the foreign ex-

* C. P. Howland, *Survey of American Foreign Relations* (New Haven, 1931), pp. 461-462. The discussion of the B. I. S. was written by Dr. Herbert Feis.

change markets, particularly by encouraging, or carrying out forward exchange transactions?

6. Should the Bank depart in any way from the high degree of liquidity which it had maintained in its more normal months, or should it, on the other hand, refrain from the long term credits such as it granted during the second year?
7. Should it be given facilities for creating credit against gold or other assets?
8. Should the Bank extend its influence more rapidly outside Europe?
9. Should it take a more aggressive position in regard to monetary theory and policy?
10. Should it extend its research activities and develop further its very real potentialities, as a center of information and as a guide to Central Bank policy?

All of these questions have been considered elsewhere. It is not possible to repeat the arguments and to describe again the experience which influenced the Bank in its early decisions. Neither is it wise to prophesy what the Bank will do in the months to come. Any such pronouncement would be misleading to the reader, since it would be based on imagination more than on fact. Only a passing comment can be ventured in order to focus attention on the importance of development in these directions as later events and theories influence, mould and change the new institution.

Perhaps the first two questions are of the greatest importance as well as the most difficult to decide. One thing seems to be implied by the arguments so far brought forward, namely, that the arrangement of any special value protection or gold clause would make the receipt of deposits from private banks more difficult. It would, of course, be possible to distinguish different types of deposits according to their sources but a gold clause might lead to a sudden diversion of huge funds through the channels of the B. I. S. for the sake of this special protection and would dislocate many existing organizations and practices. If there is a contradiction between the two possibilities the primary importance of further safeguards for B. I. S. funds over-

shadows the arguments in favor of receiving private bank deposits. Even granted that the two ideas are not mutually exclusive, the experience of the Bank in 1931 indicates that the development of value protection is highly desirable if it is possible, whereas contacts with private banks offer uncertain advantages.

In the third place, the policy of a uniform rate of interest is closely related to the theory that B. I. S. funds are in a sense international purchasing power and therefore merit special privileges and protections. It was claimed that if the Bank had varied interest rates in accord with the currency of the deposit opened in each case, it would have been little more than an intermediary or agent for reinvestment. As it was, the Bank purported to change the nature of the funds given over to it and to place them on a special plane in international finance. If it paid less interest than it received, in certain cases, a discrepancy which was often inevitable, it assumed that the difference was more than offset by the special quality which it gave to these deposits.

A further step in this reasoning was that uniform and international funds, given a special status by the B. I. S., should enjoy special privileges in the various money markets into which they were introduced through the agency of the Central Banks. The special privilege desired was the gold clause which would lessen the risk of depreciation.

Moreover, the uniform rate was a first step in the direction of equalizing rates between money markets. The Bank was anxious, even with limited resources, to lessen the national differences in currency and investment conditions. The practical workings of this general principle adopted in 1930 and 1931 were entirely satisfactory.

As to the fourth and fifth questions, clearing and exchange problems, the early experience of the Bank has indicated that in the pursuit of its major aim of furthering Central Bank coöperation it was not called on to take any very direct part in the foreign exchange markets. The feeling of most of those connected with the Bank was that it

should proceed very slowly if at all in these directions. There is, however, little doubt that the further development of forward exchange markets would increase the stability of values and that the B. I. S. should be at some time in the position to encourage this expansion directly or indirectly.

The question of liquidity is one which was settled in Basle in a somewhat paradoxical fashion. The meaning of the theory adopted was interestingly demonstrated by events. The B. I. S. in fact kept its funds very liquid so that they might become "frozen" when the emergency made such a transformation imperative. This need developed when the world in general and Central Banks in particular were faced with two distressing possibilities in 1931—either there must be cumulative liquidation of multitudes of enterprises piling up bad debts in snowball fashion, or there must be some arrangements for the extension and "freezing" of many of the credits, even though at considerable risk to the institution which would permit this extension. The Bank, along with other responsible agencies, took part in this attempt to delay the downward movement, and by virtue of its former liquidity became heavily involved in credits which were not quickly realizable. This policy, although apparently contradictory, is in fact inevitable and appropriate to the nature and functions of the B. I. S.

The result of the distressing credit conditions in 1931 was that Central Bankers and economists came to realize the need of some international agency to halt deflation. Not only were the immediate difficulties alarming but there were added to them threats of further deflation arising from the collapse of the gold exchange standard. This collapse indicated a possible increase in the demand for gold amounting to about 25 per cent of the habitual reserves as the result of a policy of replacing foreign assets with metal in the vaults of the Central Bank. The imperative need of working out a substitute for the gold exchange standard pointed to the urgency of strengthening the B. I. S. Several plans were

considered and all of them were technically possible. One was the idea of depositing gold with the Bank, gold against which credits could be granted at a ratio of two or three times the value of this gold. The exact method suggested is not so important as the fact that it is generally realized that some vigorous action will have to be taken.

This development was hampered mainly by the lack of a broad spirit of internationalism in Basle or elsewhere. It is true that the representatives of several Central Banks, and financiers from many countries met at the B. I. S. and worked together in a friendly way, but it is also true that they were seriously limited by political factors. There was a difference between the development of a common effort in constructive internationalism which was hoped for and the constant compromise and adjustment to narrow political interests which proved necessary in these years. For instance, a number of South American Central Banks had several times indicated an interest in the Basle Bank but no action was taken; in fact, there had been no sign of a desire to expand its work in this direction.*

Another criticism has been made by Professor Salin who pointed to the fact that in a year of universal crisis the B. I. S. was conspicuous for not taking a public stand on matters of money and credit.¹⁰ The *Annual Report* of May 1931, did not discuss the matter and no statement was issued at the time of the widespread abandonment of the gold standard. It is true that those who were close to the Bank said that it would gain nothing and might lose much by taking a position which might accentuate the differences of opinion between the various Central Banks, but never-

* A conference of South American Central Banks held in December, 1931, at Lima, Peru, made the following recommendations: that the Central Banks and the Bank for International Settlements study the advisability of creating sources of emergency international credits for Central Banks . . . coöperate in their work of perfecting the gold standard . . . and bring about a more intense collaboration among central banking institutions. The implication of a new activity in South America on the part of the B. I. S. in *The New York Evening Post* of February 8, 1932, was characterized as unfounded by a Bank official.

¹⁰ Edgar Salin, *Wirtschaftsdienst* (May 29, 1931).

theless in a crisis made acute by the lack of confidence some leadership in matters of general agreement seems appropriate. Thus, the Management might have issued a statement to indicate to those just beyond the circle of experts that the return to some form of gold standard was inevitable, and that studies and plans were already being formulated.¹¹ History is more likely to record the lack of courage which has been alleged in certain instances than to excuse it because of political complications.

The research activities of the Bank has already assumed considerable importance in 1931 and will inevitably develop rapidly if the Bank is to accept the rôle marked out for it in the reëstablishment of monetary standards. It was an intermediary and depository for Central Bank information as well as for money market data. Moreover, it was informed of imminent changes in gold movements, discount rates, laws, and various factors which would affect the financial relations of its affiliated banks. In addition to this, the staff of the Bank was constantly working to formulate plans and theories which would assist in the restoration of confidence, control of credit, and the stability of purchasing power. This work was inconspicuous, and was merely at its beginning, but it was clear to most of those connected with the institution, that it was of the highest importance to develop this side of the Bank's activities.

Even though its business and policies were comparatively little known, many interesting comments were made on the early work of the Bank and no little criticism was leveled at it. Some said it lacked strength and courage. Others that the whole idea was essentially unsound. There was an element of truth in some of the severe criticisms insofar as they were aimed at the general plans, for the Bank fell far short of the ideal. It was not given either the necessary

¹¹ President McGarrah made a radio speech from Basle on May 11 in which he indicated the imperative need of aggressive leadership in bringing about the coordination of national economic interests. The Second Annual Report goes further than the First Annual Report in specifying what was needed for economic recovery.

resources, or clear-cut workable theories with which to proceed. By far the most significant of the questions raised were those which concerned the long run functions of the Bank in international finance. Other criticisms which focussed on the resources, the personnel, or the skill of management were of minor importance because they were occupied not so much with the future as with the past.

A frequent criticism of the Bank which cannot be ignored was that it was too much concerned in profit making. This comment was first brought forward in 1930 in connection with various types of investments, and the implication was that the B. I. S. placed its money in certain securities because of the yield rather than because of any interest in the use to which the money would be put. After the first few months, this comment was little heard until the end of 1931. Then again the Bank was much criticized, in connection with its loans to Central Banks in distress when it was known that the nominal rates of interest, already high, were effectively increased by the fact that a part of these credits were blocked. This criticism was not entirely justified since, as a matter of principle, interest on credits was set at rates just above the discount rates of Central Banks.

Of course the direct financial effect of this alleged tendency was much less than the general and moral influence which the Bank exerted. For a while it seemed as if the Management were motivated by a desire to impress the business man and commercial banker with the ability to conduct B. I. S. affairs on a sound commercial basis, rather than with the desire to demonstrate its importance as a public service organization. It may be that it lost an opportunity for emphasizing the fact that control of money and credit in the international sphere cannot be guided by short run motives. Even the possible aim of building up B. I. S. resources through an accumulation of reserves is of negligible importance compared with the basic function of serving the public interests, coördinating the efforts of Central Banks, and preserving confidence.

It is perhaps because of this apparent uncertainty as to its aims that the fundamental soundness of the idea was questioned in some quarters, in spite of convincing evidence of the need for an International Bank. There is little doubt in the minds of those who have observed the recent crises that the drawing together of the money and credit systems of the world, whether desirable or not, is inevitable in the long run. Since this is the case, it is equally inevitable that the discount and credit policies of one country will affect economic conditions in other countries; this has already taken place in many instances and is likely to be even more true in years to come. Similarly the distribution of gold in such a way as to support any customary level of prices which may be established and prevent sudden deflation or inflation is a problem in which every country must play a part. In fact, some form of coöperation is unavoidable; the question is whether it shall be regulated by the one or two stronger Central Banks or by a neutral and international organization such as the B. I. S.

Recent history, then, points to the desirability of the Bank for International Settlements or some other similar bank acting as an intermediary and gathering place for Central Bankers, as well as an agency for knitting together certain financial policies. There are then two possibilities. One is that the Bank shall become mainly an academic or theoretical center of discussion, a club, a laboratory, a place of meeting. The second is that while fulfilling important functions in bringing together Central Bankers and in disseminating information, it should also have large funds to handle, both for the sake of gaining experience and also because it could exert a larger influence in this way. The choice between the two alternatives is not as yet definitive; much has been said on both sides. There is, however, strong support for the larger rôle in the facts with regard to the wise handling of resources in the first two years. It is very much to be hoped that the B. I. S. will be given larger opportunities and powers.

In some quarters the power of the Bank has been underestimated and there has been a false impression as to its financial status. It was said in 1931, for instance, that the resources of the B. I. S. were exhausted, and that it was, in effect, practically bankrupt.¹² This state of affairs was, however, far from being the case. The Bank had performed a financial task of very great difficulty in permitting the withdrawal of half its deposits in the course of four months, without any embarrassment or delay. Even after this large decrease in the funds in its keeping, it still held more than 60 million dollars of long term deposits, and an equal amount of short term funds, in addition to its capital. Moreover, its capital was only one-quarter paid up, so that it could, if necessary, add to its resources very quickly. Furthermore, the exchange losses which it faced were partly offset by high profits earned on certain credits. The key to the financial situation lay, then, as before, in the support granted it by Central Banks, and this support was still to be reckoned on for enterprises which seemed likely to serve the general good. In 1932 the Bank had more than 200 million dollars and was in a position to meet all its obligations and to enter into new commitments if they seemed wise.

The importance of a new venture is not always realized at the time it is made, and the Bank for International Settlements in particular was not spectacular in its early work. Only an occasional comment in the press or an appraisal by some well-known banker indicated that it was not forgotten. Nevertheless it is possible that either as a symbol, or as a beginning, a great constructive work had been accomplished. Whatever the extent of the Bank's activities in the future, these ideas and hopes have left an indelible mark. In many respects the financial develop-

¹² Jacques de Bainville, *La Liberté* (Nov. 11, 1931). This comment was given prominence in *The New York Times* on November 12. Contrary to these suggestions the resources of the Bank tended to increase in 1932, and the profits in the first part of the year were high. Total resources in July, 1932, equalled 1,066,937,526.28 swiss francs.

ment of the next decades will be molded by these enthusiasms, decisions, and business transactions in Basle. Co-operation in 1932 only made a beginning, but out of such beginnings may grow the prosperity of the future.

Thus, at the end of the first two years the Bank is faced in 1932 by great difficulties and even greater opportunities. Six of the ten countries with Central Bank representation on the Board of Directors have suspended the gold standard. The chaotic conditions of money and credit which result are comparable to those after the war, and may be considered even more threatening to the general welfare. In the earlier years of postwar reconstruction, the Bank of England and the League of Nations aided by various Central Banks had taken the leadership in the attempt to restore order. The need for such constructive action in 1932 was even greater than before and yet at this time the Bank of England had temporarily lost the confidence of many of the Banks of Issue. Moreover, the League was involved in political problems which did not enhance its power in the realm of finance.

It is generally admitted, therefore, that the Bank must become the main agency for restoring a sound basis for international financial dealings. Fortunately it has already acquired experience and is well constructed to perform this task. It is in a position to act with energy and efficiency as soon as a few of the larger Central Banks are ready to help in reconstruction measures.

Events in 1932 have borne out certain prophecies and altered some trends. Many questions are still in doubt and the Lausanne Conference is merely one of the more important foundation stones on which lasting financial reconstruction may be built.

This conference has been of importance to the Bank in two ways. The more direct of the two is probably of less importance in the long run, although dogmatic statement regarding future trends is highly inappropriate. The reduc-

tion of reparation obligations to an almost negligible figure, proposed by the Lausanne Agreement, reduced the funds and sources of income of the Bank to a considerable degree. The Agreement also cut it loose from some of the clearly specified tasks which had helped to ballast the work in the early months. These changes held both dangers and opportunities but they had, in any case, been anticipated by the Managers and Directors of the B. I. S.

The dangers involved are those which come with lessening the obvious and definite functions of the Bank and the possible attempt of those guiding it to launch it too quickly on new ventures. Fear of such an outcome is largely offset by the cautious manner of conducting business in the first two years.

The advantage of this change in the Bank's position is perhaps a lessening of antagonisms caused by Reparation which had built up a critical attitude in some quarters. Moreover, it offered a demonstration to the world in general of the view generally accepted in Basle that the Bank could stand on its own feet without this business.

The more indirect influences of the Lausanne Conference were exerted through the growing hope of a return to normal money and credit conditions. It is clear that some far-reaching readjustments of finance are essential to the work of international coöperation. The Managers of the Bank expected to find their usefulness most conspicuously evident in their efforts to aid in the forthcoming period of monetary reconstruction.

The Bank is likely to be put to many severe tests and to perform large services in the years to come. The liquidation of this new effort in financial collaboration is extremely improbable. The lines of development are, nevertheless, still uncertain. It is possible to project the curve based on past actions a little way into the future, but it is not possible to predict the influences, political and economic, which may shift its direction.

One or two modifications in the situation of the B. I. S. would greatly increase its usefulness. Conspicuous among these would be the more regular and normal participation of the Federal Reserve System in the work carried on in Basle. It has been indicated that frequent communication, participation in credits, and the assistance of the Federal Reserve as agent for transactions in the American markets have linked one with the other. This relationship has not been properly balanced, however, by representation of the Federal Reserve System in the Basle discussions or by definite responsibility comparable to that of the other powerful Central Banks. It is possible that the resulting loss of advantage to American banking may be realized in the future. Certainly it would assist the American market in sharing in the much-desired European recovery to have the knowledge that comes so quickly to Basle interpreted by the eminent financiers who meet there regularly.

Other measures which would greatly strengthen the Bank are less definite but no less important. They consist in the readjustment of differences and the building up of a desire for common action on the part of the Bank of England, the Bank of France, the Reichsbank and the other powerful financial units of the world.

The uncertainties of 1932 will give way to a period of strenuous effort at reconstruction. In this work the Bank for International Settlements will play a significant rôle,

APPENDIX

CHRONOLOGICAL TABLE OF EVENTS RELATING TO THE B. I. S. AND TO REPARATION

1918

- January 8*—President Wilson delivers message to Congress outlining Fourteen Points.
November 5—President Wilson sends note to Germany modifying Fourteen Points.
November 11—Armistice signed.

1919

- January 6*—Spartacus Revolution in Germany.
January 18—First Plenary session of Peace Conference.
June 28—Versailles Treaty signed.
July 11—International Federation of Trade Unions, Sassenbach resolutions on German responsibility.
August 11—Weimar, German constitution promulgated.

1920

- May 15-17*—Hythe, Reparation conversations.
June 21—Boulogne, Meeting of Allied Prime Ministers.
July 5-16—"Spa percentages" agreed on.
September 24 to October 8—Brussels, International Financial Conference.
December 16-22—Brussels, Conference on Reparation.

1921

- January 24-30*—Paris, Conference to discuss Reparation.
March 1-7—London, Conference of Allied prime ministers.
April 29 to May 5—London, Meeting of Allied Supreme Council.
May 5—Allied ultimatum to Germany, threatening Ruhr occupation.
May 11—Germany accepts ultimatum.
October 6, 7—Wiesbaden agreement regarding deliveries in kind.
December 18-22—London, Anglo-French Conference to discuss Moratorium.

1922

January 6-13—Cannes, Conference on Reparation.

February 9—Law establishing United States War Debt Commission.

February 28—Frankfurt, Socialist Conference Resolutions on Reparation.

April 10 to May 19—Genoa Conference. Finance and currency stabilization discussed.

May 24 to June 10—Paris, Meeting of Loan Committee of Reparation Commission. French block recommendation of loan to Germany.

July 12—German application for moratorium on reparation payment until end of 1922.

August 1—Balfour note regarding receipt and payment by Great Britain.

August 7-14—London, Allied Conference of Prime Ministers.

December 29—Secretary of State Hughes' speech at New Haven on reparation plan.

1923

January 1—Announcement of new proposals by Germany.

January 2-4—Paris, discussion of new plans.

January 11—Occupation of Ruhr by French and Belgian troops.

March 16—Beginning of German passive resistance.

May 2—New German proposals.

May 6—Franco-Belgian reply rejecting German offer.

May 13—Great Britain, Italy and Japan reject German proposals.

June 7—German memorandum.

June 13—British questionnaire to Belgian and French Governments.

June 19—Mellon-Baldwin agreement signed.

July 15—Poincaré's speech at Senlis on Reparation.

August 2—Lord Curzon publishes notes on Ruhr.

August 11—Cessation of deliveries in kind.

September 26—Cessation of passive resistance in Ruhr.

October 24—Germany requests investigation of capacity to pay.

November 11—Berlin, Stresemann's speech, predicting German collapse.

November 15—Mark stabilization at rate of 1,000,000,000,000-1 renten-mark.

November 23—M. I. C. U. M., delivery in kind agreement to last until April 15, 1924.

November 30—Reparation Commission appoints two committees.

1924

January 14—First Committee of Experts, Charles G. Dawes, chairman.

January 21—Second Committee of Experts, Reginald McKenna, chairman.

April 9—Reports of two committees.

April 16—Experts' Reports accepted by German Government.

April 24—Great Britain, Belgium, Italy agree to reports of experts.

May 28—Poincaré-MacDonald letters on Reparation published.

July 16 to August 16—London, Conference on Dawes Plan.

August 30—Delegates to London Conference sign Dawes Plan agreement.

September 3—Mr. S. P. Gilbert appointed Agent General for Reparation.

October 11—New Reichsbank act.

October 28—M. I. C. U. M. agreement liquidated.

1925

January 7-14—Paris, Conference of Allied Finance Ministers. Agreement signed for division of reparation receipts.

February to September—German economic boom at its height.

July 31—Completion of Ruhr evacuation.

August 18—United States-Belgium debt agreement signed.

August 28—Arbitration Commission appointed under Dawes Plan.

October 1—Franco-American debt negotiations fail.

November 14—United States-Italy debt agreement signed.

1926

April 29—Mellon-Bérenger agreement on French debt signed.

July 17—French franc crisis, followed shortly by *de facto* stabilization.

1927

May 19—British-American debt agreement signed.

May 4-23—Geneva, World Economic Conference.

1928

June 25—Legal stabilization of french franc.

September 16—Geneva, representatives of creditor nations and Germany suggest definite settlement of reparation question.

1929

January 10—Reparation Commission appoints experts to discuss revision of Dawes plan.

January 11—Reichsbank rate reduced from 7 to 6½ per cent.

January 19—Mr. J. P. Morgan and Mr. Owen D. Young accept invitation to Conference.

February 11—First session of "Young Conference" in Paris.

February 21—Rumor of "international clearing house."

February 22—Sir Josiah Stamp presents tentative plan.

February 24—Dr. Schacht presents plan for International Bank to Mr. Young.

February 25—Meeting of three committees presided over by Sir Josiah Stamp, Lord Revelstoke and Mr. T. N. Perkins.

March 4—Mr. Owen D. Young presents plans for a new bank.

March 9—Summary of plan for new bank issued.

March 25—Complete report on proposed International Bank made to Young Committee.

April 12—Representatives of creditor powers present memorandum on annuities to Dr. Schacht.

April 13—Dr. Schacht rejects Allies' proposals.

April 25—Reichsbank rate increased from 6½ to 7½ per cent (Capital outflow from Germany).

May 16—Secretary Stimson issues statement that no officials of Federal Reserve or United States government may take part in new bank.

June 7—Paris, Young Report signed.

July 13—German-Belgian mark agreement signed.

July 20—Franco-American debt agreement (Mellon-Bérenger) ratified.

August 6-31—The Hague, conference on Reparation.

September 14—League Assembly receives Norwegian-Polish-Danish resolution to establish contact between B. I. S. and League; withdrawn a few days later.

September 16—Three committees, appointed by Hague Conference to discuss Reparations in kind, and Eastern Reparation, meet in Paris.

September 19—*The New York Times* stock average reaches high point of three year rise.

- October 2*—Death of Stresemann.
October 3—Baden-Baden, meeting of organization committee of B. I. S.
November 9—Basle chosen as site of B. I. S.
November 13—End of Baden-Baden Conference.
November 21—Paris, Saar conference; Franco-German conversations.
December 10—Brussels, Committee of Jurists meets to draft texts for Second Hague Conference.
December 22—Hugenburg Anti-Young Plan referendum rejected in Germany by 6 million votes.

1930

- January 3*—The Hague, Reparation Conference opens.
January 5—Rumors of American separate agreement with Germany.
January 7—German Government gives pledge not to pay United States alone.
January 11—Snowden warns Germany not to oppose Young Plan on details.
January 13—Schacht refuses coöperation of the Reichsbank in Young Plan International Bank. Reichsbank rate cut to 6½ per cent.
January 14—Curtius promises German coöperation without Reichsbank. Schacht gives way.
January 17—Plans for mobilizing a part of Germany's payments formulated.
January 20—Final Act of the Hague conference. Agreement with Germany signed. Convention with Switzerland respecting the statutes of the B. I. S. and agreement on Eastern Reparation reached.
January 30—Second Hague Conference adjourned.
February 4—Reichsbank rate reduced from 6½ to 6 per cent.
February 7—German Press opposes move to make M. Pierre Quesnay General Manager of B. I. S.
February 14—Basle, meeting of committee for organizing B. I. S. Hôtel de l'Univers rented.
February 17 to March 24—League of Nations Conference for concerted economic action.
February 26—B. I. S. directors named. Mr. McGarrah and Mr. Fraser accept invitations to be on Board.
February 27—Rome, meeting to complete plans for organization.

- March 7*—Reischbank rate cut to $5\frac{1}{2}$ from 6 per cent. Dr. Schacht resigns as head of Reichsbank.
- March 11*—Dr. Hans Luther elected head of Reichsbank.
- March 12*—Final Reichstag approval of Young Plan.
- March 24*—Mr. Owen D. Young speaks on Reparation. Reichsbank rate cut to 5 from $5\frac{1}{2}$ per cent.
- March 27*—Cabinet resigns in Germany, Bruening forms new government.
- March 29*—French Chamber of Deputies ratifies Young Plan.
- April 4*—Dr. Luther appoints representatives to B. I. S.
- April 22*—Basle, First (unofficial) Directors' Meeting of B. I. S. Mr. McGarrah made President, M. Quesnay chosen as General Manager, Dr. Huelse appointed Assistant General Manager. B. I. S. shares to be offered to Switzerland, Sweden and Holland.
- May 1*—Brussels, conference of bankers on Young Loan. New York Federal Reserve, London, Paris bank rates reduced, interpreted as sign of "Central Bank coöperation."
- May 5 and 6*—Paris, meeting of treasury officials of seven countries to discuss Young Loan, quotas arranged.
- May 12*—Basle, first meeting of Board of Directors.
- May 13*—Basle, special committee appointed by Directors meets, discusses B. I. S. shares.
- May 17*—B. I. S. in operation, receives funds from Mr. S. P. Gilbert, Reparation office in Berlin closed. Trust Agreement on Bank signed by ten governments and B. I. S.
- May 19*—Burning of A, B, C Dawes Reparation bonds. Reichsbank rate cut to $4\frac{1}{2}$ per cent.
- May 20*—124,000 B. I. S. shares already subscribed. B. I. S. opens its doors for business. Payment of first instalment of 25 per cent of subscription, totaling 61 million swiss francs.
- May 30*—Committee working on final details of Young Loan.
- June 2*—Germans deposit 100 million rm. with B. I. S. in fulfillment of Trust Agreement requirement.
- June 10*—Agreement on Young Loan, German Government $5\frac{1}{2}$ per cent, 1965 loan, general bond signed.
- June 12*—Bonds issued on various markets.
- June 15*—First regular annuity instalment paid to B. I. S.
- June 17*—Basle, second meeting of B. I. S. Directors, decision to invite 12 more European Central Banks to subscribe to capital stock.
- June 20*—Reichsbank rate cut to 4 per cent.

- June 23*—United States and Germany execute agreement settling claims.
- June 28*—10 European Central Banks subscribe to B. I. S. capital stock.
- June 30*—Evacuation of the Rhineland.
- July 14*—Third Directors' Meeting. 10 Banks represented. Agreement to act as trustee for Austrian loan. Discussion of Spanish and Yugoslavian currency stabilization.
- July 18*—German Reichstag dissolved.
- September 14*—German general elections, large gains of National Socialists and Communists.
- September 17*—B. I. S. publishes first report of trusteeship of loans.
- September 23*—First League Gold Report published. Heavy exports of German gold.
- September 24*—M. Moreau resigns as head of Bank of France.
- October 9*—Berlin discount rate raised from 4 to 5 per cent.
- October 10*—B. I. S. Board confers on German financial situation. Flight of gold from Germany.
- October 11*—Lee, Higginson credit of 125 million dollars for German government arranged.
- October 13*—B. I. S. fourth Board Meeting. Esthonia invited to subscribe to shares.
- November 6*—Paris, Oustric collapse, stock scandals.
- November 10*—B. I. S. fifth Directors' Meeting. Committee of exchange experts appointed to examine transfer of assets from one currency to another, Yugoslav credit and report of middle term credits committee discussed.
- November 11*—M. Quesnay goes to Spain to discuss stabilization of peseta.
- November 12*—Gold Committee in session in Geneva.
- November 14*—President McGarrah speaks in New York.
- November 17-28*—League of Nations, Second Conference for concerted economic action.
- November 20*—M. Quesnay leaves Madrid; arranges credit to Spain.
- November 24*—B. I. S. meeting of small committee on exchange clearing.
- December 1*—Gold from Spain arrives in England in connection with B. I. S. credit.
- December 3*—President McGarrah speaks at Bankers' Forum, New York.
- December 4*—French ministry resigns.

- December 8*—B. I. S. sixth Directors' Meeting. Discussions of Spain, medium term credit, and Latvia.
- December 10*—Reports of United States banking difficulties, including Kidder, Peabody & Co.
- December 11*—Bank of United States fails. English House of Commons discuss B. I. S. and League. Proposed international mortgage bank in Amsterdam discussed by Press.
- December 15*—War debt payment \$101,405,000 by Allies to the United States.

1931

- January 6*—*The Times*, London, editorial against reparation revision.
- January 12*—Geneva, Gold Committee of League reconvened.
- January 14*—Statement that French will accept gold 900/1000 fine.
- January 16*—Geneva, "United States of Europe" committee meets; discusses agricultural credits and other economic problems. Rumor that League will refer gold question to B. I. S.
- January 19*—B. I. S. seventh Board of Directors' Meeting. Brazilian credits reported. Action on gold transfers. Governor of Bank of Spain visits Basle.
- January 20*—Geneva, second interim report of Gold Committee.
- January 23*—Report that Latvia asks aid from the B. I. S. to steady foreign exchange.
- January 27*—United States Senate banking committee indicates opposition to State Department interference in finance, and action to bar participation in B. I. S. Swiss position regarding taxation of B. I. S. deposits is clarified.
- February 9*—B. I. S. eighth Directors' Meeting.
- February 10*—Geneva, Financial Committee of League approves creation of international organization for agricultural credits.
- February 11*—Second Lee, Higginson credit for German Reichsbahn arranged. Pound sterling weak.
- February 12*—President McGarrah speaks in Paris, urging "more foreign loans."
- February 17*—New Government in Spain.
- February 19*—Spanish Central Bank Governor resigns.
- February 21*—Paris, Discussions of middle term credits by MM. Melchior (Germany), Siepmann (England), and Paul van Zeeland (Belgium).
- February 27*—Stabilization of Spanish currency still being considered. Discussion in Press of "Norman Bank."

- February 28*—Chancellor Bruening says a moratorium would not solve reparation problem.
- March 2*—Dr. Luther urges revision. Dr. Schacht speaks against Young Plan in Stockholm. "International Mortgage Bank" founded in Basle.
- March 7*—"Norman Bank" project widely discussed.
- March 9*—B. I. S. ninth Directors' Meeting. Peseta plan agreed on. Bank of Lithuania invited to subscribe to 500 shares.
- March 22*—Austro-German tariff union plan announced in Press.
- March 26*—Stabilization loan to Spain arranged by the Morgan Bank.
- March 31*—End of first financial year of the B. I. S.
- April 1*—Pound sterling weak.
- April 14*—Spanish revolution, abdication of King Alfonso.
- April 19*—Spanish (Morgan) loan canceled.
- April 20*—B. I. S. tenth Directors' Meeting. Norway invited to subscribe. Allocation of shares to Yugoslavia and Albania. Soviet drafts refused for rediscount by B. I. S.
- April 22*—B. I. S. profits approximately 11 million swiss francs.
- April 23*—B. I. S. places suggestion of exchange transfer system before Central Banks.
- April 25*—Amsterdam International Mortgage Bank shares issued.
- April 27*—British Budget presented. Treasury to use "dollar reserves" and trust B. I. S. to secure exchange for debt payments.
- May 4, 5*—Brussels, Middle Term Credit Committee meets, under M. Francqui.
- May 11*—Credit Anstalt difficulties announced.
- May 13*—French presidential elections; M. Briand defeated.
- May 18*—B. I. S. eleventh Directors' Board Meeting.
- May 19*—B. I. S., General Meeting of Shareholders. Representatives of 24 Banks of Issue present. Allocation to dividend reserve fund, and legal reserve fund. Dividend 6% on paid up capital, profits 11 millions. Additional directors elected.
- May 25*—Austrian conditions become worse.
- May 27*—German Young loan weak.
- May 29*—B. I. S. announces its coöperation with 10 Central Banks in granting credits to Austrian National Bank.
- June 1*—International Committee formed to help Credit Anstalt.
- June 5*—Dr. Bruening and Herr Curtius arrive in London to discuss German difficulties.
- June 6*—German emergency decrees signed.

- June 8*—B. I. S. twelfth Board Meeting. Report of Middle Term Credit Committee.
- June 8*—Dr. Bruin proposed as advisor to Austrian National Bank.
- June 9*—B. I. S. to extend loan to Austrian National Bank.
- June 10*—B. I. S. communiqué denying rediscount credit to Hungarian National Bank.
- June 13*—Reichsbank rate raised from 5 to 7 per cent.
- June 15*—War debt payment to the United States.
- June 15*—Yugoslav stabilization.
- June 18*—Austria gets credit in England. French offer difficulties.
- June 18*—Washington conversations on War Debts.
- June 20*—"Hoover Debt Holiday" announced.
- June 21*—Berlin accepts "Hoover Debt Holiday" plan. France objects.
- June 23*—Great Britain formally accepts "Debt Holiday" plan.
- June 25*—B. I. S. offers 100 million dollar credit to Reichsbank with Federal Reserve participation.
- June 26*—French reply unacceptable to President Hoover.
- July 1*—Report that Chile wishes to participate in the B. I. S. Stabilization of Portugese escudo.
- July 2*—Reichsbank report shows most of recent credit used.
- July 4*—Agreement reached on "Hoover Debt Holiday."
- July 8*—German banks in difficulties. Germany seeks loan 400 million dollars.
- July 11*—Central Bank governors at Basle.
- July 13*—Berlin Bourse closed. Closing of Darmstaedter Bank. B. I. S. thirteenth Board Meeting. Reichsbank credit prolonged.
- July 14*—New York bankers agree informally to "No withdrawals" from Germany.
- July 15*—Reichsbank rate raised from 7 to 10 per cent. 500 million dollar outflow from Reichsbank in 10 weeks. Unconditional Young Plan instalment deposited with B. I. S. and reloaned to Germany. Sharp break in pound sterling.
- July 17*—London debt conference.
- July 20*—London, seven power conference opens. Hague Court meets to consider Customs Union.
- July 23*—Conference adjourns, recommending renewal of 100 million dollar credit to Reichsbank, and appointment of B. I. S. committee to investigate Germany's credit needs. Bank of England rate raised from $2\frac{1}{2}$ to $3\frac{1}{2}$ per cent.
- July 30*—Mr. Albert H. Wiggin appointed American member of

Credit Committee. Bank of England rate raised to $4\frac{1}{2}$ per cent.

July 31—Reichsbank rate raised from 10 to 15 per cent. B. I. S. announces arrangements for committee requested by London Conference of July.

August 1—250 million dollar credit given to Bank of England by Bank of France and Federal Reserve.

August 3—B. I. S. fourteenth Directors' Meeting.

August 5—Pound falls sharply. German banks reopen.

August 8—Wiggin Committee meets in Basle.

August 9—Prussian plebiscite rejects Diet dissolution.

August 11—Reichsbank rate lowered from 15 to 10 per cent. "Hoover Debt Plan" signed in London.

August 14—Press announces appointment of Mr. Jacobsson to B. I. S. to extend research work.

August 18—Wiggin Committee Report urges reparation revision.

August 23—British cabinet resigns.

September 3—Austro-German customs union abandoned.

September 7—Geneva, League Assembly convenes.

September 8—British National Cabinet meets Parliament for first time.

September 9—*Stillhaltung Agreement* signed by German bankers.

September 13—Austrian *Heimwehr Putsch* fails.

September 14—Definite conclusion of *Standstill Agreement*.

September 17—Markets weak, pound in Amsterdam weak.

September 20—British Cabinet decides to leave gold standard.

Bank of England rate raised to 6 per cent from $4\frac{1}{2}$ per cent.

September 21—Gold Standard (Amendment) Bill passed.

September 22—Denmark forbids export of gold.

September 27—Norway and Sweden forbid export of gold.

October 1—Pound falls to 3.98 dollars.

October 3—President McGarrah appoints Arbitration Committee provided for by Standstill Agreement.

October 6—Berlin, Dr. Curtius resigns.

October 8—New German cabinet.

October 11—Dr. Burgess of the New York Federal Reserve confers with Central Bank governors in Basle.

October 12—B. I. S. fifteenth Directors' Meeting. Announcement of Prague foreign exchange committee. Decision to renew Austrian Credit for 3 months. Decision to renew for 3 months 25 million dollar share of the 100 million dollar credit to Reichsbank. Decision to renew credit to National Bank of Yugoslavia. Agree to name member of board of the Inter-

national Agricultural Mortgage Credit Company. Announcement of steps to insure application of gold clause to Young loan service. Dr. Vissering announces resignation to take effect at end of 1931. Finland leaves gold standard.

October 19—Canadian Government prohibits free export of gold.

October 22—Premier Laval arrives in Washington.

October 25—Hoover-Laval communiqué issued.

October 27—British general election. Crushing defeat of Labor.

October 31—20 million pounds repaid by Bank of England to New York and Paris; 30 million credit extended. Standstill committee meets.

November 3—Prague foreign exchange meeting.

November 5—British National Cabinet announced.

November 9—B. I. S. sixteenth Directors' Meeting. Resignation of Mr. Francis Rodd as manager. Subcommittee appointed to consider questions of investment and finance. Appointment of Mr. R. H. Porters as manager of B. I. S.; and of Mr. Henry J. Bruce, as advisor Hungarian National Bank.

November 19—France and Germany agree on text of letter to B. I. S. asking convocation of Young Plan Special Advisory Committee.

November 20—Germany sends request to B. I. S.

November 25—B. I. S. announces receipt of nominations to special advisory committee.

November 28—Agreement for partial reorganization of Credit Anstalt.

December 7—Special Advisory Committee meets at offices of B. I. S. Signor Beneduce made chairman.

December 8—Dr. Melchior presents memorandum of Germany's financial situation. Further German emergency decrees.

December 9—Reichsbank rate reduced from 8 to 7 per cent.

December 11—Second Standstill Committee meets in Berlin.

December 13—Japanese suspend gold exports.

December 16—United States Under-Secretary of Treasury Mills announces "United States unequivocally opposed to reduction of War Debts."

December 17—B. I. S. extends Hungarian credit.

December 22—United States Senate ratifies "Hoover debt moratorium."

December 23—Special Advisory Committee report signed.

December 30—Great Britain proposes International Conference on Reparation to be held at Lausanne; subsequently postponed.

1932

- January 9*—Chancellor Bruening announces impossibility of further payments.
- January 11*—B. I. S. Board of Directors' Meeting. Decision to extend Austria, Hungary and Yugoslav credits, and to renew its share of German credit.
- January 19*—Premier Laval says France will not reduce reparation claims without cut in her own debts.
- January 20*—Austrian Standstill Agreement signed. Lausanne Conference on Reparation postponed.
- January 25*—Geneva, Meeting of Council of League of Nations. Announcement by Bank of England of plan to repay balance of the \$250 million Franco-American credit on February 1.
- January 28*—Announcement of decision by Bank of France to renew its share in German credit due February 4.
- February 2*—Geneva, Opening of World Conference on Reduction and Limitation of Armaments.
- February 3*—Renewal by Federal Reserve Bank of New York of its share in Reichsbank credit.
- February 8*—B. I. S. Board Meeting. Appointment of arbitrators under new Standstill Agreement authorized.
- February 22*—Merger by German Government of *Dresdner* and *Darmstaedter* Banks to liquidate crisis.
- March 1*—Second German *Standstill* Agreement.
- March 2*—End of British restrictions on purchase of foreign exchange.
- March 3*—Announcement of renewal for 3 months by B. I. S. and Bank of France of their share in Reichsbank credit.
- March 4*—Renewal by Federal Reserve Bank of its share in Reichsbank credit.
- March 5*—Repayment by Great Britain of three quarters of 200,000,000 dollar credit from American private banks.
- March 7*—Death of M. Aristide Briand. Gold holdings of Bank of France in excess of those of any other central bank.
- March 12*—Suicide of Ivar Kreuger, head of Kreuger and Toll. Closing of Stockholm Stock Exchange.
- March 14*—B. I. S. Board Meeting.
- March 31*—Argentine exchange restrictions. Hungarian *Standstill* Agreement for six months.
- April 1*—Report of Financial Committee of League of Nations, advising loan to Austria and Greece.
- April 11*—B. I. S. Board Meeting. Decision to pay dividend and

to distribute remaining shares equally among 7 founder countries, original members of Board.

April 12—Meeting of League Council to consider report of Financial Committee on situation in Austria, Greece, Bulgaria and Hungary.

April 24—Large gains by National Socialists in German State elections.

April 25—Abandonment of gold standard by Greece.

April 29—Arbitration committee named by B. I. S. to settle bankers' differences under German short term credit agreement.

May 9—B. I. S. Board Meeting.

May 10—Annual meeting of B. I. S. shareholders.

May 30—Dr. Bruening resigns as head of German Government.

May 31—Colonel Franz von Papen named German Chancellor.

June 4—Renewal for three months of German international credit of \$90 millions by B. I. S., England, France and New York Federal Reserve Bank.

June 9—Conclusions of Gold Delegation of League of Nations published.

June 16—Opening of Lausanne Conference on Debts and Reparation.

July 9—Lausanne Conference adjourns, recommending drastic reduction of total German payments, remainder to be mobilized through the B. I. S. at an undesignated date.

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MAY 1930—MAY 1932
AND
TRUSTEE STATEMENT, APRIL 15, 1932

BALANCE SHEET

(in Swiss

ASSETS		
I—CASH		%
On hand and on current account with Banks	5,070,541.19	1.7
II—SIGHT FUNDS at interest . . .	32,395,474.27	10.7
III—REDISCOUNTABLE BILLS AND ACCEPTANCES (at cost)		
1. Commercial Bills and Bankers' Acceptances	125,238,198.99	41.4
2. Treasury Bills	<u>101,005,143.56</u>	33.4
	226,243,342.55	
IV—TIME FUNDS at interest		
1. Not exceeding 3 months . .	7,141,463.87	2.3
V—SUNDRY INVESTMENTS (at cost)		
1. Maturing within 1 year. . . .	15,961,620.05	5.3
2. Over 1 year	<u>15,266,859.64</u>	5.0
	31,228,479.69	
VI—OTHER ASSETS	620,376.29	0.2
	<u>302,699,677.86</u>	100.0

AS AT MAY 31, 1930
francs at par)

LIABILITIES		
I—CAPITAL		%
Authorised 200,000 shares each of 2,500 Swiss gold francs <u>500,000,000.—</u>		
Issued 124,000 shares 310,000,000.— of which 25 % paid up <u>77,500,000.—</u>		25.6
II—LONG TERM DEPOSITS		
1. Annuity Trust Account . . . 197,651,792.64		65.3
2. German Government Deposit <u>—</u>	197,651,792.64	
III—SIGHT DEPOSITS		
1. Central Banks for their own account 26,952,652.87		8.9
IV—MISCELLANEOUS ITEMS 595,232.35		0.2
	<u>302,699,677.86</u>	100.0

BALANCE SHEET
(in Swiss

ASSETS			
I – Cash			%
On hand and on current account with Banks . . .		5,120,427.01	0.5
II – Funds employed			
1. At sight	23,046,207.46		2.1
2. Short notice not exceeding 15 days	443,337,877.34		40.8
3. Between 15 and 90 days	27,684,147.37	494,068,232.17	2.6
III – Investments not exceeding 90 days, at cost			
1. Bills and Acceptances	239,294,955.—		22.0
2. Marketable Treasury Bills	261,351,777.56		24.1
3. Other short-term investments	15,920,538.25	516,567,270.81	1.5
IV – Investments exceeding 90 days, at cost .		68,352,425.33	6.3
V – Other Assets		1,612,446.10	0.1
		1,085,720,801.42	100

AS AT JUNE 30, 1930
francs at par)

LIABILITIES			
I—Capital			%
Authorised 200,000 shares, each of 2,500. Swiss gold francs	500,000,000.—		
Issued 164,000 shares . . of which 25% paid up	410,000,000.—	102,500,000.—	9.4
II—Special Deposits			
1. Annuity Trust Account	151,230,713.84		13.9
2. German Government Deposit	123,533,891.41	274,764,605.25	11.4
III—Sight Deposits			
1. Central Banks :			
(a) For their own account	111,106,650.51		10.2
(b) For the account of others	153,676,724.61		14.2
2. Other Deposits . . .	3,642,433.24		0.3
		268,425,808.36	
IV—Time Deposits			
Undistributed proceeds of the German Government International 5½% Loan 1930		438,198,394.45	40.4
V—Miscellaneous Items		1,831,993.36	0.2
		1,085,720,801.42	100

BALANCE SHEET
(in Swiss

ASSETS			
I – Cash			%
On hand and on current account with Banks . . .		6,815,012.79	0.5
II – Sight Funds at interest . .		80,476,958.10	6.2
III – Redisable Bills and Acceptances (at cost)			
1. Commercial Bills and Bankers' Acceptances .	184,141,226.76		14.1
2. Treasury Bills	180,452,553.30		13.8
IV – Time Funds at interest		364,593,780.06	
1. Not exceeding 3 months	297,955,764.13		22.9
2. Between 3 and 6 months	353,772,781.82		27.1
3. Between 6 and 9 months	75,614,882.67		5.8
V – Sundry Investments (at cost)		727,343,428.62	
1. Maturing within 2 years	107,927,700.19		8.3
2. Over 2 years	13,652,665.86		1.1
VI – Other Assets		121,580,366.05	
		2,844,104.63	0.2
		1,303,653,650.25	100

Dated: Basle, August 5, 1930.

AS AT JULY 31, 1930

(francs at par)

LIABILITIES			
			%
I—Capital			
Authorised 200,000 shares, each of 2,500 Swiss gold francs	500,000,000.—		
Issued 164,000 shares . . of which 25% paid up	410,000,000.—	102,500,000.—	7.9
II—Special Deposits			
1. Annuity Trust Account	154,604,509.20		11.8
2. German Government Deposit	87,669,120.82		6.7
3. French Government Guarantee Fund	68,326,944.81	310,600,574.83	5.2
III—Time Deposits			
1. Not exceeding 3 months:			
(a) Central Banks for their own account .	160,388,095.90		12.3
(b) Central Banks for the account of others	77,954,832.49		6.0
(c) Other depositors .	6,314,133.06		0.5
2. Between 3 and 6 months:		244,657,061.45	
(a) Central Banks for their own account	56,803,829.16		4.4
(b) Central Banks for the account of others	272,391,940.26		20.9
IV—Sight Deposits		329,195,769.42	
Central Banks :			
(a) For their own account	95,074,087.01		7.3
(b) For the account of others	217,900,251.56		16.7
V—Miscellaneous Items		312,974,338.57	
		3,725,905.98	0.3
		1,303,653,650.25	100

GATES W. MCGARRAH,
President.

(in Swiss

Dated: Basle, September 5, 1930.

AS AT AUGUST 31, 1930
francs at par)

LIABILITIES			
			%
I—Capital			
Authorised 200,000 shares, each of 2,500 Swiss gold francs	500,000,000.—		
Issued 164,000 shares . . of which 25% paid up	410,000,000.—	102,500,000.—	6.5
II—Long term Deposits			
1. Annuity Trust Account	154,526,729.33		9.9
2. German Government Deposit	76,414,016.32		4.9
3. French Government Guarantee Fund	68,343,389.92	299,284,135.57	4.4
III—Short term Deposits			
1. Between 3 and 6 months:			
(a) Central Banks for their own account	129,169,159.31		8.2
(b) Central Banks for the account of others	393,877,904.75	523,047,064.06	25.2
2. Not exceeding 3 months:			
(a) Central Banks for their own account .	262,414,791.07		16.8
(b) Central Banks for the account of others	142,156,849.17		9.1
(c) Other depositors :	6,312,819.03	410,884,459.27	0.4
IV—Sight Deposits			
Central Banks :			
(a) For their own account	74,514,828.61		4.8
(b) For the account of others	146,407,537.61		9.4
V—Miscellaneous Items		220,922,366.22	
		6,997,677.45	0.4
		1,563,635,702.57	100

GATES W. MCGARRAIT,
President.

BALANCE SHEET
(in Swiss

ASSETS			
I—Cash			%
On hand and on current account with Banks . . .		5,559,831.78	0.3
II—Sight Funds at interest . .		68,857,774.45	4.0
III—Rediscountable Bills and Acceptances (at cost)			
1. Commercial Bills and Bankers' Acceptances .	203,707,867.60		12.0
2. Treasury Bills	100,844,774.12		5.9
IV—Time Funds at interest		304,552,641.72	
1. Not exceeding 3 months	946,801,071.24		55.7
2. Between 3 and 6 months	153,956,444.59		9.1
3. Between 6 and 9 months	25,211,137.—		1.5
V—Sundry Investments (at cost)		1,125,968,652.83	
1. Maturing within 2 years	185,769,152.73		10.9
2. Over 2 years	1,049,050.20		0.1
VI—Other Assets		186,818,202.93	
		8,662,468.30	0.5
		1,700,419,572.01	100

Dated: Basle, October 6, 1930.

AS AT SEPTEMBER 30, 1930
francs at par)

LIABILITIES			
I—Capital			%
Authorised 200,000 shares, each of 2,500 Swiss gold francs	500,000,000.—		
Issued 164,000 shares . . of which 25% paid up	410,000,000.—	102,500,000.—	6.0
II—Long term Deposits			
1. Annuity Trust Account	154,332,328.75		9.1
2. German Government Deposit	79,916,014.29		4.7
3. French Government Guarantee Fund	68,715,862.68	302,964,205.72	4.0
III—Short term Deposits			
1. Between 3 and 6 months:			
(a) Central Banks for their own account	193,206,370.77		11.4
(b) Central Banks for the account of others	39,184,805.94		2.3
2. Not exceeding 3 months:		232,391,176.71	
(a) Central Banks for their own account .	268,854,931.56		15.8
(b) Central Banks for the account of others	582,594,887.65	851,449,819.21	34.3
IV—Sight Deposits			
1. Central Banks :			
(a) For their own account	72,546,655.16		4.3
(b) For the account of others	127,962,406.49		7.5
2. Other depositors . . .	118,980.51		0.0
V—Miscellaneous Items		200,628,042.16	
		10,486,328.21	0.6
		1,700,419,572.01	100

GATES W. MCGARRAH,
President.

(in Swiss

Dated: Basle, November 5, 1930.

AS AT OCTOBER 31, 1930
francs at par)

LIABILITIES			
I—Capital			%
Authorised 200,000 shares, each of 2,500 Swiss gold francs	500,000,000.—		
Issued 164,100 shares . . of which 25% paid up	410,250,000.—	102,562,500.—	5.7
II—Long term Deposits			
1. Annuity Trust Account	154,510,055.—		8.7
2. German Government Deposit	80,008,044.09		4.5
3. French Government Guarantee Fund	68,728,393.32	303,246,492.41	3.8
III—Short term Deposits			
1. Between 3 and 6 months:			
(a) Central Banks for their own account	103,625,901.80		5.8
(b) Central Banks for the account of others	142,903.26	103,768,805.06	0.0
2. Not exceeding 3 months:			
(a) Central Banks for their own account .	361,565,497.26		20.3
(b) Central Banks for the account of others	697,035,329.78	1,058,600,827.04	39.1
IV—Sight Deposits			
1. Central Banks :			
(a) For their own account	74,815,073.12		4.2
(b) For the account of others	128,410,928.34		7.2
2. Other depositors . . .	116,417.89		0.0
		203,342,419.35	
V—Miscellaneous Items		12,707,051.78	0.7
		1,784,228,095.64	100

GATES W. MCGARRAH,
President.

BALANCE SHEET

(in Swiss

ASSETS			
I—Cash			%
On hand and on current account with Banks . . .		4,279,269.90	0.2
II—Sight Funds at interest . .		71,393,191.85	3.8
III—Rediscountable Bills and Acceptances (at cost)			
1. Commercial Bills and Bankers' Acceptances .	239,983,111.61		12.8
2. Treasury Bills	170,765,771.15		9.1
		410,748,882.76	
IV—Time Funds at interest			
1. Not exceeding 3 months	1,050,808,256.90		56.0
2. Between 3 and 6 months	134,411,254.32		7.2
		1,185,219,511.22	
V—Sundry Investments (at cost)			
1. Maturing within 2 years	190,505,120.90		10.2
2. Over 2 years	523,490.29		0.0
		191,028,611.19	
VI—Other Assets		13,556,176.83	0.7
		1,876,225,643.75	100

Dated: Basle, December 5, 1930.

AS AT NOVEMBER 30, 1930
francs at par)

LIABILITIES			
I—Capital			%
Authorised 200,000 shares, each of 2,500 Swiss gold francs	500,000,000.—		
Issued 164,100 shares . . of which 25% paid up	410,250,000.—	102,562,500.—	5.5
II—Long term Deposits			
1. Annuity Trust Account	154,498,655.—		8.2
2. German Government Deposit	80,002,140.97		4.3
3. French Government Guarantee Fund	68,679,158.24	303,179,954.21	3.7
III—Short term Deposits			
1. Between 3 and 6 months: Central Banks for their own account		15,554,790.—	0.8
2. Not exceeding 3 months: (a) Central Banks for their own account .	481,844,106.72		25.7
(b) Central Banks for the account of others	665,033,108.68		35.4
IV—Sight Deposits		1,146,877,215.40	
1. Central Banks :			
(a) For their own account	99,699,849.26		5.3
(b) For the account of others	193,228,079.97		10.3
2. Other depositors . . .	118,678.16		0.0
V—Miscellaneous Items		293,046,607.39	
		15,004,576.75	0.8
		1,876,225,643.75	100

For the President,
LEON FRASER,
Alternate of the President.

(in Swiss

ASSETS			
I – Cash			%
On hand and on current account with Banks . . .		6,075,717.48	0.4
II – Sight Funds at interest . .		74,814,048.38	4.7
III – Redisable Bills and Acceptances (at cost)			
1. Commercial Bills and Bankers' Acceptances .	319,591,944.36		20.3
2. Treasury Bills	177,170,448.55		11.2
		496,762,392.91	
IV – Time Funds at interest			
1. Not exceeding 3 months	653,030,211.89		41.4
2. Between 3 and 6 months	145,268,600.03		9.2
		798,298,811.92	
V – Sundry Investments (at cost)			
1. Not exceeding 1 year .	153,789,697.11		9.7
2. Between 1 and 2 years	37,068,899.96		2.4
		190,858,597.07	
VI – Other Assets		11,324,614.46	0.7
		1,578,134,182.22	100

Dated: Basle, January 5, 1931.

AS AT DECEMBER 31, 1930
francs at par)

LIABILITIES			
I—Capital			%
Authorised 200,000 shares, each of 2,500 Swiss gold francs	500,000,000.—		
Issued 164,600 shares . . of which 25% paid up	411,500,000.—	102,875,000.—	6.5
II—Long term Deposits			
1. Annuity Trust Account	154,354,115.—		9.8
2. German Government Deposit	77,177,057.50		4.9
3. French Government Guarantee Fund. . . .	68,667,991.93		4.4
		300,199,164.43	
III—Short term and Sight Deposits			
1. Central Banks for their own account:			
(a) Not exceeding 3 months	605,012,152.17		38.3
(b) Sight	199,044,009.80		12.6
2. Central Banks for the account of others:		804,056,161.97	
(a) Between 3 and 6 months	55,135,603.92		3.5
(b) Not exceeding 3 months	154,317,155.80		9.8
(c) Sight	140,595,680.07		8.9
3. Other depositors:		350,048,439.79	
(a) Not exceeding 3 months	8,697,314.20		0.5
(b) Sight	225,134.90		0.0
		8,922,449.10	
IV—Miscellaneous Items		12,032,966.93	0.8
		1,578,134,182.22	100

For the President,
LEON FRASER,
Alternate of the President.

BALANCE SHEET
(in Swiss

ASSETS			
I – Cash			%
On hand and on current account with Banks . . .		5,691,646.38	0.3
II – Sight Funds at interest . .		85,517,704.18	5.0
III – Rediscountable Bills and Acceptances (at cost)			
1. Commercial Bills and Bankers' Acceptances .	346,968,363.74		20.3
2. Treasury Bills	185,433,590.54		10.9
		532,401,954.28	
IV – Time Funds at interest			
1. Not exceeding 3 months	722,108,229.58		42.3
2. Between 3 and 6 months	162,239,292.27		9.5
		884,347,521.85	
V – Sundry Investments (at cost)			
1. Not exceeding 1 year .	150,520,454.03		8.8
2. Between 1 and 2 years	37,179,814.58		2.2
		187,700,268.61	
VI – Other Assets		12,272,551.19	0.7
		1,707,931,646.49	100

Dated: Basle, February 5, 1931.

AS AT JANUARY 31, 1931
francs at par)

LIABILITIES			
I—Capital			%
Authorised 200,000 shares, each of 2,500 Swiss gold francs	500,000,000.—		
Issued 164,600 shares . . of which 25% paid up	411,500,000.—	102,875,000.—	6.0
II—Long term Deposits			
1. Annuity Trust Account	154,295,505.—		9.0
2. German Government Deposit	77,147,752.50		4.5
3. French Government Guarantee Fund. . . .	68,790,834.57	300,234,092.07	4.0
III—Short term and Sight Deposits			
1. Central Banks for their own account:			
(a) Between 3 and 6 months	6,196,909.—		0.4
(b) Not exceeding 3 months	580,423,740.45		34.0
(c) Sight	237,809,904.82		14.0
2. Central Banks for the account of others:		824,430,554.27	
(a) Between 3 and 6 months	124,679,373.14		7.3
(b) Not exceeding 3 months	150,590,713.53		8.8
(c) Sight	182,933,453.23		10.7
3. Other depositors:		458,203,539.90	
(a) Not exceeding 3 months	8,712,873.13		0.5
(b) Sight	225,344.41		0.0
		8,938,217.54	
IV—Miscellaneous Items		13,250,242.71	0.8
		1,707,931,646.49	100

GATES W. MCGARRAH,
President.

BALANCE SHEET
(in Swiss[illegible]

Dated: Basle, March 5, 1931.

AS AT FEBRUARY 28, 1931

(francs at par)

LIABILITIES			
I—Capital			%
Authorized 200,000 shares, each of 2,500 Swiss gold francs	500,000,000.—		
Issued 164,600 shares . . of which 25% paid up	411,500,000.—	102,875,000.—	5.5
II—Long term Deposits			
1. Annuity Trust Account	154,248,292.50		8.3
2. German Government Deposit	77,124,146.25		4.1
3. French Government Guarantee Fund. . . .	68,772,767.14		3.7
		300,145,205.89	
III—Short term and Sight Deposits			
1. Central Banks for their own account:			
(a) Between 3 and 6 months	5,691,708.—		0.3
(b) Not exceeding 3 months	555,182,235.25		29.8
(c) Sight	316,071,577.68		17.0
2. Central Banks for the account of others:		876,945,520.93	
(a) Between 3 and 6 months	214,904,660.11		11.6
(b) Not exceeding 3 months	150,470,144.50		8.1
(c) Sight	190,468,972.66		10.2
3. Other depositors:		555,843,777.27	
(a) Not exceeding 3 months	8,747,773.06		0.5
(b) Sight	227,468.74		0.0
		8,975,241.80	
IV—Miscellaneous Items		16,256,596.23	0.9
		1,861,041,342.12	100

GATES W. MCGARRAH,
President.

(in Swiss

Dated: Basle, April 7, 1931.

AS AT MARCH 31, 1931
francs at par)

LIABILITIES			
			%
I—Capital			
Authorised 200,000 shares, each of 2,500 Swiss gold francs	500,000,000.—		
Issued 165,100 shares . . of which 25% paid up	412,750,000.—	103,187,500.—	5.4
II—Long term Deposits			
1. Annuity Trust Account	154,873,960.—		8.2
2. German Government Deposit	77,436,980.—		4.1
3. French Government Guarantee Fund. . . .	68,879,621.96	301,190,561.96	3.6
III—Short term and Sight Deposits			
1. Central Banks for their own account:			
(a) Between 3 and 6 months	5,700,262.50		0.3
(b) Not exceeding 3 months	495,126,691.51		26.0
(c) Sight	310,979,622.39		16.4
2. Central Banks for the account of others:		811,806,576.40	
(a) Between 3 and 6 months	5,253,989.44		0.3
(b) Not exceeding 3 months	355,730,774.08		18.7
(c) Sight	292,190,140.10		15.4
3. Other depositors:		653,174,903.62	
(a) Not exceeding 3 months	13,793,737.30		0.7
(b) Sight	227,683.09		0.0
IV—Miscellaneous Items		14,021,420.39	
		17,767,950.54	0.9
		1,901,148,912.91	100

GATES W. MCGARRAH,
President.

(in Swiss

Dated: Basle, May 5, 1931.

AS AT APRIL 30, 1931
francs at par)

LIABILITIES			
I—Capital			%
Authorised 200,000 shares, each of 2,500 Swiss gold francs	500,000,000.—		
Issued 165,600 shares . . of which 25% paid up	414,000,000.—	103,500,000.—	5.3
II—Long term Deposits			
1. Annuity Trust Account	154,621,222.50		8.0
2. German Government Deposit	77,310,611.25		4.0
3. French Government Guarantee Fund. . . .	68,804,689.80	300,736,523.55	3.5
III—Short term and Sight Deposits			
1. Central Banks for their own account:			
(a) Between 3 and 6 months	10,889,210.70		0.6
(b) Not exceeding 3 months	457,217,869.99		23.5
(c) Sight	295,266,708.19		15.2
2. Central Banks for the account of others:		763,373,788.88	
(a) Not exceeding 3 months	589,994,946.80		30.4
(b) Sight	152,454,019.11		7.8
3. Other depositors:		742,448,965.91	
(a) Not exceeding 3 months	13,803,131.33		0.7
(b) Sight	227,570.77		0.0
IV—Miscellaneous Items		14,030,702.10	
		19,287,491.09	1.0
		1,943,377,471.53	100

GATES W. MCGARRAH,
President.

(in Swiss

Dated: Basle, June 5, 1931.

AS AT MAY 31, 1931
francs at par)

LIABILITIES			
I—Capital			%
Authorised 200,000 shares, each of 2,500 Swiss gold francs	500,000,000.—		
Issued 169,600 shares . . . of which 25 % paid up . . .	424,000,000.—	106,000,000.—	5.0
II—Reserves			
1. Legal Reserve Fund . . .	559,326.10		
2. Dividend Reserve Fund . .	1,094,189.17		
3. General Reserve Fund . .	2,188,378.35		
		3,841,893.62	0.2
III—Long-term Deposits			
1. Annuity Trust Account . .	154,196,537.50		7.3
2. German Government Deposit	77,098,268.75		3.6
3. French Government Guarantee Fund.	68,790,543.16		3.2
		300,085,349.41	
IV—Short term and Sight Deposits			
1. Central Banks for their own account:			
(a) Between 3 and 6 months	8,695,285.58		0.4
(b) Not exceeding 3 months	514,713,150.06		24.2
(c) Sight	333,636,138.51		15.7
2. Central Banks for the account of others:		857,044,574.15	
(a) Not exceeding 3 months	680,606,993.04		32.0
(b) Sight	158,993,679.23		7.5
3. Other depositors:		839,600,672.27	
Sight		857,961.91	0.0
V—Profits allocated for dis- tribution on July 1, 1931			
1. Dividend to Shareholders at the rate of 6 % per annum	5,156,250.—		
2. Participation of long-term depositors per Article 53 (e) of the Statutes	2,188,378.35		
		7,344,628.35	0.4
VI—Miscellaneous Items		11,200,748.16	0.5
		2,125,975,827.87	100

GATES W. McGARRAH,
President.

BALANCE SHEET
(in Swiss

ASSETS			
I—Cash			%
On hand and on current account with Banks		11,156,868.—	0.6
II—Sight Funds at interest . .		168,485,213.07	9.5
III—Redisable Bills and Acceptances (at cost)			
1. Commercial Bills and Bankers' Acceptances . .	438,144,840.01		24.6
2. Treasury Bills	293,094,474.80		16.5
		731,239,314.81	
IV—Time Funds at interest			
1. Not exceeding 3 months . .	594,008,678.11		33.4
2. Between 3 and 6 months . .	24,650,379.60		1.4
		618,659,057.71	
V—Sundry Bills and Invest- ments			
1. Maturing within 1 year . .	211,208,961.48		11.8
2. Over 1 year	29,526,843.74		1.6
		240,735,805.22	
VI—Other Assets		10,142,838.20	0.6
		1,780,419,097.01	100

Dated: Basle, July 6, 1931.

AS AT JUNE 30, 1931

francs at par)

LIABILITIES			
I—Capital			%
Authorised 200,000 shares, each of 2,500 Swiss gold francs	500,000,000.—		
Issued 173,600 shares of which 25 % paid up	434,000,000.—	108,500,000.—	6.1
II—Reserves			
1. Legal Reserve Fund . . .	559,326.10		
2. Dividend Reserve Fund . .	1,094,189.17		
3. General Reserve Fund . .	2,188,378.35		
III—Long-term Deposits		3,841,893.62	0.2
1. Annuity Trust Account . .	154,064,872.50		8.7
2. German Government Deposit	77,032,436.25		4.3
3. French Government Guarantee Fund.	68,801,192.87		3.9
IV—Short term and Sight Deposits		299,898,501.62	
1. Central Banks for their own account:			
(a) Between 3 and 6 months	4,104,871.50		0.2
(b) Not exceeding 3 months	551,903,076.04		31.0
(c) Sight	388,941,857.80		21.8
2. Central Banks for the account of others:		944,949,805.34	
(a) Between 3 and 6 months	31,259,247.77		1.8
(b) Not exceeding 3 months	203,294,067.66		11.4
(c) Sight	169,000,567.47		9.5
3. Other depositors:		403,553,882.90	
Sight		1,134,356.16	0.1
V—Profits allocated for dis- tribution on July 1, 1931			
1. Dividend to Shareholders at the rate of 6 % per annum	5,156,250.—		
2. Participation of long-term depositors per Article 53 (e) of the Statutes	2,188,378.35		
VI—Miscellaneous Items		7,344,628.35	0.4
		11,196,029.02	0.6
		1,780,419,097.01	100

GATES W. MCGARRATH,
President.

BALANCE SHEET
(in Swiss

ASSETS			
I—Cash			%
On hand and on current account with Banks		10,133,777.59	0.6
II—Sight Funds at interest . .		192,819,623.42	11.8
III—Rediscountable Bills and Acceptances (at cost)			
1. Commercial Bills and Bankers' Acceptances . .	389,903,862.91		23.9
2. Treasury Bills.	254,601,524.88		15.6
		644,505,387.79	
IV—Time Funds at interest			
1. Not exceeding 3 months .	530,170,143.33		32.5
2. Between 3 and 6 months .	24,647,488.80		1.5
		554,817,632.13	
V—Sundry Bills and Investments			
1. Maturing within 1 year . .	208,495,465.37		12.8
2. Over 1 year.	10,989,361.29		0.7
		219,484,826.66	
VI—Other Assets		10,137,667.05	0.6
		1,631,898,914.64	100

Dated: Basle, August 5, 1931.

AS AT JULY 31, 1931
francs at par)

LIABILITIES			
I—Capital			%
Authorised 200,000 shares, each of 2,500 Swiss gold francs	500,000,000.—		
Issued 173,600 shares of which 25 % paid up	434,000,000.—	108,500,000.—	6.7
II—Reserves			
1. Legal Reserve Fund	559,326.10		
2. Dividend Reserve Fund . .	1,094,189.17		
3. General Reserve Fund . .	2,188,378.35	3,841,893.62	0.2
III—Long term Deposits			
1. Annuity Trust Account . .	154,046,805.—		9.4
2. German Government Deposit	77,023,402.50		4.7
3. French Government Guarantee Fund.	68,772,727.40	299,842,934.90	4.2
IV—Short term and Sight Deposits			
1. Central Banks for their own account:			
(a) Between 3 and 6 months	4,115,290.26		0.3
(b) Not exceeding 3 months	436,787,101.62		26.8
(c) Sight	382,246,995.51	823,149,387.39	23.4
2. Central Banks for the account of others:			
(a) Between 3 and 6 months	31,249,968.68		1.9
(b) Not exceeding 3 months	192,769,891.49		11.8
(c) Sight	156,383,763.07		9.6
3. Other depositors:		380,403,623.24	
(a) Not exceeding 3 months	1,531,010.57		0.1
(b) Sight	872,244.73		0.1
		2,403,255.30	
V—Miscellaneous Items		13,757,820.19	0.8
		1,631,898,914.64	100

GATES W. MCGARRAH,
President.

BALANCE SHEET
(in Swiss

ASSETS			
I - Cash			%
On hand and on current account with Banks		15,572,995.68	1.0
II - Sight Funds at interest . .		284,709,899.34	17.7
III - Rediscountable Bills and Acceptances (at cost)			
1. Commercial Bills and Bankers' Acceptances . .	368,817,348.08		23.0
2. Treasury Bills.	237,285,213.87		14.8
		606,102,561.95	
IV - Time Funds at interest			
1. Not exceeding 3 months .	476,222,571.63		29.6
2. Between 3 and 6 months .	2,172,258.54		0.1
		478,394,830.17	
V - Sundry Bills and Investments			
1. Maturing within 1 year . .	199,249,981.35		12.4
2. Over 1 year	10,710,860.53		0.7
		209,960,841.88	
VI - Other Assets		11,103,667.79	0.7
		1,605,844,796.81	100

Dated: Basle, September 5, 1931.

AS AT AUGUST 31, 1931
francs at par)

LIABILITIES			
			%
I—Capital			
Authorised 200,000 shares, each of 2,500 Swiss gold francs	500,000,000.—		
Issued 173,600 shares of which 25 % paid up	434,000,000.—	108,500,000.—	6.8
II—Reserves			
1. Legal Reserve Fund	559,326.10		
2. Dividend Reserve Fund . .	1,094,189.17		
3. General Reserve Fund . .	2,188,378.35		
		3,841,893.62	0.2
III—Long term Deposits			
1. Annuity Trust Account . .	154,132,860.—		9.6
2. German Government Deposit	77,066,430.—		4.8
3. French Government Guarantee Fund.	68,811,140.57		4.3
		300,010,430.57	
IV—Short term and Sight Deposits			
1. Central Banks for their own account:			
(a) Not exceeding 3 months	333,277,741.31		20.7
(b) Sight	536,575,315.91		33.4
2. Central Banks for the account of others:		869,853,057.22	
(a) Between 3 and 6 months	31,267,424.36		1.9
(b) Not exceeding 3 months	120,136,126.44		7.5
(c) Sight	151,996,537.18		9.5
3. Other depositors:		303,400,087.98	
(a) Not exceeding 3 months	1,531,865.72		0.1
(b) Sight	1,667,683.23		0.1
		3,199,548.95	
V—Miscellaneous Items		17,039,778.47	1.1
		1,605,844,796.81	100

GATES W. MCGARRAH,
President.

BALANCE SHEET
(in Swiss

ASSETS			
I—Cash			%
On hand and on current account with Banks		9,088,832.10	0.7
II—Sight Funds at interest . .		127,073,612.20	10.0
III—Rediscountable Bills and Acceptances (at cost)			
1. Commercial Bills and Bankers' Acceptances . .	359,448,596.81		28.2
2. Treasury Bills.	161,386,416.77		12.7
		520,835,013.58	
IV—Time Funds at interest			
Not exceeding 3 months .		396,829,597.88	31.2
V—Sundry Bills and Investments			
1. Maturing within 6 months .	164,275,073.52		12.9
2. Between 6 months and 1 year	33,828,322.23		2.6
3. Over 1 year.	10,711,842.33		0.8
		208,815,238.08	
VI—Other Assets		10,975,379.92	0.9
		1,273,617,673.76	100

Dated: Basle, October 5, 1931.

AS AT SEPTEMBER 30, 1931
francs at par)

LIABILITIES			
			%
I—Capital			
Authorised 200,000 shares, each of 2,500 Swiss gold francs	500,000,000.—		
Issued 173,600 shares	434,000,000.—	108,500,000.—	8.5
of which 25 % paid up . . .			
II—Reserves			
1. Legal Reserve Fund . . .	559,326.10		
2. Dividend Reserve Fund . .	1,094,189.17		
3. General Reserve Fund . .	2,188,378.35	3,841,893.62	0.3
III—Long term Deposits			
1. Annuity Trust Account . .	153,768,617.50		12.1
2. German Government Deposit	76,884,308.75		6.0
3. French Government Guarantee Fund.	68,648,520.43	299,301,446.68	5.4
IV—Short term and Sight Deposits			
1. Central Banks for their own account:			
(a) Not exceeding 3 months	307,619,524.24		24.2
(b) Sight	316,906,008.69	624,525,532.93	24.9
2. Central Banks for the account of others:			
(a) Not exceeding 3 months	90,257,235.99		7.1
(b) Sight	123,485,214.14		9.7
3. Other depositors:		213,742,450.13	
(a) Not exceeding 3 months	1,528,245.49		0.1
(b) Sight	1,982,156.33		0.1
		3,510,401.82	
V—Miscellaneous Items		20,195,948.58	1.6
		1,273,617,673.76	100

GATES W. MCGARRAH,
President.

(in Swiss

Dated: Basle, November 5, 1931.

AS AT OCTOBER 31, 1931

francs at par)

LIABILITIES			
I—Capital			%
Authorised 200,000 shares, each of 2,500 Swiss gold francs	500,000,000.—		
Issued 173,600 shares of which 25 % paid up . . .	434,000,000.—	108,500,000.—	9.9
II—Reserves			
1. Legal Reserve Fund . . .	559,326.10		
2. Dividend Reserve Fund . .	1,094,189.17		
3. General Reserve Fund . .	2,188,378.35	3,841,893.62	0.3
III—Long term Deposits			
1. Annuity Trust Account . .	153,768,617.50		14.1
2. German Government Deposit	76,884,308.75		7.0
3. French Government Guarantee Fund.	68,648,520.43	299,301,446.68	6.3
IV—Short term and Sight Deposits			
1. Central Banks for their own account:			
(a) Not exceeding 3 months	108,838,435.36		10.0
(b) Sight	378,255,563.51	487,093,998.87	34.6
2. Central Banks for the account of others:			
(a) Not exceeding 3 months	31,193,531.97		2.9
(b) Sight	137,865,309.72		12.6
3. Other depositors:		169,058,841.69	
Sight		3,602,766.97	0.3
V—Miscellaneous Items		21,948,731.88	2.0
		1,093,347,679.71	100

For the President,
LEON FRASER,
Alternate of the President.

BALANCE SHEET
(in Swiss

ASSETS			
I—Cash			%
On hand and on current account with Banks		14,076,231.49	1.3
II—Sight Funds at interest . .		151,438,334.32	13.7
III—Rediscountable Bills and Acceptances (at cost)			
1. Commercial Bills and Bankers' Acceptances . .	357,647,449.42		32.3
2. Treasury Bills.	144,779,264.62		13.1
		502,426,714.04	
IV—Time Funds at interest			
Not exceeding 3 months .		248,841,977.83	22.4
V—Sundry Bills and Investments			
1. Maturing within 6 months .	143,678,091.68		13.0
2. Between 6 months and 1 year	33,828,322.23		3.0
3. Over 1 year	933,866.68		0.1
		178,440,280.59	
VI—Other Assets		12,084,061.92	1.1
		1,107,307,600.19	100

Dated: Başle, December 5, 1931.

AS AT NOVEMBER 30, 1931
francs at par)

LIABILITIES			
I—Capital			%
Authorised 200,000 shares, each of 2,500 Swiss gold francs	500,000,000.—		
Issued 173,600 shares	434,000,000.—		
of which 25 % paid up . . .		108,500,000.—	9.8
II—Reserves			
1. Legal Reserve Fund . . .	559,326.10		
2. Dividend Reserve Fund . .	1,094,189.17		
3. General Reserve Fund . .	2,188,378.35	3,841,893.62	0.3
III—Long term Deposits			
1. Annuity Trust Account . .	153,768,617.50		13.9
2. German Government Deposit	76,884,308.75		6.9
3. French Government Guarantee Fund.	68,648,520.43	299,301,446.68	6.2
IV—Short term and Sight Deposits			
1. Central Banks for their own account:			
(a) Not exceeding 3 months	184,205,400.25		16.6
(b) Sight	326,327,426.45		29.5
2. Central Banks for the account of others:		510,532,826.70	
(a) Not exceeding 3 months	57,106,616.97		5.2
(b) Sight	100,518,020.09		9.1
3. Other depositors:		157,624,637.06	
Sight		3,394,015.14	0.3
V—Miscellaneous Items		24,112,780.99	2.2
		1,107,307,600.19	100

For the President,
LEON FRASER,
Alternate of the President.

(in Swiss

Dated: Basle, January 5, 1932.

AS AT DECEMBER 31, 1931
francs at par)

LIABILITIES			
I—Capital			%
Authorised 200,000 shares, each of 2,500 Swiss gold francs	500,000,000.—		
Issued 173,600 shares	434,000,000.—		
of which 25 % paid up		108,500,000.—	10.4
II—Reserves			
1. Legal Reserve Fund	559,326.10		
2. Dividend Reserve Fund . . .	1,094,189.17		
3. General Reserve Fund . . .	2,188,378.35	3,841,893.62	0.4
III—Long term Deposits			
1. Annuity Trust Account . . .	153,768,617.50		14.8
2. German Government Deposit	76,884,308.75		7.4
3. French Government Guarantee Fund	68,648,520.43	299,301,446.68	6.6
IV—Short term and Sight Deposits			
1. Central Banks for their own account:			
(a) Not exceeding 3 months	166,180,014.48		16.0
(b) Sight	297,365,679.96		28.6
2. Central Banks for the account of others:		463,545,694.44	
(a) Not exceeding 3 months	34,167,806.18		3.3
(b) Sight	101,379,187.97		9.7
3. Other depositors:		135,546,994.15	
Sight		3,385,986.71	0.3
V—Miscellaneous Items		26,708,812.59	2.5
		1,040,830,828.19	100

GATES W. MCGARRAH,
President.

BALANCE SHEET
(in Swiss)

ASSETS			
I—Cash			%
On hand and on current account with Banks		17,322,718.79	1.7
II—Sight Funds at interest . .		156,968,344.22	15.2
III—Rediscountable Bills and Acceptances (at cost)			
1. Commercial Bills and Bankers' Acceptances . .	406,517,528.70		39.2
2. Treasury Bills.	100,361,023.28	506,878,551.98	9.7
IV—Time Funds at interest			
Not exceeding 3 months .		233,458,295.21	22.5
V—Sundry Bills and Investments			
1. Maturing within 6 months .	110,179,925.14		10.6
2. Between 6 months and 1 year	—		
3. Over 1 year	832,309.26	111,012,234.40	0.1
VI—Other Assets		10,419,992.91	1.0
		1,036,060,137.51	100

Dated: Basle, February 5, 1932.

AS AT JANUARY 31, 1932
francs at par)

LIABILITIES			
I—Capital			%
Authorised 200,000 shares, each of 2,500 Swiss gold francs	500,000,000.—		
Issued 173,600 shares	434,000,000.—	108,500,000.—	10.5
of which 25 % paid up			
II—Reserves			
1. Legal Reserve Fund	559,326.10		
2. Dividend Reserve Fund . .	1,094,189.17		
3. General Reserve Fund . .	2,188,378.35	3,841,893.62	0.4
III—Long term Deposits			
1. Annuity Trust Account . .	153,768,617.50		14.8
2. German Government Deposit	76,884,308.75		7.4
3. French Government Guarantee Fund.	68,648,520.43	299,301,446.68	6.6
IV—Short term and Sight Deposits			
1. Central Banks for their own account:			
(a) Not exceeding 3 months	159,419,140.80		15.4
(b) Sight	315,530,035.79	474,949,176.59	30.5
2. Central Banks for the account of others:			
(a) Not exceeding 3 months	35,515,286.59		3.4
(b) Sight	77,694,202.07		7.5
3. Other depositors:		113,209,488.66	
Sight		5,927,574.26	0.6
V—Miscellaneous Items		30,330,557.70	2.9
		1,036,060,137.51	100

For the President,
LEON FRASER,
Alternate of the President.

(in Swiss

Dated: Basle, March 5, 1932.

AS AT FEBRUARY 29, 1932
francs at par)

LIABILITIES			
I—Capital			%
Authorised 200,000 shares, each of 2,500 Swiss gold francs	500,000,000.—		
Issued 173,600 shares of which 25 % paid up . . .	434,000,000.—	108,500,000.—	10.7
II—Reserves			
1. Legal Reserve Fund	559,326.10		
2. Dividend Reserve Fund . .	1,094,189.17		
3. General Reserve Fund . . .	2,188,378.35	3,841,893.62	0.4
III—Long term Deposits			
1. Annuity Trust Account . . .	153,768,617.50		15.2
2. German Government Deposit	76,884,308.75		7.6
3. French Government Guarantee Fund	68,648,520.43	299,301,446.68	6.8
IV—Short term and Sight Deposits			
1. Central Banks for their own account:			
(a) Not exceeding 3 months	158,376,205.72		15.7
(b) Sight	321,570,448.71		31.8
2. Central Banks for the account of others:		479,946,654.43	
(a) Not exceeding 3 months	21,314,916.01		2.1
(b) Sight	61,545,425.49		6.1
3. Other depositors:		82,860,341.50	
Sight		5,936,372.33	0.6
V—Miscellaneous Items		30,597,403.09	3.0
		1,010,984,111.65	100

For the President,
LEON FRASER,
Alternate of the President.

BALANCE SHEET
(in Swiss

ASSETS			
I - Cash			%
On hand and on current account with Banks		14,211,955.14	1.3
II - Slight Funds at interest . .		74,384,533.62	6.6
III - Rediscountable Bills and Acceptances			
1. Commercial Bills and Bankers' Acceptances . .	473,560,333.12		42.0
2. Treasury Bills	136,738,464.26		12.1
		610,298,797.38	
IV - Time Funds at interest			
Not exceeding 3 months . .		206,536,295.50	18.3
V - Sundry Bills and Investments			
1. Maturing within 3 months			
(a) Treasury Bills	126,768,541.81		11.3
(b) Sundry Investments . .	47,509,636.49		4.2
2. Between 3 and 6 months .	35,851,527.86		3.2
3. Over 6 months	788,743.95		0.1
		210,918,450.11	
VI - Other Assets		9,661,125.09	0.9
		1,126,011,156.84	100

Dated: Basle, April 5, 1932.

AS AT MARCH 31, 1932
francs at par)

LIABILITIES			
I—Capital			%
Authorised 200,000 shares, each of 2,500 Swiss gold francs	500,000,000.—		
Issued 173,600 shares of which 25 % paid up	434,000,000.—	108,500,000.—	9.6
II—Reserves			
1. Legal Reserve Fund	559,326.10		
2. Dividend Reserve Fund . .	1,094,189.17		
3. General Reserve Fund . .	2,188,373.35	3,841,893.62	0.4
III—Long term Deposits			
1. Annuity Trust Account . .	153,622,762.50		13.6
2. German Government Deposit	76,811,381.25		6.8
3. French Government Guarantee Fund.	68,648,520.43	299,082,664.18	6.1
IV—Short term and Sight Deposits			
1. Central Banks for their own account:			
(a) Not exceeding 3 months	145,154,858.74		12.9
(b) Sight	463,030,162.56		41.1
2. Central Banks for the account of others:		608,185,021.30	
Sight		68,153,969.04	6.1
3. Other depositors:			
Sight		7,822,525.85	0.7
V—Miscellaneous Items		30,425,082.85	2.7
		1,126,011,156.84	100

GATES W. MCGARRAH,
President.

(in Swiss

Dated: Basle, May 5, 1932.

AS AT APRIL 30, 1932
francs at par)

LIABILITIES			
I—Capital			%
Authorised 200,000 shares, each of 2,500 Swiss gold francs	500,000,000.—		
Issued 173,600 shares	434,000,000.—		
of which 25 % paid up		108,500,000.—	9.5
II—Reserves			
1. Legal Reserve Fund	559,326.10		
2. Dividend Reserve Fund . .	1,094,189.17		
3. General Reserve Fund . .	2,188,378.35		
		3,841,893.62	0.4
III—Long term Deposits			
1. Annuity Trust Account . .	153,768,617.50		13.5
2. German Government Deposit	76,884,308.75		6.8
3. French Government Guarantee Fund.	68,648,520.43		6.0
		299,301,446.68	
IV—Short term and Sight Deposits			
1. Central Banks for their own account:			
(a) Not exceeding 3 months	300,605,628.15		26.4
(b) Sight	319,934,148.06		28.1
		620,539,776.21	
2. Central Banks for the ac- count of others:			
Sight		61,423,966.30	5.4
3. Other depositors:			
(a) Not exceeding 3 months	5,522,545.04		0.5
(b) Sight	3,981,933.25		0.4
		9,504,478.29	
V—Miscellaneous Items		34,445,822.26	3.0
		1,137,557,383.36	100

GATES W. MCGARRAH,
President.

BALANCE SHEET
(in Swiss

ASSETS			
I - Cash			%
On hand and on current account with Banks		13,084,145.70	1.1
II - Slight Funds at interest . .		68,257,237.17	5.7
III - Rediscountable Bills and Acceptances			
1. Commercial Bills and Bankers' Acceptances . .	469,135,891.97		39.4
2. Treasury Bills	182,625,488.51		15.3
		651,761,380.48	
IV - Time Funds at interest			
Not exceeding 3 months .		269,029,619.66	22.6
V - Sundry Bills and Investments			
1. Maturing within 3 months			
(a) Treasury Bills	92,916,643.56		7.8
(b) Sundry Investments . .	59,720,563.41		5.0
2. Between 3 and 6 months .	23,759,282.52		2.0
3. Over 6 months	1,932,788.69		0.2
		178,329,278.18	
VI - Other Assets		11,249,505.84	0.9
		1,191,711,167.03	100

Dated: Basle, June 6, 1932.

AS AT MAY 31, 1932

francs at par)

LIABILITIES			
			%
I—Capital			
Authorised and issued 200,000 shares, each of 2,500 Swiss gold francs	500,000,000.—		
of which 25 % paid up . . .		125,000,000.—	10.5
II—Reserves			
1. Legal Reserve Fund . . .	1,318,467.03		
2. Dividend Reserve Fund . .	2,689,570.55		
3. General Reserve Fund . .	5,379,141.10		
		9,387,178.68	0.8
III—Long term Deposits			
1. Annuity Trust Account . .	153,768,617.50		12.9
2. German Government Deposit	76,884,308.75		6.4
3. French Government Guarantee Fund.	68,648,520.43		5.8
		299,301,446.68	
IV—Short term and Sight Deposits			
1. Central Banks for their own account:			
(a) Not exceeding 3 months	351,743,460.34		29.5
(b) Sight	314,405,205.30		26.4
2. Central Banks for the account of others:		666,148,665.64	
Sight		53,392,952.18	4.5
3. Other depositors:			
Sight		8,147,447.68	0.7
V—Profits allocated for distribution on July 1, 1932			
1. Dividend to Shareholders at the rate of 6 % per annum	6,446,770.83		
2. Participation of long-term depositors per Article 53 (e) of the Statutes	3,190,762.75		
		9,637,533.58	0.8
VI—Miscellaneous Items		20,695,942.59	1.7
		1,191,711,167.03	100

GATES W. MCGARRAH,
President.

FISCAL AGENT OF THE TRUSTEES

Statements of receipts and payments

	Dollars
Nominal amount originally issued	110,000,000.—
Nominal amount outstanding as at April 15, 1932 . . .	74,200,400.—
RECEIPTS	
Balances in the hands of Paying Agents as at October 16, 1931	2,354,435.85
Received from the German Government in respect of:	
Interest	2,597,439.72
Redemption	2,310,000.—
Expenses	8,121.23
Interest received on balances held by Paying Agents . .	14,909.35
	7,284,906.15
PAYMENTS	
Interest — matured coupons and accrued interest on bonds purchased for redemption	3,107,410.87
Redemption	
Bonds purchased for redemption	2,340,905.—
Drawn bonds reimbursed (after adjustment in respect of detached unmatured coupons)	28,294.—
Expenses	
Commission and other charges of Paying Agents . .	17,618.49
Fees and expenses of Trustees and their Fiscal Agent	—
Balances in the hands of Paying Agents as at April 15, 1932	
Interest Fund	457,198.58
Redemption Fund	236,086.—
Expenses Fund	93,246.71
Matured coupons unrepresented	1,001,245.—
Drawn bonds unrepresented	2,901.50
	7,284,906.15

Dated: Basle, May 2, 1932.

FOR THE GERMAN EXTERNAL LOAN 1924 *
for the half-year ended April 15, 1932

Sterling	Lire	Swedish Kronen	Swiss Francs
21,720,000.—.— 18,235,700.—.—	100,000,000.— 84,249,500.—	25,200,000.— 21,753,000.—	15,000,000.— 12,630,000.—
679,931.17. 7	3,878,661.16	192,082.29	565,573.90
634,310. 8. 6	2,931,762.60	750,266.36	444,823.90
275,208.10. 6	1,269,500.—	320,000.—	190,411.80
1,624. 4. 5	7,582.75	1,919.50	48,732.18
7,951.11. 8	10,560.—	9,922.91	1,415.75
1,599,026.12. 8	8,098,066.51	1,274,191.06	1,250,957.53
670,938.12. 1	3,027,767.60	761,355.—	453,601.35
248,245.10.10	1,276,552.—	—	208,785.—
2,779.—.—	25,912.50	—	—
2,872. 5. 2	12,423.95	1,903.39	3,183.75
—	—	—	47,590.73
108,950.17. 2	500,829.55	126,892.50	75,448.30
31,023. 6.10	125,358.35	373,333.35	Dr. 1.60
17,944.13. 7	46,630.06	10,706.82	6,700.—
515,791.17.—	3,069,850.—	—	454,545.—
480.10.—	12,742.50	—	1,105.—
1,599,026.12. 8	8,098,066.51	1,274,191.06	1,250,957.53

GATES W. MCGARRAH,
President.

* This is one of the several regular statements issued.

CONVENTION¹
RESPECTING THE
BANK FOR INTERNATIONAL SETTLEMENTS

THE duly authorised representatives of the Governments of Germany, of Belgium, of France, of the United Kingdom of Great Britain and Northern Ireland, of Italy and of Japan of the one part

And the duly authorised representatives of the Government of the Swiss Confederation of the other part

Assembled at The Hague Conference in the month of January, 1930, have agreed on the following:

Article 1. Switzerland undertakes to grant to the Bank for International Settlements, without delay, the following constituent charter having force of law: not to abrogate this charter, not to amend or add to it, and not to sanction amendments to the Statutes of the Bank referred to in paragraph 4 of the charter otherwise than in agreement with the other signatory Governments.

Art. 2. Any dispute between the Swiss Government and any one of the other signatory Governments relating to the interpretation or application of the present Convention shall be submitted to the Arbitral Tribunal provided for by The Hague Agreement of January, 1930. The Swiss Government may appoint a member who shall sit on the occasion of such disputes, the President having a casting vote. In having recourse to this Tribunal the Parties may always agree between themselves to submit their dispute to the President or to one of the members of the Tribunal chosen to act as sole arbiter.

Art. 3. The present Convention is entered into for a period of 15 years. It is entered into on the part of Switzerland under reserve of ratification and shall be put into force as soon as it shall have been ratified by the Government of the Swiss Confederation.

The instrument of ratification shall be deposited with the Min-

¹ In respect to the Convention, Charter and Statutes the French text takes precedence.

istry of Foreign Affairs at Paris. Upon the entry into force of the Convention, the Swiss Government will initiate the necessary constitutional procedure in order that the assent of the Swiss people may be obtained for the maintenance in force during the whole of the Bank's existence of the provisions of the present Convention. As soon as these measures have become fully effective the Swiss Government will notify the other signatory Governments and these provisions shall become valid during the Bank's existence.

CONSTITUENT CHARTER
OF THE
BANK FOR INTERNATIONAL SETTLEMENTS

WHEREAS the Powers signatory to The Hague Agreement of January, 1930, have adopted a Plan which contemplates the founding by the Central Banks of Belgium, France, Germany, Great Britain, Italy and Japan and by a financial institution of the United States of America of an International Bank to be called the Bank for International Settlements;

And whereas the said central banks and a banking group including Messrs. J. P. Morgan & Company of New York, the First National Bank of New York, New York, and the First National Bank of Chicago, Chicago, have undertaken to found the said Bank and have guaranteed or arranged for the guarantee of the subscription of its authorised capital amounting to five hundred million Swiss Francs equal to 145,161,290.32 gr. fine gold, divided into 200,000 shares;

And whereas the Swiss Federal Government has entered into a treaty with the Governments of Germany, Belgium, France, Great Britain, Italy and Japan whereby the said Federal Government has agreed to grant the present Constituent Charter of the Bank for International Settlements and not to repeal, amend or supplement the said Charter and not to sanction amendments to the Statutes of the Bank referred to in Paragraph 4 of the present Charter except in agreement with the said Powers;

(1) The Bank for International Settlements (hereinafter called the Bank) is hereby incorporated.

(2) Its constitution, operations and activities are defined and governed by the annexed Statutes which are hereby sanctioned.

(3) Amendment of Articles of the said Statutes other than those enumerated in Paragraph 4 hereof may be made and shall be put into force as provided in Article 59 of the said Statutes and not otherwise.

(4) Articles 2, 3, 4, 9, 15, 20, 25, 28, 46, 53, 56, 59 and 60 of the said Statutes shall not be amended except subject to the following conditions: the amendment must be adopted by a two-thirds majority of the Board approved by a majority of the General Meeting and sanctioned by a law supplementing the present Charter.

(5) The said Statutes and any amendments which may be made thereto in accordance with Paragraphs 3 or 4 hereof respectively shall be valid and operative notwithstanding any inconsistency therewith in the provisions of any present or future Swiss law.

(6) The Bank shall be exempt and immune from all taxation included in the following categories:

(a) stamp, registration and other duties on all deeds or other documents relating to the incorporation or liquidation of the Bank;

(b) stamp and registration duties on any first issue of its shares by the Bank to a central bank, financial institution, banking group or underwriter at or before the time of incorporation or in pursuance of Articles 7 or 9 of the Statutes;

(c) all taxes on the Bank's capital, reserves or profits, whether distributed or not, and whether assessed on the profits of the Bank before distribution or imposed at the time of distribution under the form of a coupon tax payable or deductible by the Bank. This provision is without prejudice to the State's right to tax the residents of Switzerland other than the Bank as it thinks fit;

(d) all taxes upon any agreements which the Bank may make in connection with the issue of loans for mobilising the German annuities and upon the bonds of such loans issued on a foreign market;

(e) all taxes on the remunerations and salaries paid by the Bank to members of its administration or its employees of non-Swiss nationality.

(7) All funds deposited with the Bank by any Government in pursuance of the Plan adopted by The Hague Agreement of January, 1930, shall be exempt and immune from taxation whether by way of deduction by the Bank on behalf of the authority imposing the same or otherwise.

(8) The foregoing exemptions and immunities shall apply to present and future taxation by whatever name it may be described, and whether imposed by the Confederation, or by the cantonal, communal or other public authorities.

(9) Moreover, without prejudice to the exemptions specified above, there may not be levied on the Bank, its operation or its personnel any taxation other than that of a general character and to which other banking establishments established at Basle or in Switzerland, their operations and their personnel, are not subjected *de facto* and *de jure*.

(10) The Bank, its property and assets and all deposits and

other funds entrusted to it shall be immune in time of peace and in time of war from any measure such as expropriation, requisition, seizure, confiscation, prohibition or restriction of gold or currency export or import, and any other similar measures.

(11) Any dispute between the Swiss Government and the Bank as to the interpretation or application of the present Charter shall be referred to the Arbitral Tribunal provided for by The Hague Agreement of January, 1930.

The Swiss Government shall appoint a member to sit on the occasion of such dispute, the President having a casting vote.

In having recourse to the said Tribunal the Parties may nevertheless agree to submit their dispute to the President or to a member of the Tribunal chosen to act as sole Arbiter.

Done at The Hague, the 20th January, 1930.

STATUTES OF THE BANK FOR INTERNATIONAL SETTLEMENTS

CHAPTER I

NAME, SEAT AND OBJECTS

Article 1. There is constituted under the name of the Bank for International Settlements (hereinafter referred to as the Bank) a Company limited by shares.

Art. 2. The registered office of the Bank shall be situated at *Basle*, Switzerland.

Art. 3. The objects of the Bank are: to promote the cooperation of central banks and to provide additional facilities for international financial operations; and to act as trustee or agent in regard to international financial settlements entrusted to it under agreements with the parties concerned.

Art. 4. As long as the New Plan as defined in The Hague Agreement of January, 1930 (hereinafter referred to as the Plan) is in force, the Bank:

- (i) shall carry out the functions assigned to it in the Plan;
- (ii) shall conduct its affairs with a view to facilitating the execution of the Plan; and
- (iii) shall observe the provisions of the Plan in the administration and operations of the Bank;

all within the limits of the powers granted by these Statutes.

During the said period the Bank, as trustee or agent for the Governments concerned, shall receive, administer and distribute the annuities paid by Germany under the Plan; shall supervise and assist in the commercialization and mobilization of certain portions of the aforesaid annuities; and shall perform such services in connection with the payment of German Reparations and the international settlements connected therewith as may be agreed upon by the Bank with the Governments concerned.

CHAPTER II

CAPITAL

Art. 5. The authorised capital of the Bank shall be 500,000,000 Swiss gold francs, equivalent to 145,161,290.32 gr. fine gold.

It shall be divided into 200,000 shares of equal gold nominal value.

The nominal value of each share shall also be expressed on the face of each share in terms both of Swiss francs and of the currency of the country in which it is issued, converted at the gold mint parity.

Art. 6. The subscription of the total authorised capital having been guaranteed in equal parts by the Banque Nationale de Belgique, the Bank of England, the Banque de France, the Reichsbank, Banca d'Italia, a banking group represented by the Industrial Bank of Japan acting in place of the Bank of Japan, and Messrs. J. P. Morgan & Company of New York, the First National Bank of New York, New York, and the First National Bank of Chicago, Chicago, the Bank may begin business as soon as a minimum of 112,000 shares has been subscribed.

Art. 7. (1) During the two years following incorporation the Board of Directors of the Bank (hereinafter referred to as the Board) shall arrange for the subscription of any unissued portion of the authorised capital.

(2) This unissued portion may be offered to the central banks or other banks of countries which have not participated in the original subscription. The selection of countries in which such shares shall be offered for subscription and the amount to be subscribed in each shall be determined by the Board by a two-thirds majority, provided that offers of shares shall only be made in countries interested in Reparations or in countries whose currencies, in the opinion of the Board, satisfy the practical requirements of the gold or gold exchange standard and that the amount issued in any one of these countries shall not exceed 8,000 shares.

(3) The seven Banking Institutions mentioned in Article 6 shall, in accordance with their several guarantees, subscribe or arrange for the subscription in equal proportions of any part of the authorised capital which at the end of two years remains unsubscribed.

Art. 8. (1) Twenty-five per cent. only of the value of each share shall be paid up at the time of subscription. The balance may be called up at a later date or dates at the discretion of the Board. Three months' notice shall be given of any such calls.

(2) If a shareholder fails to pay any call on a share on the day appointed for payment thereof the Board may, after giving reasonable notice to such shareholder, forfeit the share in respect of which the call remains unpaid. A forfeited share may be sold on such terms and in such manner as the Board may think fit; and the Board may execute a transfer in favour of the person or

corporation to whom the share is sold. The proceeds of sale may be received by the Bank, which will pay to the defaulting shareholder any part of the net proceeds over and above the amount of the call due and unpaid.

Art. 9. (1) The capital of the Bank may be increased or reduced on the proposal of the Board acting by a two-thirds majority and adopted by a two-thirds majority of the General Meeting.

(2) In the event of an increase in the authorised capital of the Bank and of a further issue of shares the distribution among countries shall be decided by a two-thirds majority of the Board. The central banks of Belgium, England, France, Germany, Italy, Japan, and the U. S. A., or some other financial institution of the last-named country acceptable to the foregoing central banks, shall be entitled to subscribe or arrange for the subscription in equal proportions of at least 55 per cent. of such additional shares.

(3) No part of the amount not taken by the banks of these seven countries shall be subscribed in any other country unless it is interested in Reparations or at the time of issue its currency, in the opinion of the Board, satisfies the practical requirements of the gold or gold exchange standard.

Art. 10. In extending invitations to subscribe for capital in accordance with Article 7, paragraph 2, or with Article 9, consideration shall be given by the Board to the desirability of associating with the Bank the largest possible number of central banks.

Art. 11. No shares shall be issued below par.

Art. 12. The liability of shareholders is limited to the nominal value of their shares.

Art. 13. The shares shall be registered and transferable in the books of the Bank.

The Bank shall be entitled without assigning any reason to decline to accept any person or corporation as the transferee of a share. It shall not transfer shares without the prior consent of the central bank, or the institution acting in lieu of a central bank, by or through whom the shares in question were issued.

Art. 14. The shares shall carry equal rights to participate in the profits of the Bank and in any distribution of assets under Articles 53, 54, and 55 of the Statutes.

Art. 15. The ownership of shares of the Bank carries no right of voting or representation at the General Meeting. The right of representation and of voting, in proportion to the number of shares subscribed in each country, may be exercised by the cen-

tral bank of that country or by its nominee. Should the central bank of any country not desire to exercise these rights they may be exercised by a financial institution of widely recognized standing and of the same nationality, appointed by the Board, and not objected to by the central bank of the country in question. In cases where there is no central bank, these rights may be exercised, if the Board thinks fit, by an appropriate financial institution of the country in question appointed by the Board.

Art. 16. Any subscribing institution or banking group may issue, or cause to be issued to the public the shares for which it has subscribed.

Art. 17. Any subscribing institution or banking group may issue to the public certificates against shares of the Bank owned by it. The form, details and terms of issue of such certificates shall be determined by the Bank issuing them, in agreement with the Board.

Art. 18. The receipt of ownership of shares of the Bank or of certificates issued in accordance with Article 17 implies acceptance of the Statutes of the Bank and a statement to that effect shall be embodied in the text of such shares and certificates.

Art. 19. The registration of the name of a holder of shares in the books of the Bank establishes the title to ownership of the shares so registered.

CHAPTER III

POWERS OF THE BANK

Art. 20. The operations of the Bank shall be in conformity with the monetary policy of the central banks of the countries concerned.

Before any financial operation is carried out by or on behalf of the Bank on a given market or in a given currency the Board shall afford to the central bank or central banks directly concerned an opportunity to dissent. In the event of disapproval being expressed within such reasonable time as the Board shall specify, the proposed operation shall not take place. A central bank may make its concurrence subject to conditions and may limit its assent to a specific operation, or enter into a general arrangement permitting the Bank to carry on its operations within such limits as to time, character and amount as may be specified. This Article shall not be read as requiring the assent of any central bank to the withdrawal from its market of funds to the introduction of which no objection had been raised by it, in the absence of stipulations to the contrary by the central bank concerned at the time the original operation was carried out.

Any Governor of a central bank, or his alternate or any other Director specially authorised by the central bank of the country of which he is a national to act on its behalf in this matter, shall, if he is present at the meeting of the Board and does not vote against any such proposed operation, be deemed to have given the valid assent of the central bank in question.

If the representative of the central bank in question is absent or if a central bank is not directly represented on the Board, steps shall be taken to afford the central bank or banks concerned an opportunity to express dissent.

Art. 21. The operations of the Bank for its own account shall only be carried out in currencies which in the opinion of the Board satisfy the practical requirements of the gold or gold exchange standard.

Art. 22. The Board shall determine the nature of the operations to be undertaken by the Bank.

The Bank may in particular:

(a) buy and sell gold coin or bullion for its own account or for the account of central banks;

(b) hold gold for its own account under earmark in central banks;

(c) accept the custody of gold for account of central banks;

(d) make advances to or borrow from central banks against gold, bills of exchange and other short-term obligations of prime liquidity or other approved securities;

(e) discount, rediscount, purchase or sell with or without its endorsement bills of exchange, cheques and other short-term obligations of prime liquidity, including Treasury Bills and other such Government short-term securities as are currently marketable;

(f) buy and sell exchange for its own account or for the account of central banks;

(g) buy and sell negotiable securities other than shares for its own account or for the account of central banks;

(h) discount for central banks bills taken from their portfolio and rediscount with central banks bills taken from its own portfolio;

(i) open and maintain current or deposit accounts with central banks;

(j) accept:

(i) deposits from central banks on current or deposit account;

(ii) deposits in connection with trustee agreements that may be made between the Bank and Governments in connection with international settlements;

(iii) such other deposits as in the opinion of the Board come within the scope of the Bank's functions.

The Bank may also:

(k) act as agent or correspondent of any central bank;

(l) arrange with any central bank for the latter to act as its agent or correspondent. If a central bank is unable or unwilling to act in this capacity, the Bank may make other arrangements, provided that the central bank concerned does not object. If, in such circumstances, it should be deemed advisable that the Bank should establish its own agency, the sanction of a two-thirds majority of the Board will be required;

(m) enter into agreements to act as trustee or agent in connection with international settlements, provided that such agreements shall not encroach on the obligations of the Bank towards third parties; and carry out the various operations laid down therein.

Art. 23. Any of the operations which the Bank is authorised to carry out with central banks under the preceding Article may be carried out with banks, bankers, corporations or individuals of any country provided that the central bank of that country does not object.

Art. 24. The Bank may enter into special agreements with central banks to facilitate the settlement of international transactions between them.

For this purpose it may arrange with central banks to have gold earmarked for their account and transferable on their order, to open accounts through which central banks can transfer their assets from one currency to another and to take such other measures as the Board may think advisable within the limits of the powers granted by these Statutes. The principles and rules governing such accounts shall be fixed by the Board.

Art. 25. The Bank may not:

- (a) issue notes payable at sight to bearer;
- (b) "accept" bills of exchange;
- (c) make advances to Governments;
- (d) open current accounts in the name of Governments;
- (e) acquire a predominant interest in any business concern;
- (f) except so far as is necessary for the conduct of its own business, remain the owner of real property for any longer period than is required in order to realise to proper advantage such real property as may come into the possession of the Bank in satisfaction of claims due to it.

Art. 26. The Bank shall be administered with particular regard to maintaining its liquidity, and for this purpose shall retain

assets appropriate to the maturity and character of its liabilities. Its short-term liquid assets may include bank notes, cheques payable on sight drawn on first class banks, claims in course of collection, deposits at sight or at short notice in first class banks, and prime bills of exchange of not more than ninety days usance, of a kind usually accepted for rediscount by central banks.

The proportion of the Bank's assets held in any given currency shall be determined by the Board with due regard to the liabilities of the Bank.

CHAPTER IV

MANAGEMENT

Art. 27. The administration of the Bank shall be vested in the Board.

Art. 28. The Board shall be composed as follows:

(1) The Governors for the time being of the central banks of Belgium, France, Germany, Great Britain, Italy, Japan and the United States of America (hereinafter referred to as *ex-officio* Directors), or if any of the said Governors are unwilling or unable to hold office, their respective nominees (hereinafter referred to as substitute nominees).

The tenure of office of a substitute nominee shall be within the discretion of the Governor by whom he is appointed, but shall terminate in any case when that Governor vacates office.

Any *ex-officio* Director may appoint one person as his alternate who shall be entitled to attend and exercise the powers of a Director at meetings of the Board if the Governor himself is unable to be present.

(2) Seven persons representative of finance, industry or commerce, appointed one each by the Governors of the central banks mentioned in sub-clause (1) and being of the same nationality as the Governor who appoints him.

During the continuance of the liability of Germany to pay Reparation annuities, two persons of French and German nationality respectively, representative of industry or commerce, appointed by the Governors of the Bank of France and of the Reichsbank respectively, if they so desire.

If for any reason the Governor of any of the seven institutions above mentioned is unable or unwilling to serve as Director, or to appoint a substitute nominee under sub-clause (1), or to make an appointment under sub-clause (2), the Governors of the other institutions referred to or a majority of them may invite

to become members of the Board two nationals of the country of the Governor in question, not objected to by the central bank of that country.

Directors appointed as aforesaid other than *ex-officio* Directors or their substitute nominees shall hold office for three years but shall be eligible for reappointment.

(3) Not more than nine persons to be elected by the following procedure:—

The Governor of the central bank of every country, other than those mentioned in sub-clause (1), in which capital has been subscribed at the time of incorporation shall be entitled to submit a list of four candidates of his own nationality for directorship, which may include his own name. Two of the candidates on each list shall be representative of finance, and the other two of industry or commerce. From these lists the Board may elect, by a two-thirds majority, not more than nine persons.

The Directors so elected shall be divided by lot into three groups, as nearly as may be equal in number, of which one group shall retire at the end of the first, one at the end of the second, and one at the end of the third financial year of the Bank. The retiring Directors shall be eligible for re-election.

At the first meeting of the Directors in the second and succeeding financial years the Board may elect by a two-thirds majority not more than three Directors from a panel of candidates composed of lists of persons with similar qualifications to those specified in connection with the first election. The Governors of the central banks of every country, other than those mentioned in sub-clause (1), in which capital has at the date of such meeting been subscribed shall be entitled to submit a list of four persons to be included in the panel. Directors so elected shall hold office for three years, but shall be eligible for re-election.

If in any of the countries referred to in the preceding paragraph there is no central bank, the Board by a two-thirds majority may nominate an appropriate financial institution to exercise the right of submitting a list of candidates for election.

Art. 29. In the event of a vacancy occurring on the Board for any reason other than the termination of a period of office in accordance with the preceding Article the vacancy shall be filled in accordance with the procedure by which the member to be replaced was selected. In the case of Directors other than *ex-officio* Directors, the new Director shall hold office for the unexpired period only of his predecessor's term of office. He shall, however, be eligible for re-election at the expiration of that term.

Art. 30. Directors must be ordinarily resident in Europe or in a position to attend regularly at meetings of the Board.

Art. 31. No person shall be appointed or hold office as a Director who is a member or an official of a Government, or is a member of a legislative body, unless he is the Governor of a central bank.

Art. 32. Meetings of the Board shall be held not less than ten times a year. At least four of these shall be held at the registered office of the Bank.

Art. 33. A member of the Board who is not present in person at a meeting of Directors may give a proxy to any other member authorising him to vote at that meeting on his behalf.

Art. 34. Unless otherwise provided by the Statutes, decisions of the Board shall be taken by a simple majority of those present or represented by proxy. In the case of an equality of votes, the Chairman shall have a second or casting vote.

The Board shall not be competent to act unless a quorum of Directors is present. This quorum shall be laid down in a regulation adopted by a two-thirds majority of the Board.

Art. 35. The members of the Board may receive, in addition to out-of-pocket expenses, a fee for attendance at meetings and/or a remuneration, the amounts of which will be fixed by the Board, subject to the approval of the General Meeting.

Art. 36. The proceedings of the Board shall be summarised in minutes which shall be signed by the Chairman.

Copies of or extracts from these minutes for the purpose of production in a Court of Justice must be certified by the General Manager of the Bank.

A record of decisions taken at each meeting shall be sent within eight days of the meeting to every member.

Art. 37. The Board shall represent the Bank in its dealings with third parties and shall have the exclusive right of entering into engagements on behalf of the Bank. It may however delegate this right to a member or members of the Board or of the permanent staff of the Bank, provided that it defines the powers of each person to whom it delegates this right.

Art. 38. The Bank shall be legally committed *vis-à-vis* third parties by the signature of the President or by two signatures either of members of the Board or of members of the staff who have been duly authorised by the Board to sign on its behalf.

Art. 39. The Board shall elect from among its members a Chairman and one or more Vice-Chairmen, one of whom shall preside at meetings of the Board in the absence of the Chairman.

The Chairman of the Board shall be President of the Bank. He shall hold office for three years and shall be eligible for re-election.

Subject to the authority of the Board, the President will carry out the policy and control the administration of the Bank.

He shall not hold any other office which, in the judgment of the Board, might interfere with his duties as President.

Art. 40. At the meeting of the Board at which the election of a Chairman is to take place, the Chair shall be taken by the oldest member of the Board present.

Art. 41. A General Manager shall be appointed by the Board on the proposal of the President. He will be responsible to the President for the operations of the Bank and will be the chief of its operating staff.

The Heads of Departments, and any other officers of similar rank, shall be appointed by the Board on recommendations made by the President after consultation with the General Manager.

The remainder of the staff shall be appointed by the General Manager with the approval of the President.

Art. 42. The departmental organisation of the Bank shall be determined by the Board.

Art. 43. The Board may, if it thinks fit, appoint from among its members an Executive Committee to assist the President in the administration of the Bank.

The President shall be a member and *ex-officio* Chairman of this Committee.

Art. 44. The Board may appoint advisory committees chosen wholly or partly from persons not concerned in the Bank's management.

Art. 45. As long as the Plan is in force, the Board shall convene the Special Advisory Committee referred to in the Plan upon receipt of the notice therein provided for.

CHAPTER V

GENERAL MEETING

Art. 46. General Meetings of the Bank may be attended by nominees of the central banks or other financial institutions referred to in Article 15.

Voting rights shall be in proportion to the number of shares subscribed in the country of each institution represented at the meeting.

The Chair shall be taken at General Meetings by the Chairman of the Board or in his absence by a Vice-Chairman.

At least three weeks' notice of General Meetings shall be given to those entitled to be represented.

Subject to the provisions of these Statutes, the General Meeting shall decide upon its own procedure.

Art. 47. Within three months after the end of each financial year of the Bank, an Annual General Meeting shall be held upon such date as the Board may decide.

The meeting shall take place at the registered office of the Bank.

Voting by proxy will be permitted in such manner as the Board may have provided in advance by regulation.

Art. 48. The Annual General Meeting shall be invited:

(a) to approve the Annual Report, the Balance Sheet upon the Report of the Auditors, and the Profit and Loss Account, and any proposed changes in the remuneration, fees or allowances of the members of the Board;

(b) to make appropriations to Reserve and to Special Funds; and to consider the declaration of a dividend and its amount;

(c) to elect the auditors for the ensuing year and to fix their remuneration; and

(d) to discharge the Board from all personal responsibility in respect of the past financial year.

Art. 49. Extraordinary General Meetings shall be summoned to decide upon any proposals of the Board:

(a) to amend the Statutes;

(b) to increase or decrease the capital of the Bank;

(c) to liquidate the Bank.

CHAPTER VI

ACCOUNTS AND PROFITS

Art. 50. The financial year of the Bank will begin on 1st April and end on 31st March. The first financial period will end on 31st March, 1931.

Art. 51. The Bank shall publish an Annual Report, and at least once a month a Statement of Account in such form as the Board may prescribe.

The Board shall cause to be prepared a Profit and Loss Account and Balance Sheet of the Bank for each financial year in time for submission to the Annual General Meeting.

Art. 52. The Accounts and Balance Sheet shall be audited by independent auditors. The auditors shall have full power to examine all books and accounts of the Bank and to require full information as to all its transactions. The auditors shall report

to the Board and to the General Meeting and shall state in their Report:

(a) whether or not they have obtained all the information and explanations they have required; and

(b) whether, in their opinion, the Balance Sheet dealt with in the Report is properly drawn up so as to exhibit a true and correct view of the state of the Bank's affairs according to the best of their information and the explanations given to them and as shown by the books of the Bank.

Art. 53. The yearly net profits of the Bank shall be applied as follows:

(a) Five per cent. of such net profits or such proportion of five per cent. as may be required for the purpose, shall be paid to a reserve fund called the Legal Reserve Fund until that Fund reaches an amount equal in value to ten per cent. of the amount of the paid-up capital of the Bank for the time being;

(b) thereafter such net profits shall be applied in or towards the payment of a dividend of six per cent. per annum on the amount of the paid-up capital of the Bank. This dividend shall be cumulative;

(c) as to the residue (if any) of such net profits twenty per cent. shall be paid to the shareholders until a maximum further dividend of six per cent. (which shall be non-cumulative) is reached, provided that the Board may in any year withhold all or any part of this additional payment and place it to the credit of a special dividend reserve fund for use in maintaining the cumulative six per cent. dividend provided for in the preceding paragraph or for subsequent distribution to the shareholders;

(d) after making provision for the foregoing, one-half of the yearly net profits then remaining shall be paid into the General Reserve Fund of the Bank until it equals the paid-up capital. Thereafter forty per cent. shall be so applied until the General Reserve Fund equals twice the paid-up capital; thirty per cent. until it equals three times the paid-up capital; twenty per cent. until it equals four times the paid-up capital; ten per cent. until it equals five times the paid-up capital; and from that point onward, five per cent.

In case the General Reserve Fund, by reason of losses or by reason of an increase in the paid-up capital, falls below the amounts provided for above after having once attained them, the appropriate proportion of the yearly net profits shall again be applied until the position is restored;

(e) as long as the Plan is in force any remainder of the net

profits after meeting the foregoing requirements shall be disposed of as follows:

(i) as to seventy-five per cent. to such of the Governments or central banks of Germany and the countries entitled to share in the annuities payable under the Plan as have maintained time deposits at the Bank subject to withdrawal in not less than five years from the time of deposit or after four years on not less than one year's notice. This sum shall be distributed annually in proportion to the size of the deposits maintained by the respective Governments of central banks in question. The Board shall have the power to determine the minimum deposit which would justify the distribution provided for:

(ii) as to twenty-five per cent. as follows:

If the German Government elects to make a long-term deposit with the Bank withdrawable only on the terms specified under sub-clause (i) above and amounting to the minimum sum of 400,000,000 reichsmarks, the said twenty-five per cent. shall go into a Special Fund, to be used to aid Germany in paying the last twenty-two annuities provided for in the Plan.

If the German Government elects to make such long-term deposit amounting to a sum below 400,000,000 reichsmarks, the participation of the German Government shall be reduced in proportion, and the balance shall be added to the seventy-five per cent. referred to in sub-clause (i) above.

If the German Government elects not to make any such long-term deposit, the said twenty-five per cent. shall be distributed as provided in sub-clause (i) above.

The Special Fund referred to above shall carry compound interest, reckoned on an annual basis, at the maximum current rate paid by the Bank on time deposits.

If the Special Fund should exceed the amount required to pay the last twenty-two annuities, the balance shall be distributed among the creditor Governments as provided for in the Plan;

(f) at the expiration of the period referred to in the first paragraph of sub-clause (e) the disposal of the remainder of the net profits referred to in sub-clause (e) shall be determined by the General Meeting on the proposal of the Board.

Art. 54. Reserve Funds. The General Reserve Fund shall be available for meeting any losses incurred by the Bank. In case

it is not adequate for this purpose, recourse may be had to the Legal Reserve Fund provided for in Article 53 (a).

These reserve funds in the event of liquidation, and after the discharge of the liabilities of the Bank and the costs of liquidation, shall be divided among the shareholders.

CHAPTER VII

GENERAL PROVISIONS

Art. 55. The Bank may not be liquidated except by a three-fourths majority of the General Meeting. It shall not in any case be liquidated before it has discharged all the obligations which it has assumed under the Plan.

Art. 56. (1) If any dispute shall arise between the Bank, on the one side, and any central bank, financial institution, or other bank referred to in the present Statutes, on the other side, or between the Bank and its shareholders with regard to the interpretation or application of the Statutes of the Bank, the same shall be referred for final decision to the Tribunal provided for by The Hague Agreement of January, 1930.

(2) In the absence of agreement as to the terms of submission either party to a dispute under this Article may refer the same to the Tribunal, which shall have power to decide all questions (including the question of its own jurisdiction) even in default of appearance by the other party.

(3) Before giving a final decision and without prejudice to the questions at issue, the President of the Tribunal or, if he is unable to act in any case, a member of the Tribunal to be designated by him forthwith, may, on the request of the first party applying therefor, order any appropriate provisional measures in order to safeguard the respective rights of the parties.

(d) The provisions of this Article shall not prejudice the right of the parties to a dispute to refer the same by common consent to the President or a member of the Tribunal as sole arbitrator.

Art. 57. In all cases not covered by the preceding Article or by some other provision for arbitration the Bank may proceed or be proceeded against in any court of competent jurisdiction.

Art. 58. For the purposes of these Statutes:

(1) Central bank means the bank in any country to which has been entrusted the duty of regulating the volume of currency and credit in that country; or, where a banking system has been so entrusted, the bank forming part of such system which is situated and operating in the principal financial market of that country.

(2) The Governor of a central bank means the person who subject to the control of his Board or other competent authority has the direction of the policy and administration of the Bank.

(3) A two-thirds majority of the Board means not less than two-thirds of the votes (whether given in person or by proxy) of the whole directorate.

Art. 59. Amendments of any Articles of these Statutes other than those enumerated in Article 60 may be proposed by a two-thirds majority of the Board to the General Meeting and if adopted by a majority of the General Meeting shall come into force, provided that such amendments are not inconsistent with the provisions of the Articles enumerated in Article 60.

Art. 60. Articles 2, 3, 4, 9, 15, 20, 25, 28, 46, 53, 56, 59, and 60 cannot be amended except subject to the following conditions: the amendment must be adopted by a two-thirds majority of the Board approved by a majority of the General Meeting and sanctioned by a law supplementing the Charter of the Bank.

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