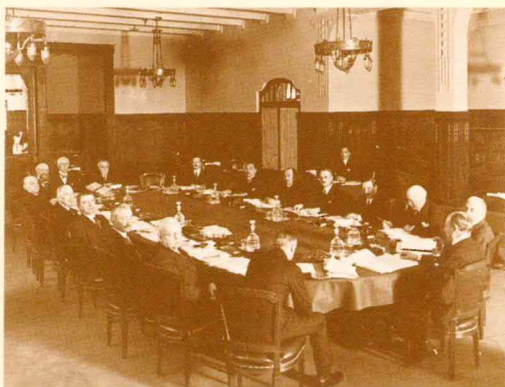

HISTORICAL PUBLICATIONS OF THE BANK OF ITALY

**THE ORIGINS
OF CENTRAL BANK COOPERATION**

THE ESTABLISHMENT OF THE BANK FOR INTERNATIONAL SETTLEMENTS

PAOLO BAFFI



with an essay on Paolo Baffi
by Antonio Fazio

Introduction
by Charles P. Kindleberger

EDITORI LATERZA

'Historical Publications of the Bank of Italy': documents, data and critical interpretations for a monetary history of modern Italy.

Paolo Baffi, the author of many writings in the field of economics and monetary analysis, returned to research upon leaving the helm of the Bank of Italy and worked on different issues and projects. His interest in historical research led him to undertake to write the history of the Bank for International Settlements, which he had served first as an outside consultant, then as a member of the Board of Directors and, finally, as Vice Chairman. Baffi died before he was able to make full use of the large quantity of material that he had assembled from archives in Europe and the United States and complete his historical investigation. However, he did leave us the manuscript published here, in which the complex negotiations and the meetings that led to the birth of the Bank for International Settlements are reconstructed and the principal events of the Bank's first two years of activity (1930-31) examined on the basis of unpublished sources.

On the cover: the first informal meeting of the Board of Directors of the Bank for International Settlements in April 1930. Historical Archive of the BIS. Photograph: Jeck, Basel.

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ESSAYS AND RESEARCH SERIES
VOLUME I

PAOLO BAFFI

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THE BANK FOR INTERNATIONAL SETTLEMENTS

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EDITORI LATERZA 2002

For the text by Baffi: © Paolo Baffi (†)
and the Bank for International Settlements

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PAOLO BAFFI, MONETARY ECONOMIST
AND CENTRAL BANK GOVERNOR

by Antonio Fazio*

1. Paolo Baffi was born in Broni, in the province of Pavia, on 5 August 1911. In 1930, while a second-year student at Luigi Bocconi University in Milan, he contributed a series of book reviews to the 'Giornale degli Economisti'. In 1930-31, on a scholarship, he studied at the London School of Economics, where the lectures of William Beveridge reinforced his interest in the issues of unemployment and social justice. He took his degree in November 1932 with a thesis on *Causes and aspects of the world economic depression*. From 1933 to 1936 he was assistant to Professor Giorgio Mortara in the Statistics Department of Bocconi University.

He left the University in March 1936 when he was called to the Bank of Italy by Vincenzo Azzolini as part of a plan to strengthen the Bank's Research Department. Here he played a major role in the compilation of credit statistics by branch of economic activity and the preparation of a three-volume study on the Italian economy in the period 1931-36,¹ continuing his collaboration with Mortara, who was adviser to the Bank of Italy for these projects.

Returning to the Bank after a wartime hiatus, in 1944 he was made Head of the Research Department; later, in 1956, he was appointed Economic Adviser.

* Governor of the Bank of Italy.

¹ Banca d'Italia, *L'economia italiana nel sessennio 1931-1936*, Istituto Poligrafico dello Stato, Rome 1938. See P. Baffi, *Testimonianze e ricordi*, Historical Research Office of the Bank of Italy, ed. Scheiwiller, Milan 1990, pp. 53 ff.

Under the guidance of Paolo Baffi economic research received a powerful stimulus, with theoretical analysis complementing empirical study of Italian economic problems. His analytical skills and ability to organise research were crucial in the immediate postwar period, when Italy's shaky economy needed to gain the confidence of the Allies. Baffi made his group of civil servants in the Research Department the Allies' preferred Italian interlocutor for economic questions.²

His own work was decisive in implanting in the Bank's staff the commitment to analytical rigour and independent judgment that would enable the central bank to serve the national interest.

Baffi was a member of the Committee set up by Marcello Soleri, the Treasury Minister, on 25 September 1944 to study the problems of postwar financial reconstruction; he also took part in the work of the Economic Committee of the Italian Constitutional Convention.

His collaboration with Luigi Einaudi, who was appointed Governor of the Bank of Italy in January 1945, began with the *Annual Reports* for 1943 and 1944. Immediately afterwards, Baffi worked with a group of Allied experts engaged in a preliminary assessment of the economic and monetary situation in Northern Italy. This collaboration paved the way to the fruitful cooperation between Italy and the United States on the problems of reconstruction.

In December 1946 the Board of Directors of the Bank for International Settlements (BIS) met again in Basle after a break of seven years. On that occasion the decision was taken to invite Per Jacobsson, the chief economist of the BIS, who was held in high esteem by Einaudi and Donato Menichella, to carry out a survey of the state of the Italian economy. Designated to work together with Jacobsson, in June 1947 Baffi went to Basle to draft the final report. This document was the international financial system's principal source of information on the economic situation of postwar Italy and helped to restore the country's access to foreign bank credit.³ A decade later, Baffi was made one of the two BIS outside

² P. Baffi, *Via Nazionale e gli Economisti Stranieri 1944-53*, in 'Rivista di Storia Economica', new series, 1985, no. 1, reprinted in P. Baffi, *Testimonianze e ricordi*, pp. 99 ff.

³ P. Baffi, *Testimonianze e ricordi*, p. 106.

economic advisers, together with Friedrich Lutz, a position he held from 1956 to 1960. His relationship with the BIS continued for the rest of his life, as is recounted in the foreword to this volume by the Bank's General Manager, A.D. Crockett. In 1988 Paolo Baffi was appointed Vice Chairman of the BIS Board of Directors.

In 1971 Baffi accepted an invitation to teach Monetary History and Policy at the Political Science Faculty of the University of Rome. His lectures, which continued regularly until 1979, hence during his years as Governor of the Bank of Italy, constituted an opportunity to reorder his ideas, to explain to his students the most important issues involved in official monetary policy documents and decisions, and to respond to objections and correct shortcomings revealed by critical review.

The importance he attached to research and his generous commitment to the preparation of young people made Paolo Baffi a model of method and style for all those, both inside and outside the Bank of Italy, engaged in work on monetary economics.

2. Baffi worked closely with Einaudi and Menichella and was their valued adviser. During their governorships he constructed the first statement about the flow of monetary savings and the money supply. Initially focused on central bank transactions, the survey was subsequently extended to the entire money supply, in order to identify the different sources of credit and money creation.⁴ His analysis focused on the interactions between the domestic and foreign components of changes in the money supply: while an excessive expansion of the domestic component, implemented with the aim of stimulating economic activity,⁵ could be neutralized by a contraction in the foreign component, he noted that an appropriate share of monetary base creation needed to come from the foreign sector in order to bring the reserves into line with the growth in foreign trade.⁶ He also

⁴ P. Baffi, *Monetary analysis in Italy*, IMF Staff Papers, February 1957.

⁵ P. Baffi, *La componente esterna della liquidità e le regole della condotta monetaria*, Cedam, Padua 1960; offprint from 'Giornale degli Economisti e Annali di economia', November-December 1960, reprinted in P. Baffi, *Nuovi studi sulla moneta*, Giuffrè, Milan 1973.

⁶ 'Growth requires the central bank to supply the amount of liquidity that will sustain it. Convertibility, and the expansion in foreign trade associated with growth, require it to increase its external reserve assets in relation to

carried out important empirical research on the determinants of the behaviour of currency in circulation.⁷

Baffi was a monetary economist who was averse to analytical simplifications. On more than one occasion he pointed out the need when assessing the effects of monetary policy to take account of the causes of changes in the velocity of circulation and the evolution of the financial structure. His monetary analysis was always underpinned by systematic attention to the problems and development of the 'real' economy. He wrote several masterly essays on Italian monetary history.⁸

When Guido Carli was named Governor in 1960, Baffi was appointed Director General and his research activity consequently grew less intense, as he himself noted. He reflected increasingly and with great acumen on issues concerning the international economy, prompted by the return of the European currencies to convertibility and stimulated by Guido Carli's vision and long experience in this field.

Baffi held that the basic cause of the economic and political instability of the thirties, with its calamitous social and political consequences, had been the lack of international cooperation. The Bretton Woods Agreements had marked the return to a regime of fixed exchange rates, with central banks committed to maintaining the stability of their currencies' internal and external value.⁹

Many of Baffi's writings of the sixties testify to his conviction that fixed exchange rates were preferable,¹⁰ and that monetary

domestic liquidity (some of which may at any time be turned into demand for foreign exchange) and other relevant yardsticks, such as the freedom of foreign transactions'. P. Baffi, *Western European Inflation and the Reserve Currencies*, in 'Banca Nazionale del Lavoro Quarterly Review', no. 84, March 1968, p. 11.

⁷ P. Baffi and A. Occhiuto, *Osservazioni sull'andamento della circolazione*, March 1954, in P. Baffi, *Studi sulla moneta*.

⁸ See the essays in *Studi sulla moneta* and *Nuovi studi sulla moneta*.

⁹ In 1961 Baffi remarked: 'The thirty years from 1930 to 1960 can be divided into two equal periods. In the first half the fabric of international trade was lacerated. In the second that fabric was reconstructed in forms that in part looked back to the former design and in part set a course of development that is still under way'. See P. Baffi, *Il dare e l'avere dei rapporti finanziari internazionali*, speech given at the Pavia Chamber of Commerce on 31 October 1961, published in 'Quaderni economici della Camera di Commercio Industria e Agricoltura di Pavia', no. 3, 1961.

¹⁰ See, for example, P. Baffi, *Western European Inflation and the Reserve Currencies*.

policy, which continued to be assigned a crucial role in fostering macroeconomic equilibrium, had to be set in a consistent economic and social policy context. In his thinking Baffi took account of Carli's ideas, discussions with the Bank's top managers and the studies conducted by the Bank's Research Department, which had made important progress in the sixties, particularly with the construction of the econometric model.¹¹

Objecting to the insulating power of floating rates, Baffi favoured 'an exchange structure of almost absolute rigidity'.¹² In part this was because he feared that a floating rate regime would slow down European integration, 'since in the promotion of policy coordination less can be expected from the deliberations of experts and ministers than from the compelling force of fixed exchange rates'.¹³

With the rapid growth of the international financial markets in the sixties, the world monetary system had acquired several important features which were potentially incompatible with fixed exchange rates and monetary stability. However, Baffi underscored that these developments now made it possible to finance external imbalances through the market, thereby reducing the need for substantial movements of official reserves.¹⁴ After evaluating the creditworthiness of banks and countries the market would be able to provide the finance needed more flexibly

¹¹ G. Carli, *Cinquant'anni di vita italiana*, in collaboration with P. Peluffo, Laterza, Roma-Bari 1993, pp. 275-276. The financial accounts compiled in those years imposed a consistency constraint on quantitative analyses and forecasts of financial flows.

¹² P. Baffi, *Western European Inflation and the Reserve Currencies*.

¹³ P. Baffi, *Comments on Professor Scitovsky's Paper 'International Liquidity and the Reform of the Adjustment Mechanism'*, in P. Samuelson (ed.), *International Economic Relations – Proceedings of the Third Congress of the International Economic Association*, Macmillan, London 1969, p. 257.

¹⁴ In his words: 'The international money market is thus acquiring the character of a market in reserve money, in the larger sense that money flows take over in part the function performed by official reserves and in the stricter sense that official foreign exchange is channelled to it in various ways – through transactions of the central bank in each country with its own commercial banks, through the deposits which central banks hold at the BIS and through direct placements by the central banks themselves'. P. Baffi, *Western European Inflation and the Reserve Currencies*, p. 20.

than the International Monetary Fund, whose credit remained correlated with the borrower's quota.

In that period Baffi opposed an extensive attribution of powers to the IMF, such as Robert Triffin was proposing, since it would have led the Fund to 'perform at the international level the functions of manager and creator of liquidity entrusted at the national level to the institute of issue'.¹⁵ Baffi feared that this would have allowed the Fund to exert 'a strong influence on countries' domestic situations and policies'.¹⁶ Underlying his position was the fact that the political weight of the United States and the United Kingdom within the Fund went well beyond their respective quotas, putting Europe at a disadvantage. For the same reason Baffi called for the development of monetary cooperation within Europe.

As regards the effects on exchange rates of the liberalization of capital movements, Baffi argued that the tendency of the industrial countries and consider the stability of international monetary arrangements as a public good would prompt effective intervention in favour of economies coming under speculative attack.

At the turn of the sixties Baffi had remarked on the willingness of governments and central banks to prevent abnormal capital movements or to offset their effects through appropriate institutional mechanisms.¹⁷ Towards the end of the decade, as the volume of business in the financial markets rose, he commented with satisfaction on the 'notable results in the field of international monetary cooperation',¹⁸ including the further build-up of the network of swaps between the Federal Reserve Bank of New York and other central banks. By contrast, he disapproved of controls on capital movements, arguing that 'controls often beget controls' and that such restrictions often stem from the need to limit the repercussions of domestic imbalances on the foreign exchange market.¹⁹

3. According to Baffi's analysis, respect for the 'rules of the game' promoted the adjustment needed to bring the balance of

¹⁵ P. Baffi, *Il dare e l'avere dei rapporti finanziari internazionali*, p. 10.

¹⁶ *Ibid.*, p. 16.

¹⁷ *Ibid.*, p. 14.

¹⁸ P. Baffi, *Comments on Professor Scitovsky's Paper*, p. 254.

¹⁹ P. Baffi, *Il dare e l'avere dei rapporti finanziari internazionali*, p. 27.

payments back into equilibrium, while in the short run compensating capital flows, facilitated by fixed exchange rates, could contribute to financing temporary excesses of domestic demand. He argued that in a regime of fixed exchange rates international economic integration would increasingly frustrate attempts to promote growth and support employment that relied solely on the expansion of domestic monetary demand, owing to the negative effects on the balance of payments. Achieving the objective also required flexibility on the supply side, as Baffi observed in his first *Concluding Remarks* to the ordinary general meeting of shareholders of the Bank of Italy.²⁰

Even more than in the past, it was necessary to have ample foreign exchange reserves and to preserve foreign confidence; maintaining an adequate capacity of recourse to other countries' credit was essential to avoid having to respond to temporary excesses of domestic demand with restrictive monetary measures, which would interrupt investment, thereby uselessly generating costs and causing an increase in uncertainty.²¹

Baffi believed the Bretton Woods system had foundered because of the lack of monetary policy coordination between the reserve-currency countries, which had ignored the effects of their own action on international liquidity, and the other countries.

The declaration of dollar inconvertibility in August 1971²² was followed by the creation of abundant international liquidity, the rise in the prices of raw materials, the introduction of floating exchange rates – which in Italy came simultaneously with the ballooning of the budget deficit – and the quadrupling of the price of oil between 1973 and 1974, which caused serious imbalances in the external accounts of non-oil countries. The industrial countries were rocked by severe inflationary and recessionary pressures.

Baffi turned his attention to the conditions that, in the new circumstances, could contribute to monetary stability, and to

²⁰ P. Baffi, *The Governor's Concluding Remarks*, Annual Report of the Bank of Italy for the Year 1975, pp. 181 and 197-202.

²¹ *Ibid.*, pp. 195-197.

²² Baffi had investigated the adequacy of the gold in the US reserves and the dollar price of gold in the early fifties. P. Baffi, *Il dollaro e l'oro*, in 'Giornale degli Economisti', May-June 1953, reprinted in *Id.*, *Studi sulla moneta*.

curbing costs for weaker economic units. He believed that, with Keynes, progress had been made in controlling the fluctuations of the business cycle and unemployment; the problem now was to find the most effective methods and strategies to defeat inflation and counter its most serious consequences.

In an inflationary situation caused by domestic shocks (large increases in labour costs and budget deficits) and changes in the terms of trade, Baffi reasoned, reliance on monetary policy action alone would be ineffective, at least in the short term, and entail very high costs. External current account equilibrium could be pursued 'only at the cost of undesirable levels of unemployment or inflation'.²³

Against this background of serious payments imbalances and high inflation, Baffi came to the conclusion that monetary action's effectiveness would be enhanced by expanding the range of very-short-term financial instruments, whose nominal interest rates could be adjusted more rapidly to shifts in inflation. He maintained that financial savings would be protected better by limited forms of indexation, which would also have made it possible to support some segments of the market in longer-term securities²⁴ and thus ensure continued financing of investment in housing and public utilities.

Baffi knew perfectly well that new forms of indexation would have further reduced the scope for absorbing inflation, which only monetary claims offered in Italy in the seventies, since wages were fully protected against rises in the cost of living. In the belief that inflation would not be subdued overnight, he argued that limited applications of indexation to long-term financial assets would reduce the distortions caused by inflation and defend the most vulnerable components of society.²⁵ Like Einaudi and Menichella, Baffi attributed an ethical value to savings and saw this as a further reason why they had to be protected.

²³ P. Baffi, *L'interazione tra moneta, prezzi e cambi*, in 'Bancaria', December 1977. These ideas recur in many of Baffi's other writings and speeches from the beginning of the seventies onwards.

²⁴ P. Baffi, *Il risparmio in Italia, oggi*, 8 March 1974, 'Atti del Convegno dei Lincei', no. 3, Rome 1975.

²⁵ P. Baffi, *Indicizzazione*, entry in *Enciclopedia Italiana di Scienze, Lettere ed Arti*, Appendix IV, Rome 1979, pp. 170-172.

An alarming recession was in course when Baffi took over at the helm of the Bank in August 1975.²⁶ The Government adopted export-support measures under which the central bank was to refinance 50 per cent of the credit banks granted to Italian exporters. The simultaneous surge in the Treasury borrowing requirement caused an excessive creation of monetary base.

The strong tensions in the foreign exchange market and the 'inadequacy of the reserves'²⁷ led to the suspension of official quotations and, even after the first restrictive measures, a depreciation of the lira. The slide in the exchange rate was countered by raising the discount rate substantially and requiring a deposit on purchases of foreign currency.

Despite Baffi's preference for a fixed-exchange-rate regime, the severity of the economic crisis, the difficulty of implementing budgetary and incomes policies consistent with the new situation, the rigidities in the economy and the scarcity of reserves demanded that a controlled depreciation of the currency contribute to the adjustment so that the costs would also be socially sustainable.²⁸

In this new situation a consensus emerged as regards the desirability of the financing of balance-of-payments deficits by the International Monetary Fund. Baffi felt that there had to be more flexible regulation of the amounts that could be drawn from the Fund than was possible under the rules based on quotas and an increase in the 'resources to which the Fund itself has access'. The strengthening of the Fund's role was set in a context marked by the risk that a widespread attempt to absorb the oil deficit rapidly would lead to an implosion of world economic activity.²⁹

The depreciation of the lira provided leeway for macroeconomic policies to manage domestic demand so as to ensure the expansion of exports, thereby permitting both an improvement in the balance of payments and an increase in GDP. Moreover, following the surge

²⁶ He was appointed Governor on 19 August 1975.

²⁷ P. Baffi, *The Governor's Concluding Remarks*, Annual Report of the Bank of Italy for the Year 1975, pp. 196 ff.

²⁸ P. Baffi, *The Governor's Concluding Remarks*, Annual Report of the Bank of Italy for the Year 1976, pp. 128-129.

²⁹ P. Baffi, *The Governor's Concluding Remarks*, Annual Report of the Bank of Italy for the Year 1976, p. 131.

in oil prices many monetary authorities were led to neutralize its deflationary repercussions by having recourse both to official borrowing and to loans contracted by the private sector.³⁰

However, Baffi knew that the positive effects of depreciation would soon be annulled if the inflationary slide was not braked with other economic policy measures.³¹ He identified two crucial obstacles to achieving growth without inflation and balance-of-payments equilibrium: the public sector deficit, which was approaching 12 per cent of GDP, and the full indexation of wages.

In order to finance the state sector deficit without creating bank money, it was necessary to place a huge quantity of government securities. Inducing a radical change in the public's preferences regarding the composition of their financial assets would have required raising interest rates to very high levels in real as well as nominal terms. Baffi clearly saw the costs of a monetary policy based entirely on very high interest rates, which would have increased the deficit, caused the public debt to explode and compromised firms' financial equilibria. He held that an excessive budget deficit was incompatible with monetary stability³² and that it was necessary to shift domestic demand from consumption to investment in order to set in motion 'the virtuous circle which will increase productivity, produce a lasting improvement in foreign trade and allow a larger and steadier expansion of foreign trade'.³³

The other factors Baffi saw as obstructing the control of inflation were the high degree of wage indexation, the over-

³⁰ 'In the absence of co-ordinated policies with regard to the recycling of funds, the banks' indebtedness vis-à-vis the international financial market has had a counter-deflationary rather than inflationary effect'; P. Baffi, *The Governor's Concluding Remarks*, Annual Report of the Bank of Italy for the Year 1977, p. 136.

³¹ P. Baffi, *The Governor's Concluding Remarks*, Annual Report of the Bank of Italy for the Year 1977, pp. 137-143; on this point see also P. Baffi, *The Governor's Concluding Remarks*, Annual Report of the Bank of Italy for the Year 1978, p. 147.

³² Statement to the meeting of the Committee of EEC Central Bank Governors held at the BIS in Basle on 14 March 1978.

³³ P. Baffi, *The Governor's Concluding Remarks*, Annual Report of the Bank of Italy for the Year 1978, p. 144.

frequent application of the mechanism³⁴ and the increased inflexibility of labour relations.³⁵

In his view, a significantly higher rate of increase in wages than in productivity would affect inflation and the exchange rate; the interaction between these variables would become destabilizing.³⁶

Baffi was aware that continuing to impose constraints on banks' operations would freeze their shares of the loan market and reduce the already inadequate level of competition.³⁷ In the critical conditions prevailing at the end of 1976, he accepted the need to reintroduce 'ceilings' on bank lending because of the costs and uncertain effectiveness in the short term of a monetary policy based only on interest rates. Compared with the measures adopted in 1974, the innovation consisted in imposing the limits only on loans denominated in lire. This encouraged banks to borrow abroad, which allowed the exchange rate to be stabilized, thereby eliminating an important source of inflation. Given the 'constraints' on banks' choices, the liquidity created via transactions with abroad had to be invested mainly in Treasury paper, thus allowing the state sector borrowing requirement to be funded without recourse to the Bank of Italy. The foundations were laid for the creation of a market first for Treasury bills and then for floating rate government bonds.

During 1977 the tight monetary and fiscal policies produced their full effects.³⁸

Starting in July 1976 and until the end of 1978, Italian inflation

³⁴ 'Full wage indexation [...] means that the real wage [...] has been fixed by trade union power. The real wage has become an independent variable [...]. The consequences are the stagnation of employment levels and the development of a grey market for labour which escapes the Diktat of the Unions'; Statement to the meeting of the Committee of EEC Central Bank Governors.

³⁵ P. Baffi, *The Governor's Concluding Remarks*, Annual Report of the Bank of Italy for the Year 1978, pp. 137 and 171.

³⁶ P. Baffi, *The Governor's Concluding Remarks*, Annual Report of the Bank of Italy for the Year 1977, pp. 138-139 and 145-148 and *The Governor's Concluding Remarks*, Annual Report of the Bank of Italy for the Year 1978, pp. 146-147.

³⁷ P. Baffi, *The Governor's Concluding Remarks*, Annual Report of the Bank of Italy for the Year 1977, pp. 162-163.

³⁸ At the end of 1976 budgetary measures amounting to around 5 per cent of GDP were adopted.

slowed down, but monetary policy's biggest success was achieved on the front of the balance of payments, which swung into surplus for the first time in ten years, thereby making it possible to repay foreign debts, redeem the gold pledged during the earlier foreign exchange crises, rebuild the reserves and restore Italy's creditworthiness.³⁹ In the first three quarters of 1978 the lira rose against the dollar and was allowed to depreciate against European currencies. Steering a course midway between the dollar and the German mark made it possible to keep down the cost of imports of raw materials and energy products while increasing the competitiveness of Italian exports to the other European countries, thereby achieving a better combination of stability and growth. The opportunity offered by the revaluation of the mark against the dollar was grasped. Baffi was aware, however, that this exchange rate policy could not be followed for long and feared that tying the exchange rate to stronger currencies while Italy had higher inflation and greater structural rigidities than the other European countries would not be sufficient, that faced with the prospect of recession and powerful social unrest the exchange rate constraint would be abandoned.⁴⁰

During the negotiations for Italy's membership of the European Monetary System, Baffi judged it essential for Italy's economy to have enough time to adapt to the new situation, given the higher rate of price inflation and the latter's roots in wage inflation. Overcoming strong resistance, he managed to ensure that the lira was anchored to the stronger currencies with adequate margins of fluctuation.⁴¹

Baffi's position was consistent with the ideas he had expressed

³⁹ P. Baffi, *Due momenti nel negoziato sullo SME: la banda larga e l'adesione del Regno Unito*, Report to the conference on 'I dieci anni dello SME', published in *Il sistema monetario europeo a dieci anni dal suo atto costitutivo: risultati e prospettive*, Proceedings of the conference sponsored by the Ministry of Foreign Affairs and Istituto Mobiliare Italiano, Rome, 5 December 1988; P. Baffi, *The Governor's Concluding Remarks*, Annual Report of the Bank of Italy for the Year 1977, pp. 138-139; *The Governor's Concluding Remarks*, Annual Report of the Bank of Italy for the Year 1978, pp. 145-146.

⁴⁰ An interview with Baffi by C. Zappulli, 'Il Giornale', 30 August 1978.

⁴¹ 'An intervention policy tying the lira to the currencies of countries with rates of inflation far lower than that prevailing in Italy could not possibly have exerted a sufficiently moderating influence on prices to validate *ex post* the value assigned to the exchange rate'; P. Baffi, *The Governor's Concluding Remarks*, Annual Report of the Bank of Italy for the Year 1977, p. 141.

many years previously on the exchange rate as a disciplinary mechanism. However, he considered that a return to a fixed exchange rate could not be a substitute for a strategy aimed at reducing the rigidities in the labour market and influencing the size and composition of public expenditure. He considered that the prospect of restoring monetary stability and the conditions for orderly economic growth was a prerequisite for tying the lira to stronger currencies with narrow margins, not least to minimize the need for later changes in central rates.⁴² He also considered effective cooperation among the central banks the creation of a fund to transfer resources to weaker countries within the Community to be essential in order to give credibility to the system.

The 1978 initiative was a Franco-German one; a great country like Italy, called to take part, had the right and the duty to contribute its own ideas. This position was interpreted by laymen, with great heat and little lucidity, as an aversion to Europe [while] as early as in 1959, at Cornell [...] I had written a [paper] on the problems of European economic integration which I not only advocated but of which I also attempted to identify the optimal area.⁴³

The wide exchange rate fluctuation band Baffi proposed was later used by other countries intending to join the European Monetary System with the flexibility needed to avoid having to adjust their central rates too often. From 2 August 1993 until the adoption of irrevocably fixed exchange rates, all the EMS currencies had a fluctuation band of 15 per cent.

4. The fourfold increase in oil prices in 1973-74 and its effects on inflation and the rate of growth of the Italian and global economies undermined the balance sheets and profitability of the big chemical companies while ambitious investment programmes were in progress. There followed events that were exploited, as Baffi wrote just a few months before he died, 'for ends that are

⁴² P. Baffi, *I cambi: ieri, oggi, domani*, Report by P. Baffi to the XXI Congresso Nazionale del Forex Club Italiano, held in Ischia on 14 and 15 October 1978, pp. 20-21.

⁴³ P. Baffi, *Discorso di accettazione della Targa d'Oro Siglienti*, Cagliari, 18 November 1988, 'Quaderni sardi di economia', nos. 1-2, 1989.

still obscure'.⁴⁴ The case based on those events turned out to have been a pretext. Baffi pointed out that the judge had confused the difficult decision to grant loans to the chemical industry, so as not to renounce the banker's function and 'not reduce it to funding public enterprises supported with contributions from the budget and endowment funds', with the easy alternative dominated 'by confidence in government rescue operations'. In October 1979 Baffi chose to resign his position as Governor.⁴⁵

The Judiciary itself, at the appeal stage, recognized Baffi's complete innocence.

Baffi resumed his scientific work with great vigour after he had stepped down and he was appointed Honorary Governor of the Bank of Italy. He wrote several papers critically re-examining many issues of the 1970s and he advanced proposals to deal with some still unresolved questions, such as that of wage indexation. He was chairman of the Società italiana degli economisti from 1980 to 1982 and deputy chairman for the following three years. From 1979 until his death, he chaired the Ente per gli studi monetari, bancari e finanziari 'Luigi Einaudi', contributing to numerous research projects and working energetically to help promising young people to gain access to postgraduate studies. In this stage of his life, his interests and his scientific knowledge and wisdom were also directed towards new issues: he was one of the first economists to address the need to protect the environment, uniting a rigorous theoretical approach with a passionate belief in the objective.

He accepted the invitation to write a history of the Bank for International Settlements shortly after giving up his position as Governor of the Bank of Italy. The invitation from the BIS, headed at the time by Jelle Zijlstra, was intended to manifest the high esteem in which Baffi was held among central bankers. He found the task intellectually stimulating, not least because it led him to re-examine events that were sometimes part of his own experience and to renew his contacts with some of the protagonists of international financial history.

Paolo Baffi died on 4 August 1989.

⁴⁴ *Ibid.*, p. 26.

⁴⁵ *Ibid.*, p. 24.

This text, which uses part of the extensive documentary research Baffi carried out, reconstructs the origins of the Bank for International Settlements and its early orientations in a brief but very eventful period. Baffi considered the chapters included here as the first step in his work on the history of the Bank.

The introduction by Charles P. Kindleberger highlights the main aspects of Baffi's contribution to the complex negotiations that led to the establishment of the BIS and the institution's initial two-year period of activity when it was trying to organise systematic cooperation among central banks. As Kindleberger points out, Baffi's archival research, which went well beyond the period covered by his text, unfortunately highlights the absence in those years of common objectives and coordination among the representatives of the leading economies, which, together with the inadequacy of the international monetary system in place at the time, led to the disasters of the 1930s.

This volume inaugurates a new collection of the Bank of Italy's Historical Series, dedicated primarily to monographs on monetary history. Its publication is a tribute to the scholar for his important writings on monetary history and analysis and the impetus he gave to research on leading economic and monetary issues.

PAOLO BAFFI AND THE BANK FOR INTERNATIONAL SETTLEMENTS

Paolo Baffi's first involvement with the Bank for International Settlements (BIS) dates back to the late 1940s. As a young economist in charge of the Bank of Italy's Office for Economic and Statistical Studies, he came into contact with the BIS's Monetary and Economic Department, then led by Per Jacobsson, the future Managing Director of the IMF. This professional relationship deepened when Paolo Baffi became the chief economic counselor of the Bank of Italy in 1956. In this capacity, he spent a number of weeks each year in Basel, contributing his analytical and writing skills to the drafting of the BIS's Annual Report. In 1960, on being appointed General Manager of the Bank of Italy, Baffi joined the Board of the BIS as an Alternate to the two permanent representatives of the Bank of Italy, Governor Carli and former Governor Menichella. In August 1975, when Baffi was appointed Governor of the Bank of Italy, he became an *ex officio* member of the BIS Board of Directors, a position he held until his resignation as Governor in October 1979. In February 1980, Baffi's successor at the helm of the Bank of Italy, Dr. Ciampi, re-appointed his predecessor as a member of the BIS Board for the Bank of Italy. In September 1988, Baffi was elected Vice-Chairman of the BIS Board. In this function, Prof. Baffi remained active until his death on 4 August 1989.

As a prominent member of the BIS Board of Directors, Baffi was closely involved with the preparations for the Bank's fiftieth anniversary in 1980. On that occasion, it was decided to commission an official history of the BIS. The Bank did not have to look far to find a qualified author. Because of his rich experience in central banking, his intimate knowledge of the BIS, his command of economics and his keen historical interest, Baffi

was the natural choice. Baffi, who in the meantime had been made honorary Governor of the Bank of Italy, accepted this gigantic task, renouncing a full remuneration because, in his own words, he took on this job for his own pleasure.

In the course of his work during the 1980s, Prof. Baffi conducted extensive archive research, not just in the BIS's own archives, but also in the archives of a number of central banks, most notably the Bank of Italy, the National Bank of Belgium, the Bank of England and the Federal Reserve Bank of New York, as well as in the State Archives of France, the United Kingdom and the United States. The results of this massive research effort are to this day preserved in the BIS Archive, under the form of some 30 archive boxes crammed with handwritten notes, references and photocopies, covering episodes in the BIS history from 1930 until the 1960s. Unfortunately, as time progressed, serious bouts of illness frequently interrupted Prof. Baffi's work. By the time he died, on 4 August 1989, he had finalised the draft of twelve chapters dealing with the foundation and first years of operation of the Bank.

The BIS is happy to be able to publish Prof. Baffi's account of the early days of the BIS. That this is done in a partnership with the Bank of Italy, and in both the English and Italian languages, is fitting. There is a good reason to make Prof. Baffi's work available to a wider audience at this time. It is now more than a decade since Paolo Baffi passed away, but the public and academic interest in this statesman of Italian central banking remains very much alive. In addition, the BIS recently decided to pick up the thread where Baffi had left it. Prof. Gianni Toniolo of the University of Rome at Tor Vergata has been commissioned to write an academic history of the Bank covering the period 1930-73. The current publication of Prof. Baffi's manuscript provides a useful starting point for Prof. Toniolo's work. I am convinced that by the time the BIS will celebrate its 75th anniversary in 2005, the work for which Prof. Baffi laid the foundations in the early 1980s will finally be completed.

A.D. Crockett
General Manager, BIS

Basel, October 2001

INTRODUCTION

*by Charles P. Kindleberger**

This slim book is sadly only a fragment of the early history of central-bank cooperation at the BIS that Dr. Baffi started, as he died before getting beyond the events of 1930 and 1931. It is nonetheless a fascinating document, fascinating in many respects: as an account of the complex problems of starting a new institution, with respect to its role in helping to transfer German reparations to European Allies, its personnel, powers and purposes in dealing with world finance, and even politics, in the face of a gathering financial crisis. It stops abruptly six months short of the useful if much earlier book by Eleanor Lansing Dulles (*The Bank for International Settlements at Work*, 1932), but has the advantage of access to more documents, reports and archives, and is written by a distinguished central banker.

Dr. Baffi's book is a history of events, but more particularly a history of thought in international monetary relations with respect to the problems of the day, not all of which have been resolved 70-plus years later. One can see in the account a foretaste of the issues faced today by the International Monetary Fund and the World Bank.

There is a trace of ambiguity in the title. One might guess that central-bank cooperation originated at the BIS, and had not existed earlier. But there was a considerable amount of help granted internationally before the 1930s, by central banks as well

* Charles P. Kindleberger is Ford International Professor of Economics Emeritus, Massachusetts Institute of Technology. He served in the Monetary and Economic Department of the Bank for International Settlements under Dr. Per Jacobsson from July 1939 to June 1940.

as private individuals like the Rothschilds or Warburgs, governments, cities such as Hamburg and private banks. The Bank of England and the Bank of France helped one another as lenders of last resort in financial crises in 1825, 1836-39, 1856, 1866, 1890, 1907, and the Federal Reserve Bank of New York in the 1920s sought to help Britain under strain by adjusting its discount policy. All of this was far from institutionalized, however, even episodic. In a few Anglo-French occasions, moreover, it gave rise to regret on the part of the assister and humiliation for the assisted. As Dr. Baffi makes clear, the attempt of central banks to organise their cooperation systematically through the BIS was a new phenomenon.

The BIS was called for by the Young Plan of 1930 which followed the Dawes Plan of 1924. Both were attempts to settle definitively the question of German reparations, the amounts in the Dawes Plan and method of transferring the funds from German marks to Allied recipients in the Young Plan. The conference to agree on the solution to the transfer problem was proposed by Shepard Morgan, the American Agent for Reparation Payments in Berlin. The Dawes Plan had started with an international loan of \$200 million, shared among the leading financial allies, including the United States. It happened to be a success, heavily oversubscribed in the United States for one thing, and starting a boom in foreign bonds, especially German, which provided the foreign exchange which the German government used to pay reparations. The Young Plan loan, on the other hand, was issued after the start of the Wall Street boom in stocks beginning in 1928, which diverted investors from foreign bonds to domestic stock, and the October 1929 stock market crash. The Young loan went to a discount after its issue, long-term capital movements declined sharply, and German prospects of continuing to be able to pay reparations became dim.

Charles G. Dawes, a Chicago banker, and later Vice-President of the United States under President Hoover from 1925 to 1929 and Owen D. Young, President of the General Electric Company and Deputy Chairman of the Federal Reserve Bank of New York, were chairmen of the conferences that produced these plans. They were private American citizens, not government officials, or quasi-official persons from the Federal Reserve System. This, the

United States ruled, was because it had not signed the Versailles treaty, refused reparations from Germany, and wanted nothing to do with reparations in foreign policy terms. The government, however, did not object to American citizens serving in private capacities. Dawes and Young served to a considerable extent as neutral 'front men', advised by bankers from J.P. Morgan and Company, while much of the negotiations and drafting were handled by the Europeans. This precedent was followed when it came to choosing the top officials of the BIS, with American individuals elected president and vice-president, though the Federal Reserve System did not contribute to the stock of the BIS. The President was Gates W. McGarrah, New York banker and Chairman of the Federal Reserve Bank of New York, the Vice-President Leon Fraser who had participated in the Paris conference which drafted the Young Plan, and served as general counsel to the Paris representative of the Reparation Delegation in Berlin, set up under the Dawes Plan. After McGarrah resigned in 1933, Leon Fraser succeeded to the presidency until his resignation followed in 1935.

The city chosen for the site of the BIS was Basel in Switzerland, located at the three-nation corner of France, Germany and Switzerland, and a prominent European railroad center. This choice may have been a mistake in a world of technological change that was opening up. Within little more than a year, on July 9, 1931, Hans Luther, President of the Reichsbank in succession to Hjalmar Schacht, flew to London, Paris and Basel, trying to raise funds to stave off defaulting on reparations and private debts. This was less than a month after President Hoover had telephoned Secretary of State Henry Stimson and Secretary of the Treasury Andrew Mellon, who were in Paris from Washington, about the June 20 moratorium on reparations and war debts, the first government official use of the transatlantic telephone. Basel was well located in a neutral country for an age of travel by rail, but it was inconvenient for easy access in an age of air travel which was just beginning. Baffi notes that Shepard Morgan, the Reparation Agent in Berlin, wrote in November 1932 that McGarrah felt exiled in Basel, would have preferred the location of the Bank in London, and this feeling may have brought about McGarrah's resignation. Initially, Governor

Montagu Norman of the Bank of England had also favoured London as the site and Jean Monnet of France as President. His colleague, Harry Siepmann, suggested Brussels and a Belgian, Carton de Wiart. In the end after both McGarrah and Fraser had resigned by 1935, it was thought time for a European president rather than an American and the Dutch banker Trip was chosen as President, but the Bank remained in Basel.

As readily anticipated, there were national and personal interests at stake. Germany wanted the amount and timing of its reparation payments finally fixed, and help with their transfer to the Allied recipients. In addition Hjalmar Schacht of the Reichsbank was fixed on German export opportunities, and kept referring for years to its need of colonial markets. Britain's goal was to maintain its leadership in European finance, and to receive sufficient reparations from Germany and payments on war debts from European Allies to meet its war debt to the United States.

France had an especially long list of wants: reparations to pay for the reconstruction of devastated areas long under way, these reparations 'commercialized', as the Franco-Prussian indemnity of 1870 had been financed by the *Their-rentes* of 1871 and 1872, bought widely in Europe, and providing the foreign exchange that enabled France to pay the indemnity quickly and force the Prussians, under the armistice treaty, to withdraw their occupation troops from French territory. In addition, the Governor of the Bank of France, Emile Moreau, pushed hard for his Director of Economic Research, Pierre Quesnay, to become General Manager of the BIS and promote French financial interests. Quesnay himself, and the Bank of France as an institution wanted to establish a system of clearing payments in gold. Quesnay had proposed a monetary unit of account, the *grammor*, or gram of gold, which could be used in clearing payments in gold between countries, perhaps reduce the use of sterling in international payments, and render useful the substantial holdings of gold of the Bank of France.

The United States kept insisting on the need for separating reparations from the war debts for which it was creditor. Countries lesser in size and economic strength, especially Italy and Belgium, were conscious of having emerged on the side of the major Allies, and sought some role in the proceedings.

These national interests diverged, rather than clashed head on, although Montagu Norman of the Bank of England and Emile Moreau of the Bank of France had earlier developed a mutual antagonism on a separate issue, the relationship of each country to the finances, and especially the central banks, of the new countries created after the break-up of the Austrian Empire. This antagonism moderated somewhat by Harry Siepmann of the Bank of England, dealing with his Governor, Norman, and when Clément Moret succeeded Moreau as Governor of the Bank of France.

Dr. Baffi's account of the origins of the BIS understandably focuses on the complex negotiations involved, especially on the Young Plan, on the meetings of the Board in the spring of 1930, and later in the year and the first half of 1931. These meetings agreed more or less on general principles, which later proved inadequate as the Devil, as always, was in the details. Many questions were ordered studied by committees, including the form of bonds issued to transfer the first tranche of reparations, relations with central banks, with private firms (none), medium-term credits, clearing of international payments, etc.

There was no need to wait for committee reports, however, as separate proposals were further accepted for study. In February 1931, Montagu Norman submitted a memorandum by Sir Robert Kindersley who had been the senior British official on the Dawes Commission in 1924, on measures to revive the international flow of capital which had been brought to a virtual halt by the October 1929 crash in the New York stock market. It called for an International Corporate Board to be organized in the Netherlands or Switzerland, with limited capital but authority to issue 10-year bonds three times the amount of its capital. The suggestion was made that the bonds be sold in France, the United States, the Netherlands and Switzerland, but only to a limited extent in London. Hans Luther, succeeding Schacht at the Reichsbank, was more interested in the revival of short-term credit to stimulate German exports and relieve the balance of payments. Clément Moret for France, replacing Emile Moreau, objected to the prospect of lending French money for unspecified purposes over which the lenders had no control. Again the decision was made to study the matter further.

More committees. In May 1931, two study groups were appointed, with representatives of central banks, and one leading BIS official each, to report, one on 'Currency' (with General Manager Quesnay as the BIS officer), one on 'Credit' (with the German Assistant General Manager, Hülse, for the BIS).

With the Austrian financial crisis starting May 11, 1931 when the Credit Anstalt, the leading bank, revealed that it had lost half its capital, central bankers on BIS study committees must have been more interested in the world collapsing around them than in planning for the unknown future. The Credit Anstalt immediately raised 100 million schillings (roughly \$14 million) from the Austrian government, 20 million from the Austrian National Bank, and 22.5 million from the Rothschilds of Vienna and Amsterdam. The total failed to stop the run. The Austrian government appealed for a loan of 150 million schillings to the League of Nations. This referred the government to the BIS. Negotiating from May 14 to May 31, Gates McGarran arranged a loan of 100 million schillings from 10 central banks. Whether the two weeks plus were needed to arrange extensions of due dates among the Credit Anstalt's creditors, to obtain an Austrian government guarantee, or to persuade the French not to require political concessions, such as abandonment of the announced German-Austrian customs union, or all three, is unclear.

In any event, the 100 million credit for the Credit Anstalt was exhausted by June 5. The Austrian government asked for another. This time the French insisted on the abandonment of the customs union. The Austrian government refused and fell. Foreign withdrawals and domestic capital flight spread the crisis to runs on banks in Hungary, Czechoslovakia, Rumania, Poland, and especially Germany. On June 15, in a slap at the French, Governor Norman of the Bank of England undertook unilaterally a loan of 50 million schillings (\$7 million) for one week. The amount and the maturity were derisory. The loan was renewed weekly through June and July until finally the British asked to be repaid in August, as sterling came under pressure.

On June 20, with the run on Germany accelerating, President Herbert Hoover proposed a moratorium on both reparations and war debts for a year. This provided little help. On June 25, a credit of \$100 million for Germany was put together with \$25 million

each contributed by the Bank of England, the Bank of France, the Federal Reserve Bank of New York, and the BIS. The BIS role in this loan, running to July 16, is not covered in Dr. Baffi's unfinished manuscript, focused on the subject of central bank cooperation. I am inevitably reminded that some important members of the British bureaucracy were studying post-war plans in November 1940 at the height of the Battle of Britain. But of course he was planning to get to the agonies of May to September 1931 later in his account.

The \$100 million credit of the end of June was again not enough. Discussion of a new loan was undertaken with the French talking in terms of \$500 million, the Germans of \$1 billion. This time, however, the United States and the United Kingdom objected for budgetary reasons. Each had budget deficits which a substantial contribution to a new loan would increase. In the impasse a conference was called for London on July 20 which produced the Standstill Agreement, agreeing that Germany had the need to halt further withdrawals of funds by foreigners and blocking domestic capital exports. Another committee was set up, with Albert Wiggin of the Chase National Bank in New York as chairman, and Sir Walter Layton, editor of the British periodical, 'The Economist', drafting the report on the difficulties faced by Germany in its balance of payments – reparations, foreign debt, capital flight and reduced reserves of gold and foreign exchange. The London conference also extended the \$100 million loan from the central banks of Britain, France and the United States, plus the BIS, for three months. This was as far as Dr. Baffi got in his account. More troubles lay ahead: the run on sterling, British borrowing from France and the United States, the May report on the British budget, critical of the dole, fall of Labor, a new National Government in Britain with Ramsay MacDonald again as Prime Minister and Philip Snowden as Chancellor of the Exchequer, a naval protest against pay cuts at Invergordon, taken by Europe as a mutiny, all ending in the depreciation of sterling on September 21. Contributing to that climax was the action of smaller central banks like the Belgians and Swiss, in converting pounds to gold. The Bank of France under Moret held off. Central-bank cooperation occurred, but was limited.

Not in chronological order but deeply evocative of the lack of cooperation were three 1930 memoranda in the Governor's file

of the Bank of England archives, discovered by Professor Baffi. One seems to have been by Harry Siepmann, high in the table of organisation of the Bank; the authors of the other two are not identified. The three memoranda deal with functions and powers contemplated by the BIS, and are marked in margins with comments by Governor Norman, called by Baffi 'acerbic and pre-emptory, consistently negative, and showing a hostile attitude to the hopes for the new Bank'. Baffi precedes the discussion with a list of eight goals for the Bank: on stability, transfer among central banks, central-bank cooperation and so on.

Pointing to specific powers the BIS might have, the memoranda evoke comments from Governor Norman such as 'ridiculous', 'no part of the duties of a central bank', 'immoral', 'improper', 'in private life this usually ends up in criminal courts. It amounts to kiting cheques', 'hocus-pocus', 'further immorality', 'we would not agree', 'we would never agree to this'. Perhaps when he was reacting in this fashion Governor Norman was having a bad day or bad days. He did suffer a nervous breakdown at the end of July 1931, and was not at his Bank of England post when sterling was forced to depreciate on September 21.

Scattered through Dr. Baffi's pages on memoranda, Board meetings, committee reports is a host of sign posts pointing the way to developments after World War II – the establishment of the International Monetary Fund and the International Bank for Reconstruction and Development (World Bank), swap arrangements, bridge loans, need to move faster in crisis (faster than the IMF with its cumbersome voting procedure), the dominance of international capital flows over trade payments, which he calls 'prescient'.

BIS interest in clearing, for the French largely in gold, for others in foreign exchange, can be viewed as a vision of the future IMF, but not of the gold pool which broke down in 1968 and 1971, the purpose of which was not clearing but support for the gold price. It is a considerable stretch to see in the early negotiations any hint of the European Payments Union of June 1950 under the European Recovery Program (Marshall Plan), but of interest that its accounts were kept initially by Frederick Conolly of the BIS, including the cancellation of bilateral mutual claims of two participants and the more complex system when more countries were involved.

Proposals for an International Corporation in the Norman-Kindersley memorandum, and by Emile Francqui for an International Credit Bank, both rejected by the French, might be thought to be early models of the World Bank created at Bretton Woods in 1944. One of the important contributions of Baffi is to emphasize the role of Emile Francqui, the Belgian economist and government official, who had served on the Young Commission, and whose contribution is not well known in English-language financial history. Not all ideas put forward early came to fruition after World War II, and some that were rejected did. The Currency Committee lacked all interest in central-bank swaps, but such a system, put forward by Charles Coombs of the Federal Reserve Bank of New York was adopted in March 1961 to help countries with what appeared to be a temporary drain. The country under stress would repay or undo the swap after six months, or if that proved impossible finance the repayment in formal credits.

Post-war institutional development in international finance unfolded in very different circumstances. Reparations were mild or non-existent. War debts had been largely avoided through Lend-lease, the United Nations Administration for Relief and Reconstruction (UNRRA), the European Recovery Program, assistance to Japan and many other ad hoc arrangements. The United States and other countries such as Canada, Australia, New Zealand and Japan contributed to large-scale expansion of the BIS coverage. New roles were taken on by the Bank well beyond anything contemplated in the early 1930s: Banking Supervision and the Global Finance System with study groups and committees on Banking Supervision and Payment and Settlement Systems. The Basel Committee on Banking Supervision initially adopted a standard of 8 per cent capital for private banks against their sight and short-term liabilities. After some experience it found that the problem was more complex than originally thought. Less time seems to be spent on theoretical financial problems and more on workable solutions.

Of basic importance is that the BIS goes on, polishing central-bank cooperation and addressing financial problems in general. At Bretton Woods, the Deputy Secretary of the United States Treasury, Harry Dexter White, wanted to liquidate the BIS, whether because it collaborated with the German Finance

Ministry during World War II as he thought, or on more general political grounds is unclear. White and a Treasury lawyer, Bernard Bernstein, are said to have been the inspiration for the so-called Morgenthau Plan, which was to reduce Germany, after its defeat, to industrial weakness. White, in the account of a Belgian, Armand Van Dormael, dominated the Bretton Woods 1944 meeting in an imperious way, but his proposal to kill the BIS was instead killed by the European representatives there. Their resistance kept the BIS going and has been richly rewarded. The Bank was more or less quiet during the later 1930s, World War II, and thereafter until 1958, when world economic recovery had gone a considerable distance, and Per Jacobsson, the head of the BIS Monetary and Economic Department, was chosen Managing Director of the International Monetary Fund. Collaboration of central banks, and between the BIS and the International Monetary Fund started afresh, as Professor Gianni Toniolo's extension of the Baffi account of the early days will explore.

In conclusion, Dr. Baffi's account of the troubled start of the BIS throws a brilliant light on the growing problems of international finance after World War I and in the 1920s, especially the lack of common goals and common thinking among officials of top economies that led to the disasters of the 1930s and 1940s. American aloofness, slipping British leadership, French insistence on going its separate way, the declining suitability of gold as an international monetary standard, all are clearly demonstrated. At the same time, the component needs of an effective international monetary system – absence of reparations and war debts, restoration of short- and long-term capital markets, and central bank cooperation on trend and in response to shocks – are separately shown in detail and point the way for the solid institutional developments after World War II.

THE ORIGINS OF CENTRAL BANK COOPERATION

The establishment
of the Bank for International Settlements

NOTE The footnotes included by Paolo Baffi are marked with an asterisk.

I

INTRODUCTION*

1. The First World War left a very heavy legacy of problems in the international monetary system. It caused prices to rise by such an extent that official gold reserves were no longer adequate, either in relation to the volume of money in circulation in individual national economies or by comparison with the flows of goods, services and capital across national frontiers, which had themselves proliferated as a result of the war.

The effects of the shortage of gold reserves in relation to the requirements of trade could have been neutralised by lowering the gold parities of currencies to compensate for the rise in prices; this did occur in some countries, including France and Italy, at the end of painful stabilisation programmes, but the two most important issuers of reserve currencies, the United States and the United Kingdom, preferred to maintain or restore the 1914 parity of their currencies, despite the fact that they had not escaped the general inflation during the war and, more seriously, in the first few years of peace (Table 1).

2. The problem of the general scarcity of gold, which was compounded in the late twenties by the 'maldistribution' of gold reserves, was therefore recognised immediately after the end of the war. It was one of the matters examined and discussed at the 1922 Genoa Conference, which concluded that one of the possible solutions was the more widespread adoption of the gold exchange standard.

* The English translation of Baffi's work has been prepared by the Bank for International Settlements.

Table 1. *Index of wholesale prices*

	1914	1919	1921	1926
United States	100	202.8	142.9	146.6
United Kingdom	100	253.0	196.0	147.2
France	100	356.3	343.8	700.0
Germany	100	395.2	1,820.0	n.a.

Source: United States: Department of Commerce, *Historical Statistics of the United States*, 1976; United Kingdom: B.R. Mitchell, *British Historical Statistics*, Cambridge University Press, Cambridge 1988; France: INSEE, *Bulletin mensuel de Statistique*, avril, Presses Universitaires de France, Paris 1983; Germany: *Statistisches Jahrbuch für das Deutsche Reich*, Puttkammer und Mühlbrecht, Berlin 1926 und 1928.

A second group of extremely serious problems that arose as a direct result of the war and the Versailles peace treaty concerned war debts – primarily those of the European Allies towards the United States – and the reparations owed by the Central Powers, especially Germany. These problems were initially resolved in the course of the twenties by means of bilateral agreements with the United States on war debts and the Dawes Plan of 1924 with regard to reparations.

The agreed payments were made regularly for a number of years, thanks to an impressive flow of American capital into Europe. The proven ability of the international financial markets, together with the desire both to mask the political nature of the transfers – not the least of the many causes of tension among the former enemies – and to enable creditor countries to mobilise the annuities in advance, led politicians and experts to devise a new plan whereby the reparation annuities would be paid via an international banking institution and could be represented by securities that could be sold in advance in the market.

It can therefore be said that the creation of the BIS stemmed from two factors: first the need to facilitate the transfer of the annuities due in respect of reparations and, indirectly, war debts that would be repaid using receipts from reparations, and secondly the need for increased cooperation among central banks; the gold shortage, the widespread adoption of the gold exchange standard and the presence of not one but two major reserve currencies had made such cooperation essential if central banks were to prevent

collapse of an international monetary system that already appeared to be inherently more unstable than its predecessor.

3. The gold standard had become the dominant monetary regime in the West after its adoption by Germany, rich with the gold spoils of the Franco-Prussian War of 1870-71. Theoretical economists recognised and examined its qualities of self-regulation or automaticity. Under such a system, the acquisition or loss of gold by a country affects that country's entire international trade and causes domestic price and wage movements that tend to bring the balance of payments back towards equilibrium.

The realisation that the system was self-regulating meant that bodies for central bank cooperation were relegated to the sidelines; institutions of this kind were advocated mainly by rather obscure economists inspired by visions of world government or fascinated by the magic of money. Practical cooperation among central banks became confined to a few instances of bilateral assistance in times of crisis, such as the Baring crisis and the crisis of 1907.

With the almost unavoidable transition to the gold exchange standard, central banks were called upon to buy or sell reserve currencies both to finance external imbalances and as part of a reserves policy that entailed switching between the gold and foreign exchange components and, within the latter, between the various reserve currencies.

Such operations have specific effects on the policy of the country issuing the reserve currency that is used in settlements or converted into gold; these effects were to be feared especially in the case of one of the major reserve currency countries, the United Kingdom, because of its traditionally low gold reserves and the acute conflict that emerged in the British economy in the twenties between the objective of stimulating economic activity, which requires low interest rates, and that of maintaining external equilibrium, which calls for high interest rates to retain or attract capital.

The changeover to the gold exchange standard therefore meant that the decline in the effectiveness of the automatic mechanisms had to be offset by developing cooperation among central banks. The need for cooperation was heightened by the reduction in the flexibility of national economies, and especially

in the flexibility of the labour market, which made it more difficult to use deflation as a means of adjustment.

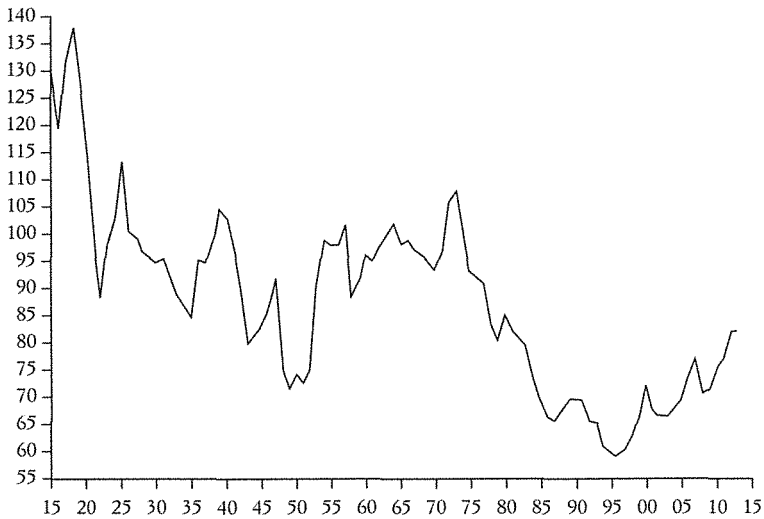
4. The *modus operandi* of the automatic adjustment mechanisms had already been less than entirely satisfactory even before their efficiency was reduced by the change in the international monetary system and by increased resistance within national economies. At the theoretical level (Nurkse, Bloomfield, Baffi and Occhiuto, Eichengreen, Dam) the conclusion has been reached that the rules of the game by which the gold standard operated were systematically altered by central bank interventions aimed at offsetting at least part of the domestic effects gold movements had on the money supply and hence on prices, interest rates and levels of activity. Moreover, the very long period of relative price stability from the end of the Napoleonic Wars to the outbreak of the First World War consisted of a series of long price cycles due in part to variations in the supply of gold: prices declined from 1815 to 1848, but the discovery of gold in California then brought a period of rising prices that lasted until 1876; the subsequent downturn was again reversed in 1898 by the exploitation of the Klondike goldfield.

Based on annual averages for the century, the coefficient of variation of the price index is fairly high: 16.3 per cent.

5. The further decline in the efficiency of the regulatory mechanisms in the wake of the First World War created a need for greater cooperation in general, but especially between particular countries or groups of countries, that is to say between the countries of issue of the reserve currencies (the United States and the United Kingdom), between these and the country that was to become the largest holder of gold towards the end of the twenties (France), and between creditors and debtors in respect of war loans and reparations, with the ultimate creditor being the United States and the ultimate debtor Germany.

Only in the first of these three areas was there effective cooperation, attributable partly to political and cultural factors but also to the personalities of the two main protagonists: Montagu Norman, Governor of the Bank of England, and Benjamin Strong, Chairman of the Federal Reserve Bank of New York. The importance of the cooperation between the two central banks was evident mainly at the time of changes in official

Commodity prices in England, 1815-1913
Index, 1821-25 = 100



Source: B.R. Mitchell, *Abstract of British Historical Statistics*, Cambridge University Press, Cambridge 1962. 1815-46: Based on the A.D. Gayer, W.W. Rostow and A.J. Schwartz, *Monthly Indices, 1846-1913*, The Sauerbeck-Statist Price Indices.

discount rates, which were made only after consideration of the effects on the other country. The correspondence between Norman and Strong and other contemporary documents show, for example, that in 1928-29 the Federal Reserve Bank would have curbed the stock market boom and its inevitable destabilising effects by pursuing a more restrictive monetary policy, had it not been constrained by the fear of exacerbating the difficulties facing the United Kingdom, which was grappling with a drain on its gold reserves.¹

The failure of monetary cooperation to develop in the other two areas can be attributed to a lack of political cohesion among the Western powers. This manifested itself in a variety of ways. The US Department of State forbade the Federal Reserve System to

¹ On this topic, see in particular S.V.O. Clarke, *Central Bank Cooperation 1924-31*, Federal Reserve Bank of New York, 1967, pp. 147-168.

participate in the BIS because American policy-makers did not want to admit, even by implication, that there was any link between reparations and inter-Allied debts. The French, both in government and in the central bank, objected to the British exerting a financial influence that was no longer backed by an adequate capacity to provide funds and which they sometimes tried to extend to countries under predominantly French influence, such as Romania. While the United Kingdom was seeking ways of economising on the use of gold, France was trying to acquire the metal as an instrument of power and to re-establish it as the sole monetary base. The Germans were keen to cooperate mainly in areas that were not the direct responsibility of central banks, such as the provision of long-term capital, export credit schemes and the opening-up of colonial territories to German political or commercial penetration; this was the direction in which the Schacht plan was oriented, as illustrated recently by Lüke.²

Although these deep-rooted and persistent causes of division limited the scope for establishing permanent cooperation arrangements, they also generated greater interest in creating a forum where countries could meet, consult one another and possibly settle disputes; in the view of the British, in particular, the embryonic International Bank could be such a forum.

The existence of these contrasting views and the difficulty of reducing them to a common denominator can be discerned in the work of the conferences of politicians and experts in Paris, Baden-Baden and The Hague that were the prelude to the establishment of the BIS.

² Baffi is referring to the article by R.E. Lüke, *The Schacht and the Keynes Plans*, in 'Quarterly Review', vol. 38, Banca Nazionale del Lavoro, 1985.

II

THE YOUNG PLAN

1. In September 1928 the representatives of six powers (Germany, France, the United Kingdom, Italy, Belgium and Japan) met in Geneva to examine Germany's request that the withdrawal of the troops occupying the Rhineland be brought forward. The Treaty of Versailles had specified a period of occupation of fifteen years from the date of signature, but Article 431 provided for the possibility of earlier withdrawal: 'If before the expiration of the period of fifteen years Germany complies with all the undertakings resulting from the present Treaty, the occupying forces will be withdrawn immediately'.¹

Compliance with all the undertakings obviously entailed completing reparation payments, or at least fixing their overall amount and distributing a certain number of annuities. The Dawes Plan had not stipulated the number of annuities to be paid; this therefore had to be done and the receipt of the payments by the creditors had to be brought forward, as far as the markets permitted, by issuing loans that would constitute a form of mobilisation or capitalisation of the debt. Even the Agent General for Reparation Payments, Parker Gilbert, who was responsible for implementing the Dawes Plan, insisted in his Reports on the need for a final settlement.²

¹ The classic reference work on the problems raised by reparations remains *The Economic Consequences of the Peace*, where J.M. Keynes also examined the question of the Rhineland and summarised the treaty's other provisions on the arrangements for the territories concerned (Macmillan, London 1971, vol. II, pp. 65-66). Preserved among the archive papers is Baffi's note on the various articles of the Treaty of Versailles relating to the question (BIS Archive, 7.16 – *Baffi Papers*, RBL/B6).

² Following the serious difficulties which culminated, in the course of 1923, in the Franco-Belgian occupation of the Ruhr basin, the Reparation

Against the background of a temporary easing of tension in Franco-German relations, and thanks mainly to the actions of the ministers Briand and Stresemann, the representatives of the six powers meeting in Geneva reached agreement in principle on three points, as expressed in their final communiqué issued on 16 September. The first and third points concerned the opening of negotiations on the early evacuation of the Rhineland and the formation of a Committee of Verification and Conciliation, while the second point affirmed 'the necessity for a complete and definite settlement of the Reparations problem and for the constitution for this purpose of a committee of financial experts to be nominated by the six Governments'.³

Commission had at the end of November appointed the two committees of experts, chaired by Charles G. Dawes and Reginald MacKenna, charged with examining how to tackle Germany's economic and financial problems. After the collapse of the German economy, it was impossible to quantify the total amount of reparations definitively. With the approval of the Dawes Plan, it was decided to set aside the controversies generated by the issue and to renegotiate the indemnities under a five-year programme (1 September 1924 to 31 August 1929) so as to enable Germany to achieve a proper 'balance' with the financial support of the other countries. In reporting to the Reparation Commission on the progress being made, Parker Gilbert confirmed what the Plan had intended to achieve when formulated, when it had been conceived as a 'transitory' solution to make it possible to proceed more realistically to the final execution of reparations: the Plan represented the means to help Germany rebalance her public finances and bring about monetary stabilisation in order to provisionally address the payment of reparations during the five-year period and to ensure the feasibility of the programme of German economic reconstruction as part of the broader issue of European reconstruction; the basic objective, however, was still to urgently reach a conclusive agreement with the creditor countries on a final settlement of reparations, in order, as assumed, to restore the international monetary system. See the *Report of the Agent General for Reparation Payments* of 7 June 1928, pp. 2 and 108, and that of 22 December 1928, pp. 166-167; in ASBI, Beneduce, b. 128. Parker Gilbert's reports were followed with great attention by the scholars of the time, among whom see, for example, A. Cabiati, 1919-1929. *Da Versailles all'Aja*, Fratelli Bocca, Turin 1933, pp. 11 and 33. Among subsequent studies, see C.P. Kindleberger, *The World in Depression. 1929-1939*, The Penguin Press, London 1973, p. 78.

³ The salient points of the Geneva meeting of September 1928, and the conclusions reached at the subsequent sessions of the committees set up to seek a final settlement of the reparations issue, are summarised in the Final Act of the second Hague Conference of 20 January 1930; see BIS Archive, 7.16 – *Baffi Papers*, RBL/B6, and *Accords conclus à La Haye, 1929-1930*, Imprimerie Nationale, Paris 1930, BIS Library, V III 23.

2. The experts met in Paris in the office of the Governor of the Bank of France, Emile Moreau, on 9 February 1929 and elected Owen D. Young, the chief American delegate, as Chairman of the Committee on the proposal of Moreau, who had previously agreed the nomination with the second American delegate, J.P. Morgan.⁴

The Committee had greater difficulty choosing a secretary; before it finally decided to appoint the American Bate as the only secretary it discussed a proposal that it should have two deputy secretaries, one of whom would have been Pierre Quesnay, the Head of the Research Department of the Bank of France, in view of the fact that he came from one of the network of central banks that would be responsible for mobilising the reparation bonds.

The discussion on the duration of German reparation payments was opened by Moreau, who referred to the figure of 132 billion gold marks at which the German debt had been quantified by the Reparation Commission in 1921.⁵ He argued that in theory the

⁴ The members of the Committee were: E. Francqui, Vice-Governor of Société Générale de Belgique, and C. Gutt, Belgian delegate of the Reparation Commission, for Belgium; E. Moreau, Governor of the Bank of France, and J. Parmentier, Governor of Crédit Foncier, for France; H. Schacht, President of the Reichsbank, and A. Voegler, General Manager of Vereinigte Stahlwerke AG, for Germany; A. Pirelli, of the Pirelli group, Chairman of the International Chamber of Commerce, and F. Suvich, member of the Financial Committee of the League of Nations, for Italy; T. Aoki, of the Nagoya branch of the Bank of Japan, and K. Mori, member of the Japanese Diet, for Japan; J. Stamp, Chairman of the London, Midland and Scottish Railway, Director of the Bank of England, Lord Revelstoke, Chairman of Baring Brothers, Director of the Bank of England, and Sir Charles Addis, Chairman of the London Committee of the Hong Kong and Shanghai Bank, Director of the Bank of England (replacing Lord Revelstoke as from April 1929), for the United Kingdom; and O.D. Young, Chairman of General Electric, Director of the Federal Reserve Bank of New York, and J.P. Morgan, Chairman of Morgan & Co, New York, for the United States. The alternates were: Ch. Terlinden and H. Fabri, for Belgium; C. Moret and E. Allix, for France; C. Melchior and L. Kastl, for Germany; Sir Charles Addis and B. Blackett, for the United Kingdom; G. Bianchini and B. Dolcetta, for Italy; S. Sonoda and Y. Matsui, for Japan; and T.N. Perkins and T.W. Lamont, for the United States. Also taking part were various other experts, mainly American: F. Bate, W.R. Burgess, S.N. Crocker, F. Eberstadt, Leon Fraser, Dean Jay, Shepard Morgan, J.A.M. de Sanchez, David Sarnoff and W.W. Stewart. See *Report of the Committee of Experts on Reparations (Young Committee, June 7, 1929)*, H.M.S.O., London 1929, in BIS Archive and BIS Library, V III 22.

⁵ The discussion in question was held during the first official meeting of

payments should continue in perpetuity, since the annuities requested were lower than the hypothetical payment of interest at 2 per cent. He called for payments to last for 60 years (compared with the thirty mentioned in the Treaty of Versailles), this being the period for which France in turn had committed itself towards its own creditors. Moreau's proposal found support from Pirelli, who had been a member of the Dawes Committee, and Francqui, but was opposed by Schacht, who maintained that Germany's obligations should be determined on the basis of its capacity to pay and should accord with the spirit of the peace treaty, which had not intended to place a burden on Germany for more than one generation, partly in order to allow the war to be forgotten. Schacht pointed out that Germany's trade balance had shown a deficit of 10 billion Reichsmarks since the Dawes Plan had come into effect; reparations totalling 6 billion Reichsmarks⁶ had been financed by

the Young Committee on 11 February 1929. The Committee's work, which culminated in the drafting of the final report in June 1929, is documented in the official minutes; see *Comité des Experts, Procès-Verbaux n. 1-29, Février à Juin 1929*, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B9. For more on the discussions referred to in this chapter, see the *Comptes Rendus* of the Committee's meetings collected by Quesnay for the period from 12 February 1929 to 22 May 1929 and by Moret from 12 February 1929 to 19 April 1929, *ibid.*; and Moret's *Comptes Rendus* for the meetings between 20 April 1929 and 7 June 1929, preserved in BIS Archive, 7.16 – *Baffi Papers*, RBL/B10. See also *Extraits des comptes rendus de M. Moret des Séances du Comité des Experts du Plan Young (Paris, Février-Juin 1929)* and the manuscript of M. van Zeeland, *B.I.S. reconsidered – Comité Young*, both preserved in BIS Archive, 7.16 – *Baffi Papers*, RBL/B13.

⁶ Schacht was referring to the indemnities paid since the Dawes Plan had been applied (1 September 1924). The Plan established that the total amount of annuities was to be 7,970 million gold marks from the end of the fifth year (31 August 1929), while from the end of the fourth it should have been equivalent to 5,470 million gold marks. See *Report of the Agent General, op. cit.*, 22 December 1928, pp. 6 and 169. The results of the Reparation Commission's calculations as to the total payments made by Germany from the end of the war up to 1931, however, showed a series of discrepancies vis-à-vis the German government's, as recalled by Kindleberger, *op. cit.*, p. 35, where the author reports the overall data on reparations as summarised by E. Mantoux in his volume *The Carthaginian Peace or The Economic Consequences of Mr. Keynes*, Oxford University Press, London 1946.

The Reichsmark had a parity of 4.198 to the dollar. With the monetary reform initiated in autumn 1923, Germany had introduced the Rentmark, equivalent to 1,000 billion paper marks; in August 1924, under the Dawes Plan, the final reform was begun with the withdrawal of the old paper marks

capital inflows of 13 billion Reichsmarks, of which 6 billion had been at short term; this gave rise to interest payments of more than 1 billion Reichsmarks a year, and this in a world economic and political climate that was unfavourable to the necessary expansion in German exports.

Francois countered these arguments by pointing out that Germany had rebuilt its domestic real assets (plant, stocks, public works) and had accumulated a mass of foreign credit in the form of investment and reserves.

At these meetings in February 1929 Schacht and Melchior raised the issue of exports in the terms that Schacht would continue to employ for the next eight years, until his involvement in the monetary negotiations in the summer and autumn of 1936 and his article in 'Foreign Affairs' in January 1937.⁷ They maintained that Germany belonged to the group of industrialised countries that had progressed beyond the stage in which the exploitation of their domestic mineral and agricultural resources could be financed by importing foreign capital. A balance-of-payments deficit was characteristic of new countries, so that it was inappropriate to compare Germany with countries such as Algeria, as Moreau had done to imply that the German deficit was a natural phenomenon. They complained that the Reich had been deprived of the coal of the Saar, the potash of Alsace and the iron of Lorraine.

A tense debate developed between the creditors and Schacht on Germany's economic condition. The creditors made much of the vast improvement in the country's economic conditions since 1922,

and the issue of the new monetary unit, the Reichsmark, which had a gold content equal to 0.358423 grams of gold.

⁷ See H. Schacht, *Germany's Colonial Demands*, in 'Foreign Affairs', vol. XV, January 1937, no. 2. Schacht considered the division of resources which had occurred at international level between the 'Haves' (the British Empire) and the 'Have-nots' (Germany, Japan and Italy) to be a risk factor for peace, and maintained that the colonies were necessary for the supply of raw materials. In support of his argument, Schacht cited in his article the speech given by a British authority some time previously in the House of Lords, which Baffi sought to track down by contacting, among others, the Bank of Italy's delegate in London. Baffi's research into the matter, regarded as 'an important element of economic history during the interwar years', led to the tracing of the text of the speech by Lord S. Arnold in the House of Lords, 25 March 1936, *Raw Materials and Fiscal Policy*, pp. 233-246; see Correspondence Baffi-De Novellis, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B22.

as documented by the latest report from the Agent General for Reparation Payments, Parker Gilbert; whereas the Dawes Plan had envisaged that Germany would achieve parity with its creditors in terms of the standard of living and the tax burden, it had in fact overtaken some of them. With regard to the level of taxation sufficient to guarantee transferability, the debate foreshadowed some of the arguments that would subsequently be used in the debate between Keynes and Ohlin.⁸ Drawing on theoretical papers by Aftalion, the creditors maintained that the equilibrating mechanism of the current account (including reparations) did not operate if there were massive capital inflows or budget deficits.⁹

Schacht counterattacked by emphasising Germany's weak spots: the balance-of-payments deficit and the crisis in agriculture. On the first point, Moreau put forward the classic argument used by Strong in their own meetings during the franc crisis of 1926, namely that if Germany could bring itself to remove the restrictions on both inward and outward movements of funds German capital that had been transferred abroad would be repatriated.

As to the improvement in the standard of living of the German population, the German experts conceded that real wages were considerably higher not only in relation to 1922 but also in relation to 1914, but they maintained that the living conditions of farmers and the middle classes had deteriorated. They also admitted that the public debt was only a fraction of what it was in creditor countries: 4 per cent of the budget, compared with 44 per cent in the United Kingdom, 30 per cent in France and 25 per cent in Italy.

Despite the smallness of Germany's public debt, interest rates were higher in Germany than in the creditor countries. A debate also ensued on this differential, with the Germans claiming that it

⁸ The exchange of views in 1929 between Keynes and Ohlin on the German question unfolded in 'The Economic Journal'; see J.M. Keynes, *The German Transfer Problem*, March 1929; *A Rejoinder*, June 1929; *A Reply by Mr. Keynes*, September 1929; and B. Ohlin, *The Reparations Problem: a Discussion*, in 'The Economic Journal', vol. XXXIX, June 1929, no. 154. The discussion, which subsequently drew the attention of scholars, is mentioned by R.S. Masera in the preface to the Italian edition of S.V.O. Clarke's volume, *La collaborazione tra banche centrali dal 1924 al 1931*, Cariplo-Laterza, Milano-Bari 1984, which assembles bibliographical notes on the matter.

⁹ See A. Aftalion, *Monnaie et industrie. Les grands problèmes de l'heure présente*, Sirey, Paris 1929.

was holding back the economic development of their country and the creditors arguing that it proved the existence of greater and more profitable investment opportunities in Germany. Schacht pointed out that the municipalities had used a large proportion of the capital inflows from abroad on unproductive expenditure.

3. Although the experts were unable to agree on the economic conditions of Germany and its capacity to pay, they moved on to discuss the 'organisation' of the transfers. The creditors showed themselves willing to make concessions on the transferability of the annuities, on condition that the 'new idea' of commercialisation be introduced into the system and that the total amount of debt commercialised be large enough to justify dividing it into two parts, one of which would be conditional.¹⁰ In opting for division of the debt into two parts the Committee had to overcome the resistance of Moreau, who considered that only total commercialisation would make it possible to settle once and for all the 'irritating problem' of the financial relations between states resulting from the war.

It was agreed that both parts of the annuities would be paid to an independent trustee, who would take the place of the Transfer Committee established under the Dawes Plan. The division into the two parts could be decided from time to time by a committee or set automatically on the basis of indicators, such as the balance-of-payments situation, the exchange rate or interest rates. The experts opted for a Special Advisory Committee, whose members would be appointed by the governors of the central banks. This was basically a new Transfer Committee, which would be called into action in the crisis in the summer of 1931.¹¹

The experts then came to discuss the question of the trustee, and wondered whether the institution should encompass all the interested parties, amongst whom were mentioned central banks, representatives of the League of Nations, commercial banks and representatives of the foreign holders of German securities.

¹⁰ See note 11.

¹¹ As established in the Young Plan, the Special Advisory Committee had to be convened to examine when Germany's difficulties might be such as to require a postponement of the transfer of part of the German annuity. See also Chapter XI below.

Initially they endorsed Francqui's proposal that the main commercial banks of the entire world should set up an institution to act as trustee; Morgan suggested it should be based in the United States, but the idea of establishing it in a neutral country subsequently prevailed.

A number of possible alternatives as to the nature of the bonds to be issued and the means of placing them were put forward in the Sub-committee on Commercialisation. Moreau suggested dividing the commercialised debt into several tranches, each backed by a specific guarantee (revenue from the Reich railways, a lien on industry, duty on alcohol, other taxes, and so on). The American delegates, Morgan and Lamont, opposed the division into several sub-tranches backed by separate guarantees since it would fragment the market. The discussions led to the drafting of various alternative formulae, some of which would entail the Reich undertaking to maintain railway fares at remunerative levels and would make certain revenues (customs duties, consumption and transport taxes) subject to a negative pledge. Moreau suggested internationalising the bonds, in other words issuing them in various currencies at a fixed parity; however, it was decided instead to denominate them in the national currency of the country of issue, mainly to allay two fears, namely the fear among creditors that the supply of German bonds could become concentrated in a single market (France, for example) and the fear on the part of Germany that in the event of exchange rate changes holders would always demand debt servicing in the strongest currency, thus increasing the burden on the debtor and making the precise liability impossible to predict. Moreau's other proposal that each government should have the right to convert its domestic public debt by offering bonds of this kind was accepted.

It was agreed to follow the formula adopted for the Dawes Loan, which was issued in several currencies (the French tranche being in sterling). It was debated whether it was better to speak of mobilisable and non-mobilisable annuities or of unconditional and conditional annuities.¹² Melchior differed from Schacht in

¹² For a definition of partly 'unconditional' German debt, i.e. with non-deferrable transfer (corresponding to the mobilisable part), and partly 'conditional', with the possibility of deferring transfer of the sums due in exceptional cases of difficulty, see the *Report of the Committee of Experts*, *op.*

that he was concerned to set limits on the transferability of the annuities rather than on their amount.

4. While the Committee was in session Young had private meetings with Schacht, Randolph Burgess and others, as a result of which he introduced the idea that the trustee should be an institution of considerable weight. It should be able to perform a clearing function between the central banks of the countries involved in the payment of reparations and war debts and be authorised to grant loans and to issue a kind of world currency. It would obtain its resources by accepting deposits, including initially a sufficiently large deposit from the German Government to allow the final twenty-five of the sixty annuities in payment of the governmental debts to the United States to be discounted. The institution could lend to Germany if there was question of a suspension of transfer. In some ways it would be a general war settlements agency, intended to take the two problems of reparations and inter-Allied debts out of the political arena. In Schacht's view there should also be provision for the institution to issue non-interest-bearing notes, which would be treated in the central banks' books as reserve instruments comparable to gold and would be guaranteed by non-mobilisable securities issued by the German Government. However, the latter idea was vigorously opposed by the French (Quesnay), and was therefore discarded.¹³

5. The Young Plan was examined in early March by a working party composed of Shepard Morgan (Finance Director, Office of the Agent General for Reparation Payments in Berlin), Stewart (of the Federal Reserve Bank of New York), Eberstadt and Quesnay.

The working party divided the functions of the proposed 'agency for international settlements' into those that were

cit., part 8, *Annuities*. The same document enunciates all the terms and procedural modalities prescribed for commercialising the debt; *ibid.*, Annex III, *Mobilisation* and Annex IV, *Conditions of postponement of transfer and of payment*.

¹³ Some references to the first informal meetings held to discuss Young's idea can be found in *Extraits des comptes rendus de M. Moret des Séances du Comité des Experts du Plan Young (Paris, février-juin 1929)*, BIS Archive, 7.16 – *Baffi Papers*, RBL/B13; see also M. van Zeeland, *Comité Young*, *op. cit.*, RBL/B16.

obligatory and those that were optional, the obligatory functions being those that had already been considered by the Subcommittee on Commercialisation.¹⁴

The final text of the plan for the organisation of the new 'international institution' was drafted by three Americans (Eberstadt, Shepard Morgan and Stewart). The institution would derive its resources from (a) subscribed own capital, (b) working funds consisting of a financial contribution from Germany, (c) the proceeds of the sale of notes or securities issued as a counterpart to existing securities denominated in non-convertible Reichsmarks, (d) central bank deposits and (e) the rediscounting of bills.

The function of trustee would involve managing three types of German obligation: (A) unconditional obligations, (B) conditional obligations and (C) payments in kind. This would entail distributing the unconditional and conditional obligations among creditors in the form of certificates or payments, distributing the proceeds of the sale of bonds to the public, servicing the bonds, investing in Germany balances in Reichsmarks that had not been converted into other currencies and administering the German External Loan 1924 (the Dawes Loan).¹⁵ Provision was also made for the possible issue of negotiable warrants in respect of payments in kind; these would give the bearer title to the deliveries, with provision for the German suppliers to discount them at German banks and to present them to the Reichsbank for payment at maturity.

As a counterpart to the investment of the untransferred portions of annuities in Germany, the institution would have the power to issue bills, notes and bonds and to use the proceeds to make the foreign payments owed by Germany.

The institution's functions as a central body would include not only lending to and accepting deposits from central banks but also operations in foreign exchange markets to correct exchange

¹⁴ See what Moret writes about the meeting of 4 March 1929 in relation to the working party, in M. Moret, *Extraits des comptes rendus*, *op. cit.*

¹⁵ The External Loan of 800 million gold marks, with a 25-year maturity, was issued in October 1924 in New York, London and the other European markets as part of the German stabilisation effort and in line with the objectives of the Dawes Plan. On the role played by central bankers in negotiating the loan and the terms of its issue, see Clarke, *op. cit.*, pp. 49-68.

abnormalities and the creation of earmarked gold deposits in order to replace physical transfers of gold between countries by book entries and to use the deposited gold as collateral for loans.

The text insists, however, that the institution's operations in national markets may not jeopardise control of the markets by the competent central banks.

Finally, it expresses the desire that the administration of the new institution be entrusted to non-political staff. To that end, it provides that the directors be selected from lists submitted by the governors, comprising candidates drawn half from the world of finance and half from industry.

This initial American plan of March 1929 represents the first and at the same time the most advanced attempt to depoliticise the problem of reparations; the administration of the payments would be entrusted to a body independent of governments, with central banks merely contributing capital, while management would be vested in representatives of industry and finance. The reparations debt, including even the part represented by deliveries in kind, would be converted into marketable securities by means of an operation that would replace a small number of official creditors (governments) by a host of private holders in a relationship protected from the vicissitudes of relations between states and backed by long-established and exacting commercial ethics.

In this plan 'it is obviously desirable that this institution should be sufficiently broad to permit its activities to extend beyond the field of Germany's obligations, and to provide facilities for international settlements in general'.¹⁶ The American authors of the draft informed the experts unofficially that this sentence was intended as an allusion to the role the institution could play in dealings with the US Government on the settlement of inter-Allied debts and Morgan confirmed this during discussion of the plan. In the distributed text the proposed institution was called the 'Bank for International Settlements'. The capital envisaged was 400-500 million Reichsmarks, to be raised by selling securities issued by the German Government and

¹⁶ See Young's presentation of the plan to the Committee of Experts at the meeting of 6 March 1929. See M. Moret, *Extraits des comptes rendus*, *op. cit.*

allocating shares in the institution to creditor governments, which would be free to dispose of them.¹⁷

6. Moreau noted that the great advantage of the Young proposal was that it 'sought the means of removing the problem of reparations from the political arena in order to treat it as a commercial and financial problem'.¹⁸

As regards the new Bank's investments, he emphasised that the transfer of amounts owed by Germany should not be financed through investments by the Bank in securities issued by the Reich Treasury. He wanted the Bank's investments in Germany to be in shares, or better still in assets represented by securities that could be realised in the international market.¹⁹

Schacht wanted the Bank to have even wider lending powers. It should issue non-interest-bearing notes equivalent to gold on the basis of non-mobilisable securities transferred to it by the German Government.

Recalling the recent experiences of inflation in France, Italy and Belgium, Moreau said that in his view Schacht's proposal represented an artificial method of organising credit. The Bank should not compete with private commercial banks.

The plan envisaged that the untransferred portion of the reparation annuities would be deposited at the Reichsbank in an account in the name of the BIS; Parmentier wanted the deposit to be held in the form of 'Reichsmark notes' in order to have an effect on the cover ratio, but both Schacht and Stamp opposed this bizarre idea.

Schacht was hostile to the issue of shares to the public; the Bank's profits should be capitalised and the Bank should have the character of an institution of public interest.

The committee discussed whether the Bank's resources should consist of deposits from governments or from central banks. Moreau thought it advisable that the reparations annuities be paid entirely to the Treasuries and that the central banks use foreign exchange drawn from their own reserves to make deposits at the Bank.

¹⁷ See the report on the presentation of the plan and the ensuing discussion, which includes Morgan's speech; *ibid.*

¹⁸ Speech by Moreau on 8 March 1929; see M. Moret, *Extraits des comptes rendus*, *op. cit.*

¹⁹ *Ibid.*

Francqui wanted the shareholders to be private banks.²⁰

On 12 March, at the suggestion of Sir Basil Blackett, it was decided that the Bank's capital should be \$100 million, one-quarter paid up. Voting rights would be reserved to the central banks, which would appoint the directors, with each country exercising equal voting rights.

Moreau and Francqui, however, wanted voting rights and representation on the board of directors to be proportional or at least positively correlated to the credits (and debits) for each country's reparations. In Morgan's view, on the other hand, voting rights and representation on the board should be correlated to the size of the countries' financial markets.

Moreau considered that there should be a first category comprising France and Germany, a second consisting of the United States and the United Kingdom, and so forth. He suggested adding Switzerland and the Netherlands to the countries with an interest in reparations in view of the importance of their markets.

Melchior accepted that Germany should place bonds worth 5 billion Reichsmarks at the disposal of the Bank, to be amortised by annual payments by the Reich independent of the payment of ordinary annuities. He too thought that the Bank's resources should include compulsory deposits from the central banks in proportion to the annuities paid to their governments.²¹

It was decided that the shares of the Bank, with a nominal value of \$100 million, would be offered for subscription in the seven countries, with the option for each country to resell up to 4,000 of their allotted shares. At Moreau's insistence, it was decided that until reparations had been settled in full both France and Germany would have three members each on the board of directors, compared with the two allotted to each of the other five countries. It was also decided that five other countries – Greece, Romania, Poland, Portugal and Czechoslovakia – could have one director each.²²

²⁰ Discussions on the meeting of 11 March 1929. See M. Moret, *Extraits des comptes rendus*, *op. cit.*; for the speech by Parmentier, in particular, see also the discussion of 8 March 1929, transcribed in *Comptes Rendus*, M. Moret and M. Quesnay, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B9.

²¹ Meeting of 12 March 1929; see M. Moret, *Extraits des comptes rendus*, *op. cit.*, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B13.

²² Meeting of 15 March 1929; *ibid.*

The French, supported by the British and the Americans, proposed that the Bank have its headquarters in Brussels, but the proposal was not acceptable to the Germans. Schacht especially did not want the Bank to be located in a country with which Germany had a territorial dispute (Eupen and Malmédy);²³ he ruled out Brussels in the same way as he would rule out Warsaw because of Danzig or Kovno because of Memel. The question of the institution's domicile remained open.²⁴

7. In mid-March Sir Charles Addis, on behalf of the British, submitted draft statutes that would greatly restrict the scope of the Bank's activities; for example, there was no provision for interest to be paid on central bank deposits.

In the discussion of the proposal it was conceded that countries could sell as much as 44 per cent of their allotted shares; this would create room for subscriptions by other countries (Switzerland, the Netherlands and Yugoslavia) in addition to the five mentioned above. The maximum number of directors was set at 25 (14 + 2 + 9).²⁵

The draft provided that part of the reparation payments could be assigned to the BIS to create a 'Special Reserve Fund', with the Bank issuing 'certificates of participation' to governments

²³ In fixing Germany's new boundaries, the Treaty of Versailles (Articles 27-30) had provided for Eupen and Malmédy to be ceded to Belgium; it had also sanctioned the transfer of Alsace-Lorraine to France and of Poznan and the Polish Corridor up to the Free City of Danzig to Poland, while proclaiming Danzig and Memel free cities (Articles 99-102).

²⁴ Meeting of 16 March 1929, in BIS Archive, 7.16, *Baffi Papers*, box RBL/B13.

²⁵ The final statutes text which emerged from the meeting established that the new organisation's capital would be made up of issues of equivalent amounts of shares in the seven countries represented on the Committee of Experts; but each central bank would in fact be able to sell part if its subscription rights provided that the quota sold did not exceed 4 million dollars and total sales did not exceed 44 million. This mechanism enabled the maximum number of directors to be set at 25; for the seven countries represented, the total number of appointees (central bank governors, ex officio board members, plus the board members appointed by the governors themselves) came to 16 directors, taking into account Moreau's proposal; these in turn would appoint nine other directors, mainly from lists presented by the member countries, including industrialists and financiers. See the meetings of 18 and 19 March 1929; *ibid.*

with reparation claims, and that the certificates should give holders entitlement to a share in the profits of the Bank.

The proposals laid down that the Bank's accounts in the various countries should be held exclusively at the central bank.

They also stipulated that in order to increase its resources the Bank could issue its own bonds secured on the German annuities allocated to the Special Reserve Fund.

The draft statutes presented by Addis were incorporated into a general plan drawn up by Stamp on the basis of the discussions and the work of the three Sub-committees on Transfer Safeguards, Commercialisation and Deliveries in Kind, chaired respectively by Stamp, Lord Revelstoke and Perkins.²⁶

8. The negotiations on reparations progressed with greater difficulty, such that the negotiators sought relief by alternating them with the easier task of defining the responsibilities of the new financial institution.

Difficulties were encountered with regard to the amount and duration of the annuities to be transferred, their division into unconditional and conditional parts, the possibilities for mobilisation and the moratory provisions.

The initial French position was that German reparations should be sufficient to cover payments for war debts to the United States and the cost of reconstruction in devastated regions. However, France was prepared to reduce its demands on condition that the debt be commercialised. As an indication of the extent of possible French concessions, Moreau cited the reductions accepted by the Americans in the Mellon-Bérenger agreement on the settlement of France's war debts (60 per cent of the amount owed).²⁷

²⁶ The general draft statutes were approved at the meetings of 18 and 19 March 1929; *ibid.*

²⁷ The Mellon-Bérenger agreement had been reached in 1926 and was part of the series of bilateral agreements on the settlement of inter-Allied debts entered into on the basis of separate negotiations, given America's intransigence towards accepting a general cancellation of war debts and recognising any interdependence between reparations and debts. At the time, the French Parliament had added a 'security clause', with which it reserved the right to revise the terms of the agreement if Germany failed to make her reparation payments. In fact, the issue dragged on until, in 1929, the French Parliament decided to drop the clause and ratify the agreement. See P. Renouvin, *La crisi del secolo XX*, vol. 7, in *Storia politica del mondo*, UNEDI, Rome 1975, pp. 310-311.

A debate developed between Moreau and Young on the discount rate to be used to calculate the current value of the annuities; Moreau called for a rate of 6 1/2 per cent, whereas Young suggested 4 1/4 per cent.

It became plain that there was implacable disagreement on the burden Germany should be expected to bear; as a result, Young dissociated himself from the creditors and the French envisaged reverting to the Dawes Plan. The British (Stamp) were also inclined to compromise in order to bring the negotiations to a conclusion. Parker Gilbert intervened officially in the discussions.

It was remarked that creditors retained half of the normal annual Dawes annuity of 2,500 million Reichsmarks and the other half was supposed to meet the payment of their political debts. It was argued that since a moratorium had been announced for the early instalments of the political debts the annuity could be reduced without harming the creditors. There was also a move towards abandoning the index of prosperity:²⁸ the first half of the annuity, the part from which creditors derived a net benefit, would therefore be fixed. Among the other advantages Germany would derive from the application of the new plan, Moreau recalled the abolition of controls imposed by the Allies and the possibility of financial assistance from the BIS.²⁹

9. The creditors eventually reached agreement along lines suggested by Parker Gilbert on a joint memorandum on a new scheme able to ensure 'the complete and definitive settlement of the problem of reparations'.

²⁸ On the basis of the Dawes Plan, the burden of German payments had been spread over the five-year period (1924-29) on a rising scale of quotas reflecting Germany's capacity to pay, increasing from 1,000 million marks in the first year to the 'normal' amount of 2,500 million in the fifth. The Plan left subsequent amounts undetermined, providing for them to be related to a statistical coefficient that would measure the capacity to pay based on the country's index of 'prosperity'. See *Report of the Agent General, op. cit.*, 22 December 1928, pp. 10-11.

²⁹ These discussions regarding the various approaches to an agreement on how to calculate German annuities were held between 22 and 27 March 1929. See *Comptes Rendus*, M. Moret, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B9, and *Rapport du Premier Comité d'Experts, Paris 1924, Annexe 2075 de la Commission des Réparations*, in ASBI, Beneduce, b. 113.

The experts suggested 'to replace a part of the advantage of the index of prosperity by a participation by the Creditor States in the profits of the International Bank, and by the commercialisation of a part of their credits which can be carried out by means of the Bank'.

The memorandum confirmed that the annuity was considered as covering (a) the creditors' political debts to the United States; and (b) war damage suffered by the civil population. It indicated that the amount required under (a) was a constant annuity of 1,350 million gold marks payable for 58 years but did not rule out the possibility of an equivalent rising annuity, modelled on the instalment payments to the United States and beginning at 870 million gold marks. 'A part of the profits of the International Bank may be assigned to Germany and mount up to allow her to cover, after 37 years, all or part of the annuities remaining due for debt repayment'. The second part of the annuity was to be made unconditional and payable for 37 years; in Moreau's view, at least this part should be mobilisable.³⁰

The Committee sought formulae that would encourage the acceptance of unconditionality, such as a discount. The French suggested instead using the index of prosperity to adjust the untransferred part.

In the opinion of the experts from the creditor countries, the programme

makes it possible to relieve the problem of reparations of all political character, to get rid of the financial controls which limit German sovereignty and the uncertainties which weigh upon her credit and her economic life, to create the International Bank with its great advantages for Germany, and finally to facilitate international rapprochement and the development of world prosperity.³¹

The memorandum did not, however, satisfy the Chairman, Young, who feared that Schacht would reject it; it was only at the insistence of the creditors that Young undertook to read the memorandum to the meeting, accompanied by a personal declaration.³²

³⁰ See *Committee of Experts, Annex 6 – Memorandum on the Annuities for the Future Plan*, 27 March 1929, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B6.

³¹ Meeting of 27 March 1929; see *Comptes Rendus*, M. Moret, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B9.

³² *Ibid.*

10. The reading took place on 28 March; in his personal statement Young suggested figures for part (b), country by country; the figure for France (40 billion francs, equal to around 7 billion Reichsmarks) was immediately contested by Moreau, even on the hypothesis that it would be entirely mobilised.³³

Parker Gilbert told some of the delegations that there was reason to be optimistic about the chances of agreement, arguing that:

(i) the German Government had strong ambitions to obtain the evacuation of the left bank of the Rhine, where the military occupation was fostering communist influence; it was therefore instructing Schacht not to break off the negotiations;

(ii) the British were also eager for an agreement, partly in order to defend sterling; if a settlement were not reached, the French Parliament might refuse to ratify the Mellon-Bérenger agreement, in which case France would presumably use part of its sterling reserves to purchase the dollars needed to pay its American debt;

(iii) with an eye to the imminent elections in May, the British Labour Party was campaigning for the immediate and unconditional evacuation of the Rhineland; the Conservative Government, on the other hand, had an interest in achieving a negotiated evacuation.³⁴

One of the clarifications requested by Schacht concerned the reasons why the delegates from creditor countries had adopted moratory provisions different from those contained in the agreements on French and Italian war debts to the United States. In reply it was pointed out that the settlement of the British debts in the Baldwin-Mellon agreement³⁵ made no provision for moratoria and that in the case of Germany the country's capacity

³³ See *Committee of Experts, Annex 7, Statement by Mr. Owen D. Young*, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B6.

³⁴ Meeting of 6 April 1929; see *Comptes Rendus*, M. Moret, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B9.

³⁵ The Baldwin-Mellon agreement, signed at the beginning of 1923, had constituted the first of the bilateral agreements with which it had been intended to settle the issue of inter-Allied debts. The agreement had been concluded by the United Kingdom as one of the measures required for British monetary stabilisation and provided for a rescheduling and a reduction in the interest rate on the debt owed to the United States. See L.V. Chandler, *Benjamin Strong Central Banker*, The Brookings Institution, Washington 1958, pp. 293-294; H. Clay, *Lord Norman*, Macmillan, London 1957, pp. 176-179.

to pay had been determined under the Dawes Plan, which entailed higher annuities than those agreed.

The debate in the Sub-committee on Transfer Safeguards, on the other hand, led the experts to give the German Government the option of declaring a moratorium of two years on the conditional part of the reparations annuity, similar to the arrangement laid down in the agreements on the settlement of Italian and French inter-Allied debts; during the moratorium the payments would be made in Reichsmarks to a blocked account at the Reichsbank. A Special Advisory Committee on Transfers would also be set up, but its terms of reference did not include assessing Germany's 'capacity to pay'.

Schacht was also dissatisfied by the lack of any forecast of the part of the profits of the International Bank that would be assigned to Germany. Furthermore, he wanted to know whether Germany would be allowed to benefit from any direct or indirect reduction in political debts agreed by the United States. He was given vague assurances on this point.³⁶

11. The bilateral negotiations thus began. The negotiations between Schacht and Francqui concerned the problem of the repayment of the banknotes issued in Belgium during the German occupation; the negotiations proved extremely delicate, since Schacht typically steered them onto the political issue of the fate of Eupen and Malmédy. The same political approach led Schacht to declare himself ready to take over Austria's war debt, with an eye to the 'Anschluss'.³⁷

In the negotiations between the Germans and the French Moreau put the total damages sustained by persons and property at 350 billion francs, equal to 57 billion Reichsmarks; by comparison, France asked only for an annuity of 650 million Reichsmarks for 37 years. However, he demanded that the entire amount be part of the unconditional portion of German payments and be eligible for immediate mobilisation. Moreau discounted

³⁶ Meetings of 4 and 5 April 1929; *ibid.* See also the notes of 4 April 1929 with the written questions submitted by the German representatives, *Committee of Experts, Annex 6A, Annex 7A*, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B6.

³⁷ See, in particular, the discussion of 22 March 1929, *Comptes Rendus*, M. Moret, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B9.

the annuity at a rate of 7 per cent, but was prepared to use a significantly lower rate, and hence also to reduce the annuity.

Moreau boasted of the part he played in the creation of the BIS, which he wanted to be endowed with very substantial resources. In his view, the Bank would invest a large proportion of the capital under its management in Germany and thus aid the economic development of the Reich. Provision was made for a series of measures to ensure that Germany would be the main beneficiary of the activity of the new institution.

Schacht protested first to the French and then to the group of creditors in general that the requests he had received in the bilateral meetings added up to an annuity of 2,760 million Reichsmarks for 38 years, far in excess of the Dawes annuity, so that he refused to discuss it or to make counterproposals.³⁸

The fragmentation of the negotiations was clearly the cause of this escalation in demands; Schacht may have astutely chosen such a procedure in order to provoke just this result. Faced with his refusal, the creditors turned on one another with mutual accusations of greed and irresponsibility.

12. Young, whom the British urged to act as mediator, suggested reducing the total claims to 2,250 million Reichsmarks and severing the link with the repayment period for inter-Allied debts (62 years, of which four had already elapsed). The second of these proposals was rejected; Young was asked to present a plan that would preserve the identity between the period for the payment of war debts and that for the payment of reparations. He was to be assisted with drafting the proposal by de Sanchez, of Morgan, and Eberstadt, formerly of Dillon Read, who in their turn consulted Parker Gilbert.

The plan allotted France an annuity that covered its payments of inter-Allied debts to the United Kingdom and the United States plus a sum of 40 billion francs as reparations, the current value of 37 annuities computed at 5 1/2 per cent. The United Kingdom was allocated an annuity that would cover its debts to the United States.³⁹

³⁸ Meetings of 5 and 6 April 1929; *ibid.*

³⁹ Meetings of 6 and 8 April 1929; *ibid.* See also Young's note of 8 April 1929, *Committee of Experts, Annex 9*, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B6.

During the negotiations on the proposal, Young and Stamp tried to moderate the aspirations of the creditors, especially France, in order to keep the average annuity down to 2,200 million Reichsmarks, a figure that was assumed to be acceptable to Schacht. Young also opposed Francqui's proposal to extend the payment period from 37 to 45 annuities, arguing that Germany should not be burdened for longer than one generation. He explained that he had not been able to consider any reduction in the United States' claim on Germany, because the Americans, unlike the other experts, had not been appointed by their Government; they had received their mandate only from the Reparation Commission and Germany. He encouraged the experts from the other countries to take the initiative in demanding some sacrifice from the United States.

The action of Young and Stamp induced Moreau to moderate his demands, on condition that the German debt be mobilised immediately; although it would increase over time in accordance with a scale that had yet to be laid down, the annuity therefore had to be sufficient from the outset to guarantee the payment of interest on the securities.⁴⁰

When the note containing the demands of the four main creditors (France, the United Kingdom, Belgium and Italy) was being drafted for presentation to Schacht, Young threatened to side with Schacht if the note was couched as an ultimatum. Agreement was reached on a scale rising from 1,800 million Reichsmarks at the outset to 2,450 million Reichsmarks, with an average of 2,198 million; after the 37th year the annuity would be adjusted in line with the annuity for war debts, around 1,800 million Reichsmarks. This represented a considerable alleviation by comparison with the Dawes Plan and also entailed the abandonment of the index of prosperity.

The reduction was justified on the grounds of the advantage that mobilisation of the unconditional portion represented for creditors. It was proposed that Germany should pay special annuities in order to provide the BIS with financial resources.⁴¹

⁴⁰ Meetings of 9 and 10 April 1929; *ibid.*

⁴¹ Meeting of 13 April 1929; *ibid.* See also the note of 12 April 1929, prepared by the representatives of the main creditor countries, on the

13. During this phase in the negotiations, in mid-April, the experts learnt of a letter from the German Chancellor Müller to the Belgian socialist Vandervelde in which, in contrast to the attitude of Schacht, he stated the German Government's desire to reach agreement.

Schacht's response to the note from the creditor countries was to request a number of clarifications, in his capacity as an 'independent expert'; among other things, he wanted to know how the annuity would be distributed among the creditors.⁴²

Once he had received the information he had requested, Schacht brought the discussion back to Germany's capacity to pay, pointing out the persistent deficit in the balance of payments on current account, financed by inflows of long and short-term capital, the poor state of agriculture and industry and the difficulties in the public finances. Moreau challenged him, using German sources. In Schacht's view, however, the capacity to pay depended mainly on future conditions for the development of the German economy. The debtor country had to be able to find industrial raw materials within its own borders or in territories under its control; new markets also had to be opened up for manufactured goods, so that protective barriers against the penetration of German products had to be dismantled. Schacht also lamented the existence of a corridor of foreign territory separating a rich agricultural region such as East Prussia from the rest of Germany, thus impairing the food supply of the entire nation. Moreau countered by pointing out the Committee's complete lack of competence in political matters and Schacht persisted in refusing to give an estimate of his country's capacity to pay while the problems of the kind he had indicated remained unsettled. Urged by Stamp to indicate at least an order of magnitude for the annuity on the assumption that the outstanding points could be resolved satisfactorily, he mentioned a figure of 1,650 million Reichsmarks, of which 450 million would be in foreign currencies, 900 million in Reichsmarks with an exchange

calculation of the annuities to be paid by Germany, *Committee of Experts, Annex 8*, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B6.

⁴² It was at the meeting of 15 April 1929 that the note of 12 April was discussed; see *Comptes Rendus*, M. Moret, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B9.

guarantee and 300 million in kind. In a subsequent note he set down his own view of the fundamental conditions necessary to Germany.

If these conditions were not achieved, the annuity of 1,650 million Reichsmarks would have to be entirely protected, half from the point of view of transfer only and the other half from the point of view of payment as well. After the first 37 years the creditors would have to meet their claims solely out of any profits earned by the BIS.⁴³

Another hypothesis advanced by Young during this phase of the work was to circumvent the difficult problem of estimating Germany's long-term capacity to pay by confining discussion to the figures for the first ten years. It was remarked that the period required to place the BIS on a firm footing could be assumed to be around ten years; from then onwards the Bank's profits could be used to cover part of the debts towards the United States. Germany would meet the 'residue', but since the amount involved could not be determined, German public opinion would not be given figures on the overall burden.

The drafting of a text was entrusted to the Sub-committee on Commercialisation, of which Melchior was a member; Lord Revelstoke, the Chairman, died suddenly before completion of the work and was replaced by Sir Charles Addis.⁴⁴

14. In the meanwhile, the debate on the memorandum presented by the German delegation on 17 April raged on. Moreau declared that the proposals linked to political conditions were unacceptable, opposed the time limit of 37 years and stated that any concessions in relation to the arrangements under the Dawes Plan were conditional on the immediate commercialisation and mobilisation of France's reparations claim; he also drew attention to the danger of a massive withdrawal of foreign capital from Germany as a result of Germany's manifest ill-will and reminded Schacht of the responsibility he would bear for this disastrous outcome.

⁴³ See *Committee of Experts, Memorandum by the German Group, Annex 13*, 17 April 1929, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B6.

⁴⁴ See *Comptes Rendus*, M. Moret; meetings of 17 and 19 April 1929, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B9.

The German experts returned to Berlin to confer with their Government, which issued an official communiqué describing the memorandum as a basis for discussion from which political objectives would be excluded. Quite a different interpretation circulated within the Reparation Commission, where it was believed that the memorandum had been inspired by nationalist elements among German industrialists – of whom Voegler, the second German delegate, was one – and that Schacht himself was prepared to provoke a crisis in the negotiations and thus trigger a foreign exchange crisis and a devaluation of the Reichsmark, to the benefit of industrial interests.⁴⁵

Upon his return to Paris, Schacht explained that Germany was not asking for colonies under its direct control but for the formation of large companies with German participation to promote the economic development of the new countries; nor was it asking for the return of the Polish Corridor but for simplification of the formalities that complicated the double crossing of the frontier by products traded with East Prussia. Moreau contested this interpretation; he reproached Schacht for the contacts he had cultivated with French politicians, accused him of intending to sabotage the negotiations in order to succeed Hindenburg as President of the Reich and declared finally that he no longer believed in Schacht's good faith. A number of Schacht's declarations, actions or omissions that seemed designed to provoke a foreign exchange crisis were also recalled in the Transfer Committee, chaired by the Agent General for Reparation Payments, Parker Gilbert; these included the statement that German transfers would inevitably have to be suspended and the Reichsbank's failure to increase the official discount rate (an increase from 6 1/2 to 7 1/2 per cent occurred a few days later). The crisis was looming as a result of a withdrawal of American and French capital from Germany, a flood of anticipated payments and imports by German businesses, and transfers of short-term funds to the New York market on account of the interest rate differential.

Despite Moreau's invective, the Committee took note of the report of the Revelstoke Sub-committee and appointed the

⁴⁵ Meeting of 21 April 1929; see *Comptes Rendus*, M. Moret, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B10.

members of a drafting sub-committee to prepare its own final report; the chairmanship was entrusted to Stamp, who also took an active part in the writing of the text. This sub-committee was appointed even before the delegations had reached agreement on the figures; the negotiations would therefore continue in parallel with the writing of the report.⁴⁶

In early May the Germans offered an average annuity of 2,049 million Reichsmarks, compared with the figure of 2,198 million Reichsmarks requested in the memorandum from the four major creditors. Of the part owed to France, 500 million Reichsmarks would be mobilisable, but in exchange for this privileged treatment France would have to undertake to keep the equivalent of one mobilisable annuity, 500 million Reichsmarks, on deposit at the BIS.

The French endeavoured to present commercialisation and mobilisation as a general advantage that eliminated the political element, rather than as a privilege accorded to France, and argued that any concessions, such as the reduction in the annuity to 2,050 million Reichsmarks as suggested by Young, would enable Germany to finance expenditure on luxuries and armaments, which were already too high; military expenditure exceeded the limits set in the Treaty of Versailles and was also higher than French military spending. Such concessions would not be accepted by French public opinion and could lead to the non-ratification of the agreements on war debts to the United States and the United Kingdom and hence to the suspension of payments. However, the French experts were more or less isolated in their resistance to the compromise.⁴⁷

Meanwhile Schacht accepted the American proposal of 2,050 million Reichsmarks and also dropped his demand that payments due to the United States and the United Kingdom after the thirty-seventh year be debited from the profits of the BIS. He attached two conditions to his acceptance. The first was that in the event of serious economic difficulties in Germany the annuity would revert to the figure of 1,650 million Reichsmarks proposed in the German memorandum of 17 April; according to Schacht, this was simply a

⁴⁶ Meeting of 22 April 1929; *ibid.*

⁴⁷ Meetings of 1 and 2 May 1929; *ibid.*

'stylistic' device to create a link between the two German proposals. The second condition was that if the United States granted relief to its own European debtors Germany would also benefit at least to the extent of reducing the annuity to 1,650 million Reichsmarks. The two German conditions were not received favourably by Young, who had been formally instructed by his Government to avoid any link between reparations and war debts.

15. At this point in the negotiations Young observed that the difference between the 2,198 million Reichsmarks requested by the Allies (a figure on which the French were adamant) and the 2,050 million Reichsmarks offered by the Germans could be bridged by transferring the profits of the BIS to the Germans in exchange for their accepting the Allies' figure.⁴⁸

The Young proposal, if it was made in good faith and not simply to pull the wool over the Germans' eyes, demonstrated rash optimism as to the earning capacity of the proposed new Bank. The total profits earned by the BIS in its first decade of existence were 90 million Reichsmarks; its average annual profits, 9 million Reichsmarks, therefore amounted to only just over 6 per cent of the difference of 148 million Reichsmarks it was supposed to bridge between the two figures (Table 2).

Even the figures Young and Quesnay gave in the discussion do not justify their apparent profit expectations. They were based on the assumption that the French would make a deposit of 500 million Reichsmarks, matched by an equal German deposit. On 1,000 million Reichsmarks, each point difference between the average yield on loans and the average cost of deposits gives a gross operating margin of just over 10 million Reichsmark; moreover, any increase in this margin would be primarily to the detriment of Germany, both as a major depositor and as the largest recipient of loans. Schacht rejected the proposal, with good reason. The 2,050 million Reichsmarks in the Young proposal accepted by the Germans included 61 million Reichsmarks for servicing the Dawes Loan; the remaining 1,989 million were distributed in the following proportions: 54.1 per cent to France, 19.5 per cent to the United Kingdom, 11.2 per

⁴⁸ Meeting of 3 May 1929; *ibid.*

Table 2. *Net profits of the BIS, 1931-40* (in millions)

Financial year*	Swiss gold francs	Equivalent in Reichsmarks**
1931	11.2	9.2
1932	15.2	12.4
1933	14.1	11.5
1934	13.0	10.7
1935	13.0	10.6
1936	9.2	7.5
1937	9.1	7.4
1938	9.0	7.3
1939	8.6	6.9
1940	7.9	6.4
1931-40	110.3	89.9

* From April to March.

** The rate of exchange ranged between 0.80 and 0.82 Reichsmarks per gold franc during the ten years in question.

Source: Bank for International Settlements, *Annual Report, Profit and Loss Account*, Basle 1931-1940.

cent to Italy, 5.5 per cent to Belgium, 3.5 per cent to the United States and the remaining 6.2 per cent to Serbia, Romania, Japan, Portugal and Greece.⁴⁹

In one later variant the United States' share (69 million Reichsmarks), the restitutions, France's share of the Belgian debt and the compensation owed to Belgium for Belgian marks were to be serviced from the profits of the BIS, with Germany guaranteeing payment in Reichsmarks in the event of any shortfall; in another the American share disappeared altogether, since the US Congress had not ratified the Treaty of Versailles and the US Government had not been party to the Spa and Paris Agreements.⁵⁰

⁴⁹ Meetings of 3 and 6 May 1929; *ibid.* The proposal was made official with the two Young memoranda of 6 and 7 May 1929; see *Committee of Experts, Annex 17 and Annex 18*, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B6.

⁵⁰ Meetings held from 9 to 15 May and from 1 to 6 June 1929; see *Comptes Rendus*, M. Moret, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B10. The absence of the Americans has to be viewed in the light of the climate of reaction to Wilsonism and the hardening of the isolationist stance which had led the

With great difficulty the French were persuaded to agree to the annuity proposed by Young and accepted by Schacht, who was using the Englishman Stamp as his spokesman and draftsman during this phase of the negotiations. The imaginary future profits of the BIS were again a factor in winning approval, although it is unclear whether the expectations in this regard were genuine or merely to save appearances; it was argued, even by the French, that the profits could bridge the difference between the demands of the European Allies and the Young-Stamp offer. Even the Agent General for Reparation Payments, Parker Gilbert, joined in the efforts to persuade the French, estimating their share of the BIS profits at between 30 and 40 million Reichsmarks a year. This high estimate was based on the prediction that there would be a substantial inflow of deposits to the BIS from governments and central banks.⁵¹

United States to refuse to sign the Treaty of Versailles and to reach a separate peace with Germany following Congress's decision of 2 July 1921. The peace treaty had left unresolved the two issues of the quantification of the German debt and its distribution among the creditor states. The Spa Conference (5-16 July 1920) had produced the first concrete results regarding the distribution of the debt, after a series of meetings that had not elicited any substantial agreement (London, March 1920; Sanremo, April 1920; Hythe, May 1920; and Boulogne, June 1920). Various plans were drawn up by financial experts at the next meeting, in Brussels (December 1920), before the German debt was finally established at 226 billion marks at the Paris Conference (22-29 January 1921). Then came the two London Conferences (1-7 March and 29 April-5 May 1921), at the first of which negotiations were broken off, while the second saw Germany issued with an ultimatum demanding fulfilment of the peace treaty and payment of the debt, reduced to 132 billion marks. US interest in these problems was rekindled when the Secretary of State, Charles E. Hughes, in December 1923 took the first step towards the setting-up of a committee of experts with American participation (the Dawes Committee). Among the bibliographical references on the issue, see: H.G. Moulton and C. McGuire, *Germany's Capacity to Pay. A Study of the Reparations Problem*, McGraw-Hill Book Company, New York 1923; J.M. Keynes, *Treaty Revision and Reconstruction*, in *The Collected Writings of John Maynard Keynes*, vol. XVII, Macmillan, London-Basingstoke 1977; R. Dawes, *The Dawes Plan in the Making*, The Bobbs-Merrill Company, London-New York 1926; S.A. Schuker, *The End of French Predominance in Europe*, The University of North Carolina Press, Chapel Hill 1976; A. Pirelli, *Dopoguerra 1919-1932: note ed esperienze*, Tipografia Ghezzi, Milan 1961; F. Costigliola, *Anglo-American Financial Rivalry in the 1920s*, in 'Journal of Economic History', 1977; Kindleberger, *op. cit.*; and M. De Cecco, *The International Debt Problem in the Interwar Period*, in 'EUI Working Papers' no. 84/103, Florence, April 1984.

⁵¹ Meetings of 13 and 15 May 1929; *ibid.*

16. While the negotiations were proceeding, the Reichsbank's gold reserves were steadily falling towards the minimum obligatory cover ratio of 40 per cent; the creditors thought this would force the Germans to reach agreement, but in reality at the end of May the monetary crisis looming over Germany led Schacht to threaten that if a compromise was not reached he would not only withdraw from the conference – following the example of Voegler, who was himself a steel industrialist and who had resigned after meeting representatives of major German industrial companies in Essen – but also resign as President of the Reichsbank; Schacht was prepared to sign for 2,050 million Reichsmarks, while continuing to maintain that his country's capacity to pay did not exceed 1,650 million Reichsmarks and that the *future* would prove him right. However, the experts were aware that a breakdown in the negotiations would precipitate an *immediate* financial crisis; the flight of capital would necessitate credit restrictions, which would cause a financial crisis for the state and for businesses, leading in turn to an industrial crisis. The German crisis would spread to the rest of Europe and would engulf sterling.⁵²

A hardening of the attitude of the Belgian delegation became apparent, however; Francqui demanded that the figures given in the Allies' memorandum, which included the special annuity for Belgian marks, should stand, at least as far as Belgium was concerned. In order to mollify the Belgians, the Committee continued to promise that the new banking institution would be based in Brussels.⁵³

A draft general report was produced which provided for a Special Advisory Committee on transfers to be set up at the proposed BIS; the Committee, composed of seven members appointed by the governors of the central banks of the countries represented at the Conference, would have the task of assessing the conditions that might justify a suspension of transfers.⁵⁴ The

⁵² Meetings of 21, 23 and 29 May 1929; *ibid.* The circumstances surrounding Voegler's withdrawal are recalled by Schacht in his volume *My First Seventy-Six Years*, Allan Wingate, London 1955, p. 246. On Schacht's resignation, see Chapter VI, § 4 below.

⁵³ Meeting of 27 May 1929; *ibid.*

⁵⁴ The idea of setting up a Special Advisory Committee was born when work began, in February; see M. van Zeeland, *op. cit.*, p. 8, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B13. The Committee's role would be conclusively

draft also gave Germany the right to suspend payment for two years of one-half of the sums covered by a suspension of transfers. During the subsequent discussion the German experts proposed a different formula, similar to the one contained in the Baldwin-Mellon agreement of British war debts to the United States,⁵⁵ namely the total suspension of payments of principal in the second year of a moratorium on transfers.⁵⁶

17. In mid-May a new factor emerged in the shape of a statement by Stimson, the US Secretary of State, that the US Government would not permit officials of the Federal Reserve Bank of New York to participate directly or indirectly in what was described as an 'international reparations bank'.⁵⁷ This announcement dashed the earlier hope that the new institution could act as a link between the European central banks and the Federal Reserve System and enjoy the support of the largest money market in the world. It also scotched the proposal to use the new institution to establish a connection between the payment of reparations and the payment of inter-Allied war debts. The plan left in abeyance the problem of the distribution of the Bank's profits, which was linked to the issue of the 'special deposits' France and Germany would be asked to make. For example, it was argued that France, which received an unconditional and mobilisable annuity of 500 million Reichsmarks, should make a special deposit at the BIS or subscribe additional shares of the Bank if the transfer of the conditional portion of reparations was suspended. Germany was asked for an undertaking regarding a similar deposit, also of the order of 400-500 million Reichsmarks.

defined in Articles 119 ff. of the final report of 7 June 1929; see *Report of the Committee of Experts, op. cit., part 8*, BIS Archive. See also Chapter XI below.

⁵⁵ See note 35 on p. 26.

⁵⁶ Meetings of 29 and 30 May 1929; see *Comptes Rendus*, M. Moret, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B10.

⁵⁷ See *Public statement issued by the Secretary of State*, 16 May 1929, in *Harrison Papers*, papers collected as copies in the archives of the Federal Reserve Bank of New York (FED), in BIS Archive, 7.16 – *Baffi Papers*, RBL/B1. See also M. van Zeeland, *op. cit.*, pp. 29-30, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B13; the reports on the discussions of the Committee of Experts at the meetings of 16 and 31 May 1929; and *Comptes Rendus*, M. Moret, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B10.

In the final phase of the negotiations Moreau and Francqui maintained the pressure on Melchior for Germany to undertake to make substantial payments to the new Bank. Since it was unrealistic to hope that the central banks would make very large voluntary deposits, the Committee counted on governmental deposits. The creditors envisaged that governments would sell German bonds in the market in order to mobilise the unconditional part of the reparations annuities owed to them (660 million Reichsmarks, guaranteed by a special tax on the Reichsbahn) and would deposit part of the proceeds at the BIS, the equivalent of one annuity, for example.

Germany was asked to make a special long-term deposit equal to the difference between the annuity owed under the Dawes Plan and the smaller amount owed under the Young Plan. It was calculated that these various sources could provide the new Bank with deposits worth around one and a half billion Reichsmarks and net profits of 30 million Reichsmarks. (The unreliability of these estimates has already been discussed in paragraph 15.) The Committee also considered the possibility of strengthening the Bank's reserves by providing for part of the benefits deriving from any American concessions on war debts to be transferred to the reserves.⁵⁸

Once the level of payments owed by Germany had been established, the experts from the creditor countries took care to ensure that the gold equivalent would remain constant. Accordingly, they had Schacht write a letter containing an undertaking by the German Government that for the purposes of the Plan the sums owed in gold and foreign exchange would remain convertible in accordance with Section 31 of the Reichsbank Law; for these purposes the Reichsmark would retain the gold parity laid down in the Coinage Law of 30 August 1924 (1/2790 kilograms of fine gold).⁵⁹

Agreement on the figures at the end of May coincided with the general election in the United Kingdom and followed a period of absence on the part of Schacht, who had withdrawn to Versailles; however, sections of the German press, perhaps

⁵⁸ Meeting of 30 May 1929; see *Comptes Rendus*, M. Moret, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B10.

⁵⁹ Meeting of 6 June 1929; *ibid.*

reflecting Schacht's reservations, presented the agreement as unrealistic, since it was far in excess of the debtor's capacity to pay.⁶⁰ These German reactions alarmed the French, who feared that the Transfer Committee to be set up at the BIS would become a permanent instrument for revising the new plan. They tried in vain to insist that the final report should explicitly exclude powers of revision.⁶¹ The signing of the report took place on 7 June and was accompanied by a speech by Young in which he praised what he considered had been the 'wise businessman's approach' to the negotiations and which had ensured their success. These words reflect the rather naive illusion that a businessman's approach to the problem and the mobilisation of the debt by placing German securities in the market had diluted or eliminated the political nature of the obligations imposed upon Germany.⁶²

⁶⁰ *Ibid.*

⁶¹ Meeting of 7 June 1929; *ibid.*

⁶² *Ibid.*

III

THE HAGUE CONFERENCE AND THE ORGANISATION COMMITTEE

1. The conclusions reached by the experts in their report of 7 June 1929 had to be translated into an international agreement between governments. Accordingly, the six powers that had been party to the Geneva resolution of 16 September 1928 decided to call a conference in a neutral country, to which representatives of the other former belligerents would also be invited: the United States (which would take part as an 'observer'), the Dominions (Canada, Australia, New Zealand, South Africa and India) and the minor European powers (Greece, Portugal, Poland, Romania, Czechoslovakia and Yugoslavia).

The conference opened in The Hague on 6 August under the chairmanship of the Belgian Prime Minister, Henri Jaspar, and completed the first phase of its work on 31 August with the approval of a Protocol.¹

The discussions during this phase, which is often referred to as the First Hague Conference, turned mainly on the distribution of the total German annuity among the creditor countries and its division into reparations in cash and in kind and into unconditional and postponable portions. They also dealt with the reparations owed by countries other than Germany (Austria, Hungary and Bulgaria) and the claims of some of the minor Allied powers (Yugoslavia and Romania). An open aversion to reparations in kind was displayed both by countries that were

¹ The agreements concluded in August 1929 provided for the advance evacuation of the Rhineland and the application of the Young Plan; see *Accords conclus à La Haye, 1929-1930*, Imprimerie Nationale, Paris 1930.

direct 'beneficiaries' and by those that were Germany's competitors as potential suppliers, especially the United Kingdom as far as coal was concerned. All of these points were resolved by the substantial concessions in favour of the United Kingdom that the British Chancellor of the Exchequer, Snowden, managed to extract from the other creditors.² Discussion did not, however, touch upon the organisation of the new Bank, except on one point: the participation of some of the minor allied powers (Yugoslavia, Romania and Greece) in the management and direction of the Bank, which their representatives strongly desired. The Final Protocol, adopted at the closing session on 31 August, merely stressed the advisability of proceeding as soon as possible with the appointment of the Organisation Committee for the Bank, as foreseen in Section III of Annex I of the expert's Report of 7 June. The central banks of the six inviting powers quickly followed the recommendation contained in the Final Protocol by each appointing two independent experts to sit on the Organisation Committee of the BIS.

2. The Federal Reserve System was prevented from appointing representatives itself by the Department of State's policy of non-involvement, formalised by the Stimson declaration of May 1929. The two American experts therefore had to be chosen from among persons outside the Federal Reserve System by the Governors of the central banks of the six powers; their choice fell on Reynolds and Traylor.³ Provision had been made for this eventuality in

² See the letter of 31 July 1929, from Fraser to Pirelli, and the Bank of France's note of 1 August 1929, which summarise British criticism of the Young Plan ahead of The Hague Agreement; in BIS Archive, 7.18(3) – *Documents Pierre Quesnay*, 'Papers collected at the Direction des Archives de France', AF, B/4.

³ See the documentation on the American position in July-August 1929, collected in *Harrison Papers* – FED, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B1; in particular, see Young's note of 1 August 1929 to O.L. Mills, undersecretary of the Treasury in Washington. Regarding the appointment of the American representatives entrusted with maintaining contact with the Organisation Committee for the BIS, see also G. Royot's manuscript *Banque des Règlements Internationaux – Evolution de juin 1929 à octobre 1929*, 21 June 1944, pp. 3 and 5, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B13; in addition, see the correspondence of the Governor of the Federal Reserve Bank of New York, G.L. Harrison, concerning August and September 1929, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B1.

Annex I to the Young Plan, which laid down that the Organisation Committee 'shall be appointed by the Governors of the central banks of the seven countries to which members of the present Committee belong' but added that 'if for any reason, the Governor of any of these central banks shall be unable officially or unofficially to designate members of the Organisation Committee, or refrains from doing so, the Governors of the remaining central banks shall invite two fellow-nationals of the Governor not participating, to act as members of the Committee'.⁴

3. The organisation Committee gathered in Baden-Baden in October, four months after the signing of the Young Plan.⁵ No German expert had participated in the drafting of Annex I to the Plan, which concerned the 'suggested outline for the organisation' of the Bank; Beneduce, one of the Italian delegates, quipped that this led Schacht to distinguish between the Bible of the Plan and

⁴ See Harrison's note of 14 June 1929 to Crane containing the *Summary of the Experts' Provisions for the creation of an International Bank, Annex I to the Report of June 7, 1929* (Young Report); *Harrison Papers – FED*, in BIS Archive, 7.16 – Baffi Papers, RBL/B1.

⁵ The Organisation Committee for the BIS (COBRI) completed its work on 13 November 1929. The members of the Committee were: L. Franck, Governor of the National Bank of Belgium, for Belgium; C. Moret, Vice-Governor of the Bank of France, for France; H. Schacht, President of the Reichsbank, for Germany; T. Tanaka, delegate of the Bank of Japan in London, for Japan; Sir Charles Addis, Chairman of the London Committee of the Hong Kong and Shanghai Bank, Director of the Bank of England, for the United Kingdom; A. Beneduce, Chairman of Crediop, for Italy; and E. Reynolds, President of the First National Bank of New York, coopted by the central banks at the suggestion of J.P. Morgan & Co, for the United States (Chairman of the Committee). The alternates were: L. Delacroix, member of the Reparation Commission (subsequently replaced by P. van Zeeland of the National Bank of Belgium), for Belgium; P. Quesnay, Head of the Research Department of the Bank of France, for France; W. Vocke, member of the Directorate of the Reichsbank, for Germany; S. Sonoda, Manager of the Yokohama Specie Bank, for Japan; Sir W. Layton, Editor of 'The Economist', for the United Kingdom; V. Azzolini, General Manager of the Bank of Italy, for Italy; and M.A. T aylor, President of the First National Bank of Chicago, for the United States. On the specific characteristics of the Organisation Committee, which was provided for by the Young Committee Experts' Report of 7 June 1929 and agreed on by the government representatives with The Hague Protocol of 31 August 1929, see W. Roncagli's interpretation in *L'oeuvre du Comité d'Organisation de la Banque des Règlements Internationaux*, preserved in BIS Archive, 7.16 – Baffi Papers, RBL/B13.

the apocryphal gospels of Annex I. Now, however, these guidelines were being transformed into formal documents (the Constituent Charter and the Statutes) by an international conference meeting on German soil and with full German participation for the first time since the war.⁶

The British, French and Belgian delegations submitted draft statutes at the first meeting of the Committee on 4 October; discussion was to centre mainly on the French and British texts. The major role in the Drafting Committee would be played by the Englishman Layton.

In their initial declarations the experts were favourable to representatives of the 'small states' serving on the board of the Bank as requested by their representatives at The Hague; this could be arranged on a rotational basis, for example.

The delegates were not unanimous in their interpretation of the scope of the committee's mandate; initial discussions did not succeed in resolving the differences, which resurfaced later, giving rise to repeated and conflicting statements of position on two central issues:

- the Organisation Committee's freedom to deviate from the stipulations of Part 6 and Annex I of the expert's Report;
- the division of powers between governments and central banks.

⁶ At the opening meetings, however, differences of opinion emerged as to the interpretation of the legal sources for the rules that would govern the new organisation. While Beneduce maintained that the new Bank's constituent structure had to be established with new legal acts independent of the Young Plan, but conforming to it according to the principles of Annex I of the Plan, Schacht was firm regarding his own idea that the Young Plan alone was the basic source for the BIS's regulations. See COBRI – *Compte Rendu de la délégation française* – meeting of 10 October 1929 – BIS Archive, 7.16 – *Baffi Papers*, RBL/B14. The Organisation Committee's work is documented: in the French delegation's reports on the meetings from 4 October to 13 November 1929, with annotations by Baffi, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B13; in BIS Archive, 7.16 – *Baffi Papers*, RBL/B14 (COBRI I); RBL/B15 (COBRI II); RBL/B15 (COBRI III); and in the Italian delegation's reports, from the Historical Archive of the Bank of Italy, ASBI – Beneduce, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B15. See also G. Royot, *Banque des Règlements Internationaux – Evolution de juin 1929 à octobre 1929*, *op. cit.*, and W. Roncagli, *L'oeuvre du Comité d'Organisation de la Banque des Règlements Internationaux*, *op. cit.*, both in BIS Archive, 7.16 – *Baffi Papers*, RBL/B13.

The two extreme positions were those of Beneduce and Schacht. In Beneduce's view, the experts' Report, which had been approved by governments, entrusted the central banks with the task of creating the new Bank. The new institution should give concrete expression to the idea of central bank cooperation, as propounded for some time by such eminent persons as Luigi Luzzatti and Montagu Norman. According to Beneduce, the BIS could have been brought into being as the result of a central bank initiative unconnected with the reparations problem; that was one of the reasons why the members of the Committee had been appointed by the governors. It was to this institution that governments were considering entrusting the problem of reparations; they would decide whether to do so or not after examining the statutes, which it was not their responsibility to write and which would reflect the terms of a company contract between central banks. Beneduce made a clear distinction between the statutes and the trust agreement; whereas governments could do no more than take note of the statutes of the Bank, the trust agreement would have to be negotiated with them.⁷

At the opposite extreme Schacht argued that the Organisation Committee could not deviate in any way from the wording of Part 6 of the Report; it could innovate only with regard to Annex I. The Plan had been accepted by means of The Hague Protocol, which was a legal document, in the same way as the Dawes Plan had been approved by means of the London Agreement of 1924. Schacht maintained this line throughout the discussions, attempting to have repeated references to the experts' Plan introduced into the wording of the statutes in addition to the general statement in Article 4 that the Bank 'shall observe the provisions of the Plan in the administration and operations of the Bank'.⁸ His attitude was

⁷ The meeting in question is still that of 4 October 1929, where most of the divergent positions on the interpretation of the constituent mandate of the BIS emerged; see, in particular, BIS Archive, 7.16 – *Baffi Papers*, RBL/B14 (COBRI I).

⁸ The quotation is from the final version of Article 4 of the Statutes of the BIS; see BIS Archive, 7.16 – *Foundation*, RBL/1A. See the complete publication of the experts' Plan, *Report of the Committee of Experts on Reparations (Young Committee, June 7, 1929)*, H.M.S.O., London 1929. On Schacht's position, in addition to the discussion of 4 October, see the subsequent meetings, in particular those of 8, 10 and 29 October, in BIS

probably determined by the broad role that Part 6 of the Plan assigned to the Bank in the development of world trade; he feared amendments in a restrictive sense.

4. The French position was close to that of the Italians, so that in Committee it was referred to as the 'Latin thesis'.⁹ In Quesnay's view it was necessary to abide by the 'recommendations' the experts had made in the Plan; these had no legal force, however, and had to be translated into legal terms, avoiding the wholesale references to the Plan repeatedly sought by Schacht.

The British position, expounded by Layton and Addis, differed from that of the Germans by placing less insistence on faithfulness to the Plan and from the Latin position by allowing wider scope for governmental involvement in the establishment of the new Bank. The British experts based their view on Article 7 of The Hague Protocol of 31 August, which stated that 'The Conference will reassemble at a date and place to be fixed by the President after consultation with the Inviting Powers for the purpose of considering the Reports which will be submitted to it by all the committees referred to above and for giving such effect thereto as may be considered desirable'.¹⁰

According to the British, this provision meant that all the documents – not only the trust agreement but also the Constituent Charter and the Statutes of the Bank – would have to be examined by the governments; the central banks had been asked to organise the BIS, but its creation required an international deed bearing the ultimate approval of governments. The terms of the Constituent Charter would have to be laid down by international treaty and be subject to revision by governments at ten-year intervals; legal status would be conferred on the Bank by the law of the country in which it was domiciled.¹¹

Archive, 7.16 – *Baffi Papers*, RBL/B14 (COBRI I), and that of 13 November, with the final approval of Article 4, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B15 (COBRI III).

⁹ See meeting of 4 October 1929, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B14.

¹⁰ The complete text of The Hague Protocol is preserved in the BIS Library; see *Accords conclus à La Haye 1929-1930*, BIS Library, V III 23.

¹¹ See the meetings of 4 and 7 October 1929, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B14 (COBRI I).

5. Discussion of the means of establishing the Bank was followed by an examination of the general objects of the Bank. The Young Plan gave the Bank a mandate 'to provide additional facilities for the international movement of funds'; all the delegates reasoned that this objective went beyond the servicing of reparations to embrace other international financial operations and cooperation among central banks, although the French insisted on laying special emphasis on the functions associated with reparations and the Germans stressed the need to avoid competition with private banks.¹²

With regard to the Bank's capital, the Committee was inclined towards a figure that some thought modest: \$100 million (150 million *grammors* in the French proposal, equivalent to approximately the same amount), only one quarter of which would be paid up initially. It was widely felt that the capital should be denominated in the currency of the country in which the Bank had its registered office; only the French delegates insisted on the *grammor*, expressed in a weight of gold. They argued that one of the Bank's objects was to maintain monetary stability and that its capital should not be expressed in a currency for which it bore no responsibility; moreover, they claimed that the adoption of the *grammor* would avoid rivalry between national currencies as the currency for international financial operations, such as stabilisation loans. The majority of the delegates considered that to choose a 'money of account', in other words an artificial currency, would make it difficult to place the shares and could alarm the public about the stability of national currencies.¹³

6. The delegates debated the relative merits of two formulae for the Bank's operations; the first consisted in a list of permitted operations that followed the lines of the list in the Young Plan and could be further elaborated, while the other comprised general indications. It was agreed to take the list from the Young

¹² See *Report of Committee of Experts, op. cit., Annex I*. The bank's sphere of activity was discussed at the meeting of 7 October 1929; *ibid.*

¹³ *Ibid.*, meeting of 8 October 1929. The French drew up a note, dated 12 October 1929, on the introduction of the *grammor* as a unit of account; see the papers of *Quesnay* – AF, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B6; see also *Dossier G. Royot*, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B13.

Plan and to adopt a broad formula that would give the central banks in individual countries a right of veto over operations to be carried out by the Bank in their markets. This right of veto was to be maintained for the central banks of the countries in which the Bank's shares were issued.

The question of the extent to which the Statutes should be specific had already arisen with regard to operations, and it reappeared in respect of interest rates on deposits. The Plan laid down that the Bank would not pay interest on deposits with a maturity of less than thirty days; some experts feared that this provision would drive away the most interesting deposits, namely those of central banks. On the other hand, it was feared that the removal of all restrictions on the Bank's ability to pay interest on deposits might be considered an encroachment on the territory of the commercial banks. The view that the limitation laid down in the Young Plan should not be incorporated into the Statutes eventually prevailed.

Various percentage ratios of gold or other liquid sight assets to deposits were discussed (25 per cent, 40 per cent), but here again none was stipulated in the Statutes, which merely required the Bank to be administered with particular regard to maintaining its liquidity.

As regards deposits, special attention was paid to central banks' deposits in gold and foreign currencies. The French (Moret and Quesnay) entertained the hope that such deposits would be used to settle international trade payments without passing through the foreign exchange market or giving rise to physical movements of gold, in other words to establish a kind of international clearing house, which would help not only to reduce costs but also to maintain exchange rate stability. To the same end the BIS would later be able to offer credit facilities to central banks. The British experts, who were clearly concerned to preserve the role of the London market, resisted these ambitious French plans; they accepted only the creation of earmarked gold deposits and insisted on the central bank's right of veto over individual operations or categories of operation carried out in its market. The French, by contrast, envisaged that deposits of gold and foreign exchange would be converted into a unit of account, the *grammar*, which would become an international settlement

currency. The highly innovative nature of the French plan and its impact on exchange rate policy gave rise to an inconclusive debate about the respective fields of competence of governments and central banks in this regard, with Schacht supporting the governments' right to intervene.¹⁴

7. Other forms of fund-raising that were discussed included the issue of promissory notes and bonds; all except the British were inclined to permit the issue of bonds. Opinions were divided with regard to the issue of promissory notes; for the French experts this would be equivalent to creating money, while in the view of others (Schacht, in particular) it could be permitted to finance short-term lending operations and/or if the BIS received commercial bills from the recipient bank as collateral, in words if there was a close correlation between the securities issued and those received as collateral. As with regard to gold operations and the right of veto, the British adopted a restrictive stance on this point; their draft statutes had allowed the issue of bonds in certain cases – to finance advances to central banks or in the event of a German moratorium, for example – but now they were inclined to prohibit it.

At the opposite extreme, Schacht wanted to give the Bank wide issuing powers, having in mind the investment of the proceeds in Germany, for example in mortgage bonds.

Another limit discussed was that on investment in an individual country, with the French wanting a ceiling of 25 per cent of total assets. The question was set on one side, together with those of the issue of promissory notes and bonds and investments in mortgage bonds.¹⁵

¹⁴ See the meeting of 9 October 1929, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B14; and the meeting of 22 October 1929, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B15. On the question of the 'right of veto', see also the report sent to the Fed, New York, by J.E. Crane (the Fed's unofficial envoy in Baden-Baden), who commented by giving his own positive opinion on the projected article; cablegram of 16 October 1929, with annotations by Baffi, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B1. On the French proposal concerning the *grammar*, see also note 13 on p. 47; in addition, see Crane to Harrison, 20 October 1929, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B1.

¹⁵ The bank's operations were the focus of discussion at the meetings of 8 and 9 October; see BIS Archive, 7.16 – *Baffi Papers*, RBL/B14 (COBRI I). As for the different stances on the scope of its operations, see also the meetings

8. The Committee was also divided on the advisability of allowing the Bank to open branches; some of the experts thought branches could become a means of competing with commercial banks, could give the Bank an image too different from that of the central banks from which it had sprung, could acquire an exaggerated importance by comparison with that of the central bank in small countries owing to the power of the parent bank, could not be accorded the privileges and immunities that would be granted to the head office, and could make it more difficult for the central bank of the host country to exercise its right of veto than if it were itself acting on behalf of the BIS. On the other hand, it was pointed out that without branches the BIS would have to operate via local banks subject to the normal tax regime and would have difficulty operating in countries with no central bank, such as Egypt or India. In the end the opening of branches was permitted, provided the Board's decision was taken by a two-thirds majority.¹⁶

9. On the question of the composition of the Board of Directors, one point of contention concerned the distribution of powers between the fourteen (or sixteen) directors appointed by the seven founding central banks or banking groups and the other directors (up to a maximum of nine) from countries in which the Bank's shares were to be issued, who would be elected by the *ex officio* directors. The granting of full discretion to the first category of directors in exercising this right was a source of puzzlement; it was defended, at least for the 58 years' duration of the Plan, on the grounds of the importance of the Bank's role in the administration of reparations. This French-inspired 'aristocracy of the founders' was opposed by Beneduce, Addis and Schacht, but it prevailed.¹⁷

Another point of discussion related to the wording of the clause excluding persons in government service; it was feared that this would implicitly exclude the governors of state central banks

of 28 and 30 October 1929, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B15 (COBRI II).

¹⁶ Meeting of 10 October 1929; *ibid.*

¹⁷ See the meeting of 11 October 1929; *ibid.* The quotation refers to a phrase of Beneduce's during the discussion.

(such as that of the USSR) or unelected members of legislative bodies such as the House of Lords or the Italian Senate.¹⁸

There was also a significant clash of ideas on the formation of an Executive Committee. The idea for such a Committee had germinated in the minds of the American authors of Annex I of the Young Plan. Some of the delegates now wanted the Committee to be made up of persons selected on the basis of expertise rather than nationality; they would have to guarantee their continuous presence at the Bank, particularly if the Board were to meet only quarterly. Others, however, foresaw difficulty in finding persons of stature who would be qualified to deliberate on the rather delicate matters entrusted to the Bank (exchange market intervention, for example) and who would also be prepared to leave their normal place of business for a long period.

Furthermore, it was pointed out that an Executive Committee with responsibility for continually monitoring the affairs of the Bank would necessarily have to exclude the governors in office, who were too busy; the powers the Board would have to delegate to the Committee would reduce the governors' interest in attending Board meetings.

In view of these considerations, the hostility of the French (jealous guardians of the prerogatives of the General Manager) and the indifference of the Germans on account of their non-involvement in the drafting of Annex I, it was finally agreed to hold Board meetings monthly and to insert a provision in Article 43 of the final version of the Statutes simply giving the Board the power to appoint such an Executive Committee if it thought fit. Such a body might have proved necessary if a very large number of non-European countries (those in South America, for instance) had become members of the Bank, making it impractical to call frequent Board meetings. Participation on such a large scale did not come about, however, and the power remained a dead letter.¹⁹

10. The discussion on the administrative control of the Bank involved the criteria for selecting the chief executive officer and

¹⁸ See the discussion of 28 October 1929, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B15.

¹⁹ See the meetings of 11 and 14 October 1929, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B14.

defining his powers, the powers of the General Manager or Managers, the organisation of the various departments and the powers of the General Meeting.

It was debated whether the chief executive officer should have the title of governor or president; delegates favoured the latter, since the title 'governor' would have created 'confusion'. Given the political tensions in Europe and the burden of commitments borne by the governors, the majority of members tended towards the view that the President should not be a governor (while not approving an explicit exclusion of the governors) and should preferably be an American. 'If France was able to regard the United States as her ally during the war', remarked Schacht, 'we consider her our ally in the work of peace'. The proposition put forward by some delegates that the President might not be a member of the Board was dropped in the course of the discussion. It was decided that the President would be assisted by one or more Vice-Chairmen and by a single General Manager.

With regard to the distribution of powers between the President and the General Manager, the French proposal to give the General Manager considerable autonomy was opposed by Schacht, who considered that the policy of the Bank should be defined by the President in accordance with guidelines laid down by the Board.

These differences of approach are not unconnected with the fact that the French had a candidate for the post of General Manager waiting in the wings: Quesnay. Schacht defended his flank by seeking to give the President power to determine the general policy of the Bank and by maintaining that the General Manager should have the nationality of the country in which the Bank was situated or that of the President, who would presumably be American. Schacht remarked that if the President and the General Manager both had powers to determine the general policy of the Bank their relations with the Board of Directors could create a situation of dualism prejudicial to the smooth operation of the Bank.²⁰

In the debate on the organisation of the Bank into departments the call for flexibility prevailed, in that it was decided not to lay down any binding structure in the Statutes.

²⁰ See the meetings of 12 and 14 October 1929; *ibid.*

The discussion does, however, reveal the grandiose scale of the scheme and the variety of tasks the Committee envisaged assigning to the BIS at that time. Ten or more departments were mentioned: secretariat, accounting, legal, economic research, foreign exchange, central banking, investments in Germany, reparations in kind, mobilisation, trustee and even a department for economic aid, responsible for long-term lending operations. Schacht viewed the role of the Bank in very broad terms, but he was opposed to defining the organs of what was in danger of becoming a cumbersome bureaucratic machine; another reason for his opposition was the fact that he contested the authority of Annex I of the Plan, which included among the tasks of the Organisation Committee that of determining 'the administrative departments to be created within the Bank'.²¹

The General Meeting was hardly mentioned in the Suggested Outline for the Organisation of the BIS (Annex I of the experts' Report) and its powers were not defined, perhaps because the composition of the Board of Directors as foreseen by the Plan was almost identical with the voting rights. The Committee strove to give the General Meeting 'powers' that went a little further than simply 'receiving' the report of the Board of Directors.²²

11. At the end of October the Committee turned its attention to the draft Constituent Charter of the Bank. The plan was that the Charter would be approved at a governmental conference, in other words at the reconvened Hague Conference, and would then be the subject of a Convention between the governments promoting the Bank and the country in which the Bank would be situated, which for the time being was referred to in the discussions as the 'country of Utopia'. The Charter that the host country would have to grant the Bank, according it force of law, was in fact intended primarily to define the rights, privileges and immunities of the Bank itself.

At Schacht's request, the preambles referring to the Plan and reparations were deleted from the draft Charter.²³

²¹ *Ibid.*

²² See the meeting of 11 October 1929; *ibid.*

²³ See the meeting of 30 October 1929, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B15.

With regard to tax immunities, the Committee agreed on a formula that would exempt the Bank's capital and income from taxation; shareholders would remain liable to the ordinary tax systems of the countries in which they received distributed dividends, but the Bank would be exempt from levying withholding tax.²⁴

12. Discussion of the Charter was followed by consideration of the trust agreement; a sub-committee chaired by the American Reynolds, who was a lawyer, prepared a draft along the lines of the provisions contained in Section VIII of Annex I of the experts' Plan, an annex which was itself the work of American experts.

Sharp differences of opinion arose on various aspects of the draft. The French demanded that the agreement mention the division of the annuities into a conditional (postponable) part and an unconditional (non-postponable) part, basing their demand on paragraphs 89 and 90 of the Plan, which provided for such a division.²⁵ The British opposed this, since in their view this was a question that had still to be settled at governmental level.

Another disagreement related to the respective powers of the BIS to demand and Germany to offer specified currencies in payment; the French wanted to exclude 'unstabilised currencies', including the yen, the currency of one of the seven countries taking part in the negotiations. In fact, the trust agreement was to state that it was 'understood that payments in currencies other than Reichsmarks which are not based upon the gold or gold exchange standard will only be made with the consent of the Trustee'.²⁶

The Reichsmark would be accepted as a currency of payment only for amounts owed in Reichsmarks by conversion at the average of the middle exchange rates prevailing on the Berlin exchange in the fifteen days preceding the date of payment. If the

²⁴ *Ibid.*

²⁵ On the same subject, see also Articles 47 and 48 of the Plan; see *Report of the Committee of Experts, op. cit.*

²⁶ For the English version of the trust agreement, see *Final Act of The Hague Conference, Annex VIII*; in BIS Archive, 7.16, *Baffi Papers*, box RBL/B6.

Reichsmark depreciated rapidly, the use of the average rate would reduce the real value of the transfers. The creditors protected themselves against this eventuality by repeating in the trust agreement Germany's undertaking to maintain the parity set in 1924.*²⁷

The French also demanded that where the Plan was insufficiently precise the rights and obligations should be spelled out rather than indicated by simple reference to the paragraphs of the Plan, which up to then had only been approved in principle**²⁸ by governments and might be amended when The Hague Conference reconvened.

The Committee debated whether payments for the service of the Dawes Loan should have priority over those for the unconditional annuity and concluded that they should, despite the French view that the service of the Dawes Loan and the unconditional annuity should enjoy equal treatment.***²⁹

The criteria for determining the fee to be paid to the Bank for the services it would be called upon to provide as trustee were discussed. One of the proposed criteria was based on the difference between the presumed return on the paid-up capital (4 per cent) and the cumulative dividend (6 per cent); this would

* Article III of the trust agreement states: 'The Trustee takes note of the undertaking given by the German Government that the Reichsmark shall have and shall retain its convertibility in gold or foreign exchange as provided in Section 31 of the Law of the 30th August, 1924, and that, in all circumstances, for the general purposes of the Plan, the Reichsmark shall have and shall retain a mint parity of 1/2790 kilogram of fine gold, as defined in the German coinage law of August 30, 1924'.

²⁷ See *Final Act of The Hague Conference, Annex VIII; op. cit.*

** Acceptance in principle is expressed in the following terms in the Protocol adopted on 31 August 1929 at the close of the First Session of The Hague Conference: 'The President states that in view of the fact that various questions relative to the application of the Plan of June 7, 1929, drawn up in Paris by the Committee of Experts, have been settled in outline [...], all the Governments represented by delegates at the Conference have accepted the said Plan in principle'.

²⁸ For the first part of The Hague Conference, see *Accords conclus à La Haye 1929-1930, op. cit.*

*** Under Article IV of the trust agreement the payment of the sums owed for the service of the Dawes Loan 'shall have priority over all others. This service constitutes a first charge, expressly provided for as such, on the German annuities, whether non-postponable or postponable'.

²⁹ See *Final Act of The Hague Conference, Annex VIII; in op. cit.*

amount to around 2 million Reichsmarks, or 1 per mille of the reparations annuity. The formula of 1 per mille was adopted. Schacht raised the hypothesis of a suspension of transfers and enquired how the Bank could operate in such an event.³⁰

13. The Committee then returned to the discussion of the non-postponable annuity and its mobilisation, which had been marked by a lively difference of opinion between the French and the British at an earlier stage in the proceedings. The French stressed that by accepting the Young Plan in place of the Dawes Plan they had made substantial sacrifices in the expectation that they would receive a non-postponable, mobilisable annuity, as envisaged in the new Plan. Moret drafted a text modelled loosely on the provisions of Annexes I and III of the Young Plan, which related to the BIS and mobilisation respectively.

Schacht agreed to take the Moret text as a basis of discussion in preference to another text prepared by the drafting sub-committee, arguing that mobilisation of the debt was also in Germany's interest.

The issue terms for securities to mobilise the debt were discussed. These securities, which would be a charge on the German Government, could be issued by creditor governments in amounts corresponding to the capitalisation of all or part of the unconditional annuities due to them; they could be issued in the creditor's own market or that of another country, subject to the consent of the central bank of the country in question. The BIS itself could also issue them directly. In all instances, it was the BIS that would request the German Government to create issuable securities. In the case of issues by individual creditor governments in their own markets, the trustee would be entitled to set the minimum issue terms in order to prevent the securities being issued at an inappropriate time or at such a low price that they damaged Germany's credit standing. The trustee's power to set minimum terms would not apply to operations for the conversion of existing public debt instruments. In this case at

³⁰ With regard to the discussion on the draft trust agreement presented by Reynolds, see the report on the meeting of 4 November 1929, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B15.

least, countries were given complete freedom to adapt issue terms to the ability of the individual national market to absorb the paper, as judged by the government carrying out the operation. At the end of the debate Schacht stressed that he had remained silent as proof of his sincere desire not to impede mobilisation.³¹

14. The Committee subsequently turned to the questions of the official language of the Statutes, deliveries in kind and the domicile of the Bank.

The discussion on the language was marked by a mixture of pride, common sense and humour in which solemnity alternated with jocularly. All but the French were prepared to accept English as the official language, but Moret's insistence that the French text should be authentic as well led Schacht, Beneduce and even the Japanese Tanaka to request that the texts also be prepared and authenticated in the languages of their respective countries. Rather than have so many official texts in different languages, which would lead to confusion, Sir Charles Addis accepted that only the French text should be authentic; it was so decided, amidst thanks from Moret for the homage paid to the clarity of the French language and ironic remarks from the others.³²

15. The discussion on deliveries in kind took place in two stages. Deliveries in kind, which were already taking place, were governed by 'Wallenberg Regulations'³³ and administered by two bureaucratic bodies, one Allied and one German. Since these were costly to operate, there was a desire to merge them into a single Department, either within the Bank or outside. A document prepared by the Committee on Deliveries in Kind chaired by the Italian Mosca served as the basis of discussion. It was feared that any link between the department and the BIS

³¹ See the meeting of 5 November 1929; *ibid.*

³² See the meeting of 6 November 1929; *ibid.*

³³ The procedures followed by Germany for making deliveries in kind had been summarised by the Agent General for Reparation Payments; his last report specified that the relevant rules derived from the so-called 'Wallenberg Regulations' (named after the Swedish Finance Ministry's delegate at the League of Nations) should be regarded as having been extended unless the parties concerned requested an amendment. See *Report of the Agent General for Reparation Payments*, 1 July 1929, pp. 17-23, in ASBI, Beneduce, b 128.

could alter the banking nature of the institution and involve it in a system of political controls contrary to the spirit of the Young Plan, which aimed to remove such controls. On the other hand, it was noted that the purpose of deliveries in kind was to increase Germany's capacity to pay and that the Plan did not provide for the creation of bodies external to the Bank; the Bank could therefore not dissociate itself from this issue. The view prevailed that the BIS could not be party to any system of controls and should assume the sole function of paying agent. However, the Bank would have the power to establish an advisory committee to keep it informed of the general progress of deliveries in kind. This power would be written into the new Regulations on deliveries in kind; the trust agreement would only mention in Article XV that the trustee took note of the agreements and regulations concerning deliveries in kind and '... agrees to observe the same as far as lies within its province and powers as a bank as set forth in the Statutes'.³⁴

16. The question of the domicile of the Bank was tackled on 7 and 8 November at confidential meetings for which no minutes exist; it was decided that the Bank should be located in a Swiss city. The Belgian delegation, which had cherished the hope of having the seat of the Bank in Brussels, felt betrayed and did not attend the regular meeting on the 8. From 9 November to the end of the work of the Committee the two assistants to the Belgian delegation, Frère and Marx, attended as observers; in a further session held that day, Basel was chosen as the domicile of the Bank. The choice of Switzerland meant fixing the capital at an amount in Swiss francs (500 million Swiss gold francs) approximately equal to the planned \$100 million.³⁵

³⁴ The discussion refers to the meetings of 5 November (afternoon session) and 6 November 1929; see BIS Archive, 7.16 – *Baffi Papers*, RBL/B15. Article XV of the Trust Agreement was given final approval at the meeting of 9 November; for the quotation, see *The Hague Agreements*, Annex VIII, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B6 (or, in the French version, *Accords conclus à La Haye 1929-1930, op. cit.*).

³⁵ On the content of the confidential meetings, see what was reported in a note by Moret, dated 7 November 1929, and in a letter dated 9 November 1929, again from Moret, to Governor Moreau; in BIS Archive, 7.16 – *Baffi*

17. With its work almost complete, the Committee resumed discussion of the four articles that had been held over to the final stage and read the texts of the other articles that had already been agreed in principle, on which further debate also took place.

The four articles of the trust agreement that remained to be finalised were IV, VI, XI and XVIII. Article IV concerned the allocation of the sums paid by Germany, VI any foreign exchange profits or losses made by the trustee, XI the trustee's actions in the event of the suspension of transfer and XVIII the remuneration of the trustee.

With regard to Article VI the Committee agreed that profits or losses should be credited or charged to the governments involved in the underlying operations. It decided to make no suggestions for Article XVIII; as mentioned above, the Second Session of The Hague Conference would set the bank's remuneration at 1 per mille of the sums paid by Germany. With regard to Articles IV et XI Moret remarked that the Plan made no distinction between annuities actually mobilised and those that were mobilisable; together they constituted the non-postponable annuity. Schacht wanted to know whether Germany could consider it had fulfilled its obligations to holders of mobilisation securities once payment had been made to the trustee; it was suggested that he should have a clause to this effect written into loan contracts so that holders could not have recourse to Germany for deficiencies on the part of the trustee. The suggestion did not satisfy Schacht, who considered it damaging to the credit standing of the Reich. He then succeeded in eliminating the possibility of deficiencies on the part of the trustee by providing for the sums needed to service the bonds to be transferred immediately to appropriate accounts for the loan issues, where they would remain until disbursement.³⁶

18. The further debate on the other articles revolved around questions of principle affecting links between the Statutes and the Plan, Germany's position with regard to the trust agreement and

Papers, RBL/B13. The reports on the meetings of 7, 8 and 9 November 1929 are preserved in BIS Archive, 7.16 – *Baffi Papers*, RBL/B15.

³⁶ See the meeting of 9 November 1929; *ibid.*

the trustee and the relations of both the Committee and the trustee with governments.

Schacht was most insistent about references to the Plan. He was placated by the insertion of a general reference in Article 4 of the Bank's Statutes.³⁷

Since Germany was not party to the trust agreement, he objected to provisions in the agreement that placed obligations towards Germany on the trustee – for example, with regard to the periodic certification of the amount of non-interest-bearing funds left on deposit in the Annuity Trust Account by creditor governments. It was pointed out to him that the compulsory non-interest-bearing deposit from the German Government was to be equal to 50 per cent of the funds in question. Schacht and Vocke also contested the wording of Article XIV, which required the trustee to receive and administer the long-term deposit from the German Government (up to 400 million Reichsmarks), again arguing that it related to relations between the Bank and a government that was not a party to the trust agreement, namely the German Government. Other members of the Committee replied that Article 53 (e) of the Bank's Statutes made the long-term deposit subject to the rules on the distribution of the Bank's profits, part of which was assigned to Germany in order to help it pay the final twenty-two annuities; the deposit was therefore one of the mechanisms of the system of payments for which the Plan provided and which passed via the trustee.³⁸

19. With regard to relations between the Committee and governments, Schacht objected to a copy of the text of the Statutes being sent to Jaspars, the President of The Hague Conference and Prime Minister of Belgium, on the grounds that the Committee had been appointed by the central banks and consequently should have nothing to do with governments. It was pointed out that Article 7 of The Hague Protocol of 31 August provided for the Conference to reassemble to consider the reports to be submitted by the Committees (including the Organisation

³⁷ Article 4 was given final approval at the meeting of 13 November 1929; *ibid.*

³⁸ The issue had been the topic of the meeting of 8 November 1929; *ibid.*

Committee for the BIS) and to take whatever action was considered desirable. Schacht persisted, producing the argument that governments had not communicated The Hague Protocol to the central banks. Other delegates replied that central banks had not been notified of the Young Plan either, but this had not prevented their representatives on the Organisation Committee from taking note of it and using it as the basis of their work. Beneduce remarked that the members of the Committee represented the embryonic bank and had to think of the future of the child that was to be born. Schacht yielded to what he called 'an appeal to his paternal instincts' and it was agreed that Jaspard would be sent a copy of the Statutes.

As to relations between the trustee and governments, the Committee debated the trustee's right and duty to take the lead in notifying governments when market conditions made a bond issue practicable; it was concluded that the Bank had an obligation to monitor the state of the markets and to notify the governments involved speedily whenever it considered that suitable conditions obtained.³⁹

20. The work of the Committee was concluded on 13 November with the signature of the documents that had been prepared: the Charter, the Statutes and the Trust Agreement; Frère was present as Belgian observer. The three documents were to be sent to the six central banks and also to the Chairman of the Federal Reserve Bank of New York.⁴⁰

21. The Hague Conference reassembled on 3 January 1930 for what was officially a 'Second Session' but which was sometimes called the 'Second Hague Conference'. The participants were quite different from those who had attended in August of the previous year. One of the two most influential voices of moderation and harmony between victors and vanquished, Stresemann, had since died; the other, Briand, was present, but the French delegation was led by the Prime Minister, Tardieu,

³⁹ *Ibid.*

⁴⁰ See the meeting of 13 November 1929, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B15.

who was more nationalistic. The representatives of Austria, Hungary and Bulgaria attended for the first time.⁴¹

The sitting on the 3 was followed by another on 20 January at which the Conference completed its work, persuaded, if we are to believe the terms in which the closing speeches were couched, that the consequences of the war had been finally settled.⁴²

22. During the Second Session the representatives of the creditor powers proposed a number of changes in the trust agreement drafted by the Organisation Committee; these were approved after consultation with the Committee. The new text required the BIS, as trustee, to notify the German Government and the Governments of the creditor countries of the average of the daily balances on non-interest-bearing deposits made with the Bank by creditor governments and arising from German payments under the Dawes and Young Plans.⁴³

On 20 January the Reparation Commission drafted the text of the Convention respecting the new Bank and its Constituent Charter. The representatives of Romania, Poland and Portugal agreed to the texts on condition that their countries had a representative on the Board of Directors of the Bank.⁴⁴

During the Second Session the obligation to maintain the convertibility of the Reichsmark was laid down in the following terms at the request of the Inviting Powers, the underlined words being amendments approved by the Committee of Jurists:

The German Government undertakes that the Reichsmark shall have and shall retain its convertibility in gold or devisen as contemplated in Article 31 of the Reichsbank Law of the 30th August, 1924, and that *in all circumstances for the general purposes of the New Plan*, the Reichsmark

⁴¹ For Austria, Hungary and Bulgaria, as well as for Germany and Czechoslovakia, specific agreements were signed under which all the problems still outstanding vis-à-vis the creditor powers were considered resolved and which were annexed to the Final Hague Act of 20 January 1930; see *Accords conclus à La Haye 1929-1930, op. cit.*

⁴² *Ibid.*; *Acte final* and *Annex I*.

⁴³ The amendment was discussed at The Hague on 18 January 1930. See *Procès Verbaux et Documents de la Conférence de La Haye*, preserved in BIS Library, V III 37, no. 16145.

⁴⁴ The condition for the final agreement was tabled at the meeting of 19 January 1930; *ibid.*

shall have and shall retain a mint parity of 1/2790 kilogramme of fine gold as defined in the German Coinage Law of the 30th August, 1924.⁴⁵

⁴⁵ Thus worded, the German undertaking was appended to the Final Act of The Hague Conference; see *Accords Conclus à La Haye 1929-1930, op. cit.*, and *Accord avec l'Allemagne, Annex III*. Regarding the unfolding of the Conference, see also G. Royot's reconstruction *La Banque des Règlements Internationaux après Baden-Baden et Jusqu'après la deuxième conférence de La Haye*, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B13.

IV

THE CONTROVERSY OVER THE SENIOR POSITIONS IN THE BANK

1. Between the end of 1929 and April 1930 a lively debate developed between Berlin, London, Paris and New York about the senior positions in the Bank. It revolved around the distribution of powers between the Board of Directors, the Executive Committee (if any), the President and the General Manager and was inextricably linked with discussion of the persons to be appointed President and General Manager.

From the outset there was agreement on the advisability of appointing an American as President, thereby continuing to give the United States the role it had consistently been assigned in the institutions tackling the problem of the payments laid down in the peace treaty, namely the Reparation Commission, the Dawes Committee, the Young Committee and the Organisation Committee for the BIS.

The exchanges of view in Europe on the choice of President were mainly between Norman, Schacht and Moreau; on the other side of the Atlantic they were dealing not so much with the Federal Reserve System, which was the victim of the State Department's veto, as with the US members of the Young Committee, in other words Young himself together with J.P. Morgan and T.W. Lamont, both of whom were leading representatives of the world of private finance.¹

¹ This correspondence is described in Baffi's notes with the results of his visit to the Historical Archive of the Bank of England; BEA, G1/4-940/4, docs. 6-13, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B6, 'Staffing-Chairman'.

Various names were put forward initially, the most favoured being Dwight Morrow and W.W. Stewart.² However, on 10th January, even before the Second Hague Conference had ended, Young and Morgan telegraphed to Norman that they were prepared to nominate 'Gates W. McGarrah, now Chairman of the Federal Reserve Bank of New York, and Leon Fraser, a member of the law firm of Ropes, Gray Boyden and Perkins',³ as American directors of the BIS. It was noted that McGarrah was also an American member of the Council of the Reichsbank⁴ and that Fraser had previously worked in the office of the Agent General for Reparation Payments and had been adviser to the American delegations in the Young Committee in Paris and the Organisation Committee in Baden-Baden.

Moreau accepted the American proposal at the end of January on condition that the two Americans were not both appointed as directors with permanent functions; he wanted to reduce Fraser's role to that of legal adviser.⁵ His restrictive proposal did not win approval from Norman, who wanted Fraser to be alternate to the President. In Norman's view, Fraser 'would carry out the duties of President in McGarrah's absence and will be his Deputy and Representative'; he should therefore be appointed Vice President and Legal Adviser.⁶

Moreau stood his ground and also opposed the formation of an Executive Committee, because he wanted to maintain the powers of the General Manager, a position he would insist be given to Quesnay. On 4 February he telegraphed to J.P. Morgan:

It is understood that Leon Fraser will give to the Chairman his constant cooperation and will be deputised by him to carry out the duties of President in his stead and place as his representative in cases of

² See Baffi's notes – BEA, *op. cit.*, docs. 6, 9 and 10; *ibid.*

³ This is documented in the note of 10 January 1930 sent by Young and Morgan to Moreau and Norman; see Baffi's notes – BEA, *op. cit.*, doc. 13; *ibid.*

⁴ On the composition of the Council of the Reichsbank, see note 12 on p. 90.

⁵ Moreau wrote to Morgan on 27 January 1930; see Baffi's notes – BEA, *op. cit.*, doc. 16; *ibid.*

⁶ Draft of a cable sent on 3 February 1930 to Young. Baffi noted that the telegram 'should have been sent jointly by Moreau and Norman to Young. But Moreau let it be known that he disagreed and that he would send an answer "in his own name"'; Baffi's notes – BEA, *op. cit.*, doc. 25; *ibid.*

Chairman's absence [...] To propose Leon Fraser as Vice Chairman would add nothing to his position and would have for sole result to hurt public opinions in various European countries.

He went on: 'We should object to any creation in Basle of an Executive Committee composed of Directors which would in fact undermine the authority of the personalities who are responsible for the good management of the business'.⁷ The following day Norman wrote to Schacht, who was on the point of leaving the Reichsbank, to inform him of Moreau's resistance and to reproach Schacht for his self-assertion: 'Your personal position and difficulties do indeed seem to me to make the line between us politically and financially difficult to discern. I still wish that you had avoided Paris and later Baden-Baden'.⁸

In mid-February Norman visited Moreau and informed Schacht that the latter accepted that Fraser would be 'a Director, and Alternate to McGarrah in his absence' but without the title of Vice President.⁹ In an earlier letter Norman had stated that 'this will lead in the future to great confusion', because the directors would have 'different ideas as to the extent of Fraser's duties'.¹⁰ However, Norman too was now resigned to the idea of having a European Vice Chairman. In the event, two Vice Chairmen were appointed – Melchior and Beneduce; Fraser would be given the title of Alternate to the President.¹¹

2. The debate on the Chairmanship and Vice Chairmanship subsided at this point, but a new controversy erupted about the

⁷ Telegram sent to Morgan by Moreau on 4 February 1930; see Baffi's notes – BEA, *op. cit.*, doc. 24; *ibid.* See also Moreau's note, on the same date, to Franck, originally from the archives of the National Bank of Belgium, preserved in BIS Archive, 7.16 – *Baffi Papers*, RBL/B3.

⁸ Norman's letter of 5 February 1930 to Schacht; see Baffi's notes – BEA, *op. cit.*, doc. 29, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B6.

⁹ Norman's letter of 14 February 1930 to Schacht, in which Norman tells of his last visit to Moreau in Paris; see Baffi's notes – BEA, *op. cit.*, doc. 29; *ibid.*

¹⁰ Norman's letter of 5 February 1930 to Schacht; see Baffi's notes – BEA, *op. cit.*, doc. 29; *ibid.*

¹¹ The appointments were approved at the meeting of the governors appointed to the board of the BIS, held in Basel on 22-23 April 1930; see BIS, *Minutes of the Meeting of the Board of Directors*, in BIS Archive. For the composition of the Board of Directors, see Chapter VI, note 1, below.

person to be appointed General Manager. Schacht's initial position on this issue was that there should be two General Managers, one French and one German, but he found no support from the British and Americans, who had accepted the idea of appointing Quesnay. In February Schacht wrote to Norman to complain at this; in his view Young and Morgan were not entitled to express an opinion that committed McGarrah and Fraser, who were American members of the Board of Directors, the body responsible for choosing the General Manager.¹²

In a telegram to Grenfell in February, Lamont disputed Schacht's position. He said he had learnt that Schacht was opposed to the appointment of a Frenchman as General Manager as this would indicate that the BIS was 'purely a reparations bank'. Nothing was further from the truth as far as American views were concerned; they were in line with Montagu Norman's, in other words that the BIS should become an 'Agency of central banking cooperation'. Lamont added that he had written in this vein to the Chancellor of the Exchequer, Snowden, stating that 'McGarrah and Fraser were chosen for their qualifications, not for their connection with the Dawes Plan' and that 'Quesnay is the best, most broad-minded French, except possibly Jean Monnet, who is not available'.¹³

The debate among the monetary authorities of the four countries was dramatised in the press to such an extent that Norman wrote to Moreau and Schacht calling for a 'press armistice' on BIS appointments. Moreau replied that he was in agreement but stressed that the attack had come from the German press (which was hostile to Quesnay) and that many thought it had been incited by Schacht himself.¹⁴ Schacht in turn wrote to Norman that it was his sincere hope that the Press Armistice Agreement 'is not subject to the appointment of a French general manager'. He went on: 'For the moment, I leave aside the question of the personality of Quesnay who, in my feeling, would be an especially unfortunate

¹² Schacht's letter of 13 February 1930 to Norman; see Baffi's notes – BEA, *op. cit.*, doc. 33, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B6.

¹³ Lamont's telegram of 14 February 1930 to Grenfell; see Baffi's notes – BEA, *op. cit.*, doc. 35; *ibid.*

¹⁴ See Baffi's notes – BEA, *op. cit.*, Norman's letters, docs. 42-43; Moreau's reply, doc. 49; *ibid.*

choice because he was the most ardent defendant of French interests during all this last year and he therefore cannot possibly instantly become the man of general confidence'. According to Schacht, the appointment of a Frenchman would make German cooperation in the activity of the Bank very difficult.¹⁵

Schacht and the Council of the Reichsbank were also irritated because Quesnay spoke as though he had already been appointed. The 'Neue Zürcher Zeitung' of 30 January carried an interview with Quesnay, at that time Head of the Research Department at the Bank of France, and presented him as the main author of the BIS:

Quesnay has participated in all the great undertakings for the financial reconstruction of Europe, in particular the stabilisation of the French franc, the zloty and the leu [the currencies of Poland and Romania]. The initiative for the drafting of the Young Plan came from Quesnay; there are good grounds for stating this, since Owen Young himself has said as much publicly. He is therefore the originator of the plan to create such an institution [the BIS].

In the interview, which irritated Schacht in particular, Quesnay defined the objectives of the BIS in a way that emphasised its functions as agent for reparations and clearing, which would be performed according to the following mechanism:

Quesnay believes that the central banks may keep current accounts at the BIS denominated not in pounds sterling, Swiss francs or dollars but in a certain weight of fine gold. Hence if a central bank has to take measures to protect its currency it is not forced to sell foreign currencies and thus place a strain on the money market of the neighbouring state [...] it will draw on its reserves in fine gold [...] The gold currency will therefore be the currency for future financial transactions.¹⁶

3. In February Norman visited Moreau in Paris, but the meeting did not reconcile their differences. Mr. Peacock of Baring, who met Moreau after Norman's departure, wrote in a memorandum preserved in the archives of the Bank of England:

¹⁵ Schacht to Norman, 19 February 1930; see Baffi's notes – BEA, *op. cit.*, doc. 55; *ibid.*

¹⁶ *Ibid.*

The French thesis is that this Bank should be organised so as to act as an instrument capable of keeping up continual pressure on the Germans to pay their reparation debts. Moreau said that he did not think that Norman realised how all important it was for France that Germany should punctually meet reparation payments. Moreau's inclination is, therefore, to insist that the direction of the Bank should be in the hands of a representative of one of the Allied Nations and that there should be a French representative in a position of authority who would watch the interests of France and keep Moreau advised of any sign of German default.

At this point a marginal note in Norman's handwriting reads: 'Ominous for future conduct and goodwill of BIS'.

The note continues:

This function of keeping up the pressure on Germany seemed to Norman, Moreau said, of secondary importance compared with the eventual regulation by the Bank of Payments of international questions of transfers and exchange, the distribution of gold reserves etc., and the eventual smooth working of international finance.

Norman added: 'agree'.¹⁷

4. In March the Quesnay affair became the subject of diplomatic exchanges. The German ambassador in London sent the Foreign Office an *aide mémoire* expressing the German Government's objections to Quesnay's candidature. The note argued that his appointment would not help to keep the Bank out of politics and to depoliticise the whole problem of payments. In this context the note remarked that

the German Government attach the utmost importance to Monsieur Quesnay not being entrusted with this post. It is one of the fundamental conceptions of the Young Plan that the payment of reparations should in future be divorced from politics and should assume a purely business aspect [...] Consequently the International Bank also should not be invested with a political character. Therefore at Baden-Baden the German members of the Organisation Committee urged that the two

¹⁷ Mr. Peacock's memorandum of 10 February 1930; see Baffi's notes – BEA, G1/2 – 940/2, doc. 4; *ibid.*

most important posts [...] should not be filled politically, i.e. not with individuals from any of the countries chiefly concerned, but with neutral persons. If one post goes to a Frenchman, the other should go to a German [...]. If the Plan is carried out in a normal manner the decision of the Bank will have the most potent effect on the German foreign bill market and the market for German State and private loans, and thereby on the entire German economic fabric. Their decisions might have an even more profound influence in the preliminary stages of a possible moratorium and during eventual moratoriums.

If the post went 'to an individual in whose case national and unilateral prejudices can be assumed [...] the Bank would be deprived of the general confidence which is necessary'.¹⁸

The reply from the Foreign Office was that 'His Majesty's Government has no *locus standi* in the matter' and could not interfere in the free choice of the Board of the BIS.¹⁹

The same month Luther, who had just succeeded Schacht,²⁰ sent ambivalent messages to London: he did not wish to begin his term of office with a rift over Quesnay, but he feared that any sign of weakness would be exploited by Schacht to harm him and the BIS. In his own view,

a German second-in-command would not make for smooth working of the whole machine [...] Germany would feel that the new régime was beginning with an expression of cynical disregard for her views, and would regard the BIS as the successor, not the supplanter, of the Reparation Commission [...] If the real function of the BIS is to create confidence, and so to stop the need for a moratorium, Germany must have confidence in the motives inspiring the management of the BIS.²¹

Throughout March Luther resisted all attempts to persuade him. Even at the beginning of April he wrote to McGarrah rejecting the Quesnay solution and suggesting three possible alternatives: (a) a

¹⁸ Aide-mémoire submitted by the German ambassador to Sir R. Vansittard; see Baffi's notes – BEA, G1/4 – 940/4; *ibid.*

¹⁹ Vansittard's letter of 5 March 1930 to Norman; see Baffi's notes – BEA, *op. cit.*, doc. 64, in BIS Archive; *ibid.*

²⁰ On the subject of Schacht's succession, see also Chapter VI, § 4 below.

²¹ Passages from a letter dated 16 March 1930, from Berlin, initialled 'E.R.D.', which reveal where Luther stood; see Baffi's notes – BEA, *op. cit.*, doc. 66; *ibid.*

neutral General Manager; (b) a second General Manager of German nationality; (c) a General Manager from one of the European countries with an *ex officio* director in accordance with Article 28 (1) of the Statutes, but not from France or Germany.²² The third solution was also warmly supported by Norman, both in correspondence and during a visit McGarrah paid to London.²³ However, McGarrah notified Luther that he would propose Quesnay despite German opposition.²⁴ Indeed, Quesnay was elected at the meeting of nominated directors summoned in April by Sir Charles Addis in his capacity as Vice Chairman of the Organisation Committee.²⁵ In spite of the fact that everyone, including the Germans, declared that they attached great importance to a unanimous vote,²⁶ Luther and the other two German members of the Board voted against Quesnay's appointment, citing serious reasons of principle in a written note that states:

For us there is a question of principle at stake, regarding the character of the Bank, with which the position of Germany within the Bank is indissolubly connected.

On the way which led to the origin of the Bank the parity between Germany, the sole debtor country, and France, the main creditor country, has been clearly expressed. The Young Plan and the Statutes of the Bank grant to both countries a position of preference, but of equal rights in the Bank. It was on this very principle of parity, among others, that the German people, when giving their majority vote for the Young Plan, based the expectation that the new Bank will prove a useful instrument not only for the world's economy but also, in particular, for cooperation between France and Germany.

²² Luther's letter of 1 April 1930 to McGarrah; see Baffi's notes – BEA, *op. cit.*, doc. 72; *ibid.*

²³ Norman's letter of 16 April 1930 to Luther; see Baffi's notes – BEA, *op. cit.*, doc. 84; *ibid.*

²⁴ See Baffi's notes – BEA, *op. cit.*, docs. 77, 80 and 84; *ibid.*

²⁵ The meeting, chaired by Sir Charles Addis, was held on 22-23 April 1930 in Basel. See Sir Charles's letter of 10 April 1930 to Franck; papers collected as copies in the archives of the National Bank of Belgium (BNB), in BIS Archive, 7.16 – *Baffi Papers*, RBL/B3.

²⁶ In particular Norman had underlined how, at the outset, unanimity had to be considered essential for the future of the BIS; Montagu Norman's letter of 11 April 1930 to McGarrah; see Baffi's notes – BEA, *op. cit.*, doc. 78, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B6.

We three German members of the Board will not in any circumstances abandon our effort to develop the new Bank in the spirit just mentioned. But, in accord with the views of the German people, we must express our opinion that the election of Monsieur Pierre Quesnay as General Manager would not be in conformity with the aforementioned principle of parity. Therefore to our regret we feel compelled, for serious reasons of principle, to vote against the election of Monsieur Pierre Quesnay as General Manager.²⁷

Germany provided the 'second-in-command', in the person of Dr. Hülse, the Assistant General Manager.

McGarrah urged Norman to nominate Siepmann as Head of the Central Banking Department. The post went instead to Rodd, who was also appointed liaison officer with the Bank of England, where in fact he dealt with Siepmann himself.²⁸

²⁷ See BIS, *Minutes of the Meetings, op. cit.*, Annex A, 22-23 April 1930.

²⁸ Rodd's appointment was ratified by the BIS Board on 16 June. See *Board of Directors – BIS, Annex B, Annex 4*, 16 June 1930. See also Chapter VI, § 1 below, where the basic principles of the Bank's internal organisation are recapitulated.

AMERICAN DISAFFECTION

1. The American Presidency of the Bank soon proved to be the most unstable element in the leadership of the institution. This instability appears to have been attributable to three factors or 'deficiencies':

(a) a lack of communication between the monetary authorities of the United States and the United Kingdom, the countries of issue of the two reserve currencies;

(b) a cultural disparity between the American directors and the European central banks;

(c) shortcomings in realising the initial intentions as to the role of the Bank, associated with the two foregoing factors.

2. When the central bank governors met in Rome in February 1930¹ they knew that the Federal Reserve Bank of New York was unable to appoint the American directors in view of the Department of State's veto on Federal Reserve participation in the creation and administration of the BIS. They therefore had to invite representatives of the private sector to become members of

¹ The Governors' Meeting of 26-27 February 1930, held in Rome in view of the state of health of Governor Stringher, was one of the most important milestones on the road to the actual creation of the BIS. The meeting was part of the plan put together by the organisation sub-committee that had been appointed by the Organisation Committee at the closing meetings in The Hague; the subcommittee, consisting of Siepmann, Quesnay and van Zeeland, had carried out its mandate between 24 January and 19 February 1930. See G. Royot, *La Banque des Règlements Internationaux entre La Haye et Bâle*, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B13. See also Moreau's letter of 4 April 1930 to Franck, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B3, BNB.

the Board, in the same way as Morgan and Lamont had been invited to participate in earlier deliberations.² This occurred at a time when American private financiers were tending to disengage from Europe by withdrawing the capital they had previously lent.

Faithful to the orders of his Government, the Chairman of the Federal Reserve Bank of New York, Harrison, wrote to McGarrah in the months that followed to enquire timidly whether it would be appropriate for him simply to visit Basel at the time of a Board meeting or the first Annual General Meeting.³

The lack of communication with the American authorities could have been partially remedied if the BIS had had good relations with the Bank of England, but serious difficulties soon arose in that direction too.

The United Kingdom was not represented in the five senior positions in the Bank (President, his Alternate, the two Vice Chairmen and the General Manager). This was a curious absence, since the functions assigned to the BIS in the settlement of international commercial transactions and the clearing of payments had traditionally been performed by the network of financial intermediaries in the City of London using sterling as the settlement currency. Norman seems to have thought he could influence the activities of the BIS indirectly by using Rodd, the Englishman appointed to head the Central Banking Department, as a conduit to the Bank of England. Norman was an empiricist,

² The names which had prevailed during negotiations on the appointment of the American representatives had been those of McGarrah and Fraser, of the Fed, New York, as seen in Chapter IV, although it was not possible for them to be appointed directly to the BIS Board by Governor Harrison owing to the Fed's veto. In this connection, see the exchange of correspondence between the governors attending the Rome meeting – Franck, Moreau, Norman, Schacht, Stringher and Tanaka (Vice Governor of the Bank of Japan) – and Harrison, McGarrah and Fraser, contained in the *Procès verbal de la première séance de la réunion des Gouverneurs des Banques Centrales, Annexes*, 26-27 February 1930, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B12 and RBL/B4.

American participation in the BIS's capital was assured by J.P. Morgan & Co., the First National Bank of New York and the First National Bank of Chicago. On the composition of the Bank's ownership structure when it was founded, see BIS, *First Annual Report, 1930-31*, pp. 3-4, and the related *Annex I*.

³ See Harrison's letter of 24 April 1931 to McGarrah, *Harrison Papers* – FED, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B1.

a 'case-by-case' man who had won his laurels salvaging industrial companies rather than in monetary management.* However, in Siepmann he had an adviser who was a good producer of ideas, and the early months of the operation of the BIS were indeed marked by very close relations nurtured by visits, correspondence and telephone conversations between Rodd and Siepmann.

In April and May Siepmann had taken part in a series of meetings held in Quesnay's office in Paris to determine the internal organisation of the Bank. According to Siepmann, 'the main purpose of the BIS is to do work which need not be done, but ought to be done. In one sense, Reparations Accounting is more "necessary" than Central Banking cooperation. But if "necessary" is to mean "inevitable" the BIS will only make economies at the expense of neglecting its opportunities'. He remarked that the personnel for administering reparations could be drawn from the staff of the Agent General.⁴ This part of the organisation of the BIS was necessary, but it should be 'relegated to the cellars of the BIS, [...] where it might serve, like some central heating apparatus, to warm the Bank by providing it with a sufficient income'. To organise cooperation among the central banks, however, staff had to be sought elsewhere, and 'we could scarcely hope to get them except by making it reasonably worth their while to get into exile, with their families, in Basel'.

3. However, the President's Office considered the flow of ideas emanating from the Bank of England insufficient to define a role for the BIS that accorded with the original plan. In a note addressed to Rodd in January 1931 and sent to Quesnay for information, Fraser commented that 'some people in the Bank who are not pressed with daily routine matters [...] should be trying to work out fields of usefulness and trying to translate into practical action the words "central bank collaboration"'. In the absence of an Advisory Counsel – a post suggested by Owen Young and for which Sprague or Rist were considered

* Cf. Sir H. Clay, *Lord Norman*, Macmillan, London 1957, pp. 318 ff.; J. Giuseppi, *The Bank of England. A History from its Foundation in 1694*, Evans Brothers, London 1966, pp. 156-157; R.S. Sayers, *The Bank of England, 1891-1944*, Cambridge University Press, Cambridge 1976, pp. 314 ff.

⁴ See Baffi's notes – BEA, G1/8-151/7, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B4.

appropriate candidates – Fraser felt that this creative function should be performed by the Central Banking Department, whereas in fact the Department was *asking* the President's Office for ideas in a kind of tennis match. 'The truth is that we have not had very much proposed to us to date, but we have had a great deal proposed to us which we should not do and a kind of general admonition from some quarters that we should do nothing at all except have tea once a month in Basle'. Fraser did not accept that the BIS was useful only to the weaker central banks; he wanted to 'find methods by which we can serve the strong, other than merely taking relatively small portions of their foreign reserves at interest rates a trifle higher than they can get in a hundred other banks'. Accordingly, he suggested that contact be made with the strong central banks by paying them individual visits to ask 'how can the International Bank be of service and what in your conception is its proper role?'

He was against the idea of laying great emphasis on studying Germany's capacity to pay reparations.

If there is anything that is clear in the Young Plan, it is that Germany is to wrestle with this problem on her own responsibility and without foreign interference or supervision. We must not try to continue the elaborate studies of Gilbert's economic service, and if we do we shall very properly have the Germans on our necks with both feet.⁵

4. The lack of ideas of which Fraser complained should have induced the President's Office to avoid weakening relations with possible sources of ideas. By contrast, two months after Fraser's note, McGarrah wrote to Norman to complain that Siepmann was interfering in the activities of the Central Banking Department by giving instructions to Rodd. According to McGarrah, 'the Division for the Liaison with Central Banks has not developed satisfactorily – neither Rodd nor Quesnay have helped it do so'. He continued on a severe note that Rodd

⁵ See Fraser's note of 14 January 1931 to Rodd, with a copy to Quesnay; in BIS Archive, 7.16 – *Baffi Papers*, RBL/B12.

has been placed in an extremely difficult position by serving, unlike any other of our Managers, in a dual role – at the same time as Liaison Officer of the Bank of England and as a Manager of the BIS. Double allegiances never work, and what we need here, if this institution is to become that which you are eager to have it, is what Sir Charles Addis described in New York as ‘an international staff selected and imbued with a spirit of loyalty to the concern’. If this ideal is to be realised, our Managers must always be in a position to keep this institution in their minds and hearts in the first, rather than in the second, place.⁶

Siepmann defended himself, writing to Norman that ‘we were the only Central Bank to take an active, constant, eager interest in the BIS, amounting virtually to a participation day by day’; after the rebuke from McGarrah, he warned, this attitude would be replaced by one of ‘sulky indifference’.⁷ In a letter to McGarrah, Norman confirmed that the limitations McGarrah had placed on telephonic and postal communications between BIS officials and the Bank of England ‘will create difficulties for the BIS Department for Relations with Central Banks’.⁸

5. The cultural disparity between the system of values proposed by the Americans and that of the European central banks is especially evident on the question of relations between politics and business and with regard to the international monetary system.

With regard to the first issue, the Americans placed the accent on the social value of business ethics. This was the basis of the Dawes and Young Plans, in the drafting of which McGarrah and Fraser had participated. By virtue of such ethics, the problem of reparations had supposedly been freed from the risks and vicissitudes of politics and had acquired the characteristics of commercial obligations to be satisfied in the same way as those

⁶ McGarrah’s letter of 16 March 1931 to Norman. See Baffi’s notes – BEA, G1/4-940/4, doc. 101, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B6.

⁷ The question of ‘interference’ had already been a point of discussion for some time, as would be revealed by Siepmann’s note of 17 October 1930 to Norman, from which the quotation is drawn; see Baffi’s notes – BEA, *op. cit.*; *ibid.*

⁸ Norman’s letter of 27 October 1930 to McGarrah; see Baffi’s notes – BEA, *op. cit.*, doc. 92; *ibid.*

arising out of a private contract, with creditors helping to create suitable conditions for meeting the commitment by granting loans, expanding their imports from Germany and fostering cooperation among central banks.

If this central tenet were to be applied consistently, it would have to be extended to the payment of war debts owed by the European victors to the United States, and hence the political authorities would have to adopt a favourable or at least neutral attitude towards all the mechanisms established both for reparations and for the debts that hinged on the BIS. In fact, the opposite was the case.

McGarrah himself was quick to realise that business criteria did not have universal validity and that they could distort the activities of the central banks. In a lecture delivered at the Academy of Political Science in New York in November 1930 on the first six months of the BIS, McGarrah said:

It is not the aim of the Bank to attain large profits. Mindful of our objective as a regulator of the exchanges, as a reserve center and international clearing house for central banks, and as a factor in the improvement of international credit and the circulation of capital, our investments subordinate the profit-making aim to a consideration of their effect on central bank policy, the foreign exchanges and the improvement of world credit.⁹

6. As far as the international monetary system was concerned, the European central banks remained faithful to gold, in accordance with a policy affirmed at the Conferences held in Brussels in 1920 and Genoa in 1922, reinforced by the experience of the German inflation of 1922-23 and confirmed by sterling's return to the gold standard at its pre-war parity, at great economic and social sacrifice. This line was pursued throughout the crisis, both in the management of reserves – with part of sterling and dollar reserves being converted into gold – and at the theoretical level, as exemplified within the ambit of the BIS by Quesnay's

⁹ Typewritten article dated 2 December 1930; in BIS Archive, 7.18(2) – *Papers McGarrah/Fraser*, box 8, f. 55. See also Baffi's notes – BEA, *op. cit.*, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B10.

elaborate studies on the *grammor*.¹⁰ The policy held until the London Monetary and Economic Conference of 1933, albeit in a diluted form after sterling, the US dollar and other currencies linked to sterling had come off the gold standard; it was torpedoed in July 1933, however, by the famous declaration by President Roosevelt, who detested the world of international finance that upheld it.¹¹

In this respect as well, from the summer of 1933 onwards the two American directors found themselves among the untiring defenders of a monetary system based on a subservience to gold from which the United States had liberated itself.

7. The central banks' deposit accounts with the BIS would have had to grow steadily if the Bank was to perform the tasks assigned to it in the original plan and recalled in McGarrah's speech of November 1930, but this did not occur. The funds at its disposal declined during its first few years of operation, as illustrated in the statistical analyses carried out by De Mattia.¹² It was characteristic of this disappointing performance that within a month of delivering his pompous address in New York McGarrah

¹⁰ See Chapter III, § 5 above.

¹¹ The decision to hold the London Monetary and Economic Conference (12 June to 27 July 1933) was taken under the Lausanne Agreement (see Chapter XI, § 6, below) with a view to overcoming the serious worldwide economic and financial difficulties. The Conference was organised with the involvement of the League of Nations and the collaboration of the BIS. Intended to achieve exchange rate stability and, more generally, to restore the international monetary system through the imposition of pegging to the gold standard and central bank cooperation as two of the essential conditions, the Conference was demolished by the message from the American President, who rejected its proposals en bloc. One of Roosevelt's statements was: 'The world will not long be lulled by the specious fallacy of achieving a temporary and probably an artificial stability in foreign exchange on the part of a few large countries only. The sound internal economic system of a nation is a greater factor in its wellbeing than the price of its currency in changing terms of the currencies of other nations'. See B.M. Anderson, *Economics and the Public Welfare. Financial and Economic History of the United States, 1914-1946*, Van Nostrand Co., New York 1949, p. 331; C.P. Kindleberger, *The World in Depression. 1929-1939*, The Penguin Press, London 1973, p. 219. Regarding the work carried out at the London Conference, see also BIS, *Fourth Annual Report, 1933-34*, pp. 5-19.

¹² The statistical analyses carried out by R. De Mattia are preserved in BIS Archive, 7.16 – *Baffi Papers*, RBL/B34.

asked Norman to transfer bills worth \$10 million from the Federal Reserve Bank to the BIS for purposes of window dressing. His request was not met.

The growth of cooperation among the central banks was equally disappointing, owing to the souring of political and commercial relations in the first half of the thirties. Nothing came of the grand schemes McGarrah announced in New York – namely the organisation of a system of international clearing through the BIS, to be operated through a foreign exchange settlement fund that would be administered by the BIS, and the creation of an adjustment fund for movements in gold.

Instead, France managed its substantial gold and foreign exchange reserves independently, the United Kingdom, whose dollar reserves were increasing rapidly after the abandonment of the gold standard, made arrangements to invest directly on the US market and to concentrate the sterling balances of the Empire in accounts held directly in London, and Germany was progressively sealing itself behind the walls of a system of exchange controls.

Nevertheless, in 1931 the BIS was called upon to participate in the loans granted to Germany, Austria and Hungary. The loans were not repaid at the original maturities, with the result that the BIS was left short of resources for further operations and obsessed with its own liquidity problems. In the summer of 1931 the British negotiated financial assistance for sterling directly with France and the United States.

8. Together with the ending of reparations, these developments in the two years from the second half of 1930 to the first half of 1933 diminished both the role of the BIS in international finance and American involvement in its shrinking activities.

The archive records testify to the growing frustration of the two American directors.

As early as February 1930 Norman expressed the opinion that the Bank of France was manoeuvring ‘to ensure that McGarrah shall be steered only by Quesnay and not by Fraser’.¹³ In the

¹³ Norman’s letter of 5 February 1930 to Schacht; see Baffi’s notes – BEA, G1/4 – 940/4, doc. 29, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B6.

autumn of the same year McGarrah again clashed with the Bank of England on the position to be given to the Englishman Porters; McGarrah did not want him in the Central Banking Department.¹⁴ Rodd wrote to Siepmann that the BIS was in a 'state of chaos'.¹⁵

A year later, in November 1932, Norman asked Morgan whether McGarrah intended to continue at the end of his three-year contract. Morgan commented upon this to Lamont: 'I was surprised and pleased to see how much importance Norman gives to the continuation of the BIS. I had thought it was probably more or less useless owing to the abandonment of the Young Plan and might as well be liquidated'. Lamont replied that 'McGarrah does not want to stay on. He suggests Fraser for a one-year interim, till a new President is found, after which Fraser also will possibly want to return'. From Lamont's telegram it appears that McGarrah's feeling of disaffection was due partly to the location chosen for the BIS: 'Somewhat to my surprise McGarrah himself, although very tentatively, is in favour ultimately of moving head office to London'.¹⁶

Lamont informed Morgan that Montagu Norman was ready to discuss with the French the location (London) and the Presidency (Jean Monnet).¹⁷

The ideas of having a European President and moving the Bank's offices were defended in a memorandum written by Siepmann in December 1932 on points for discussion in Basel. Siepmann's plan envisaged a move to Brussels and the appointment of a Belgian President (Carton de Wiart) and a British General Manager (Porters).¹⁸

McGarrah's term of office as President of the Bank ended in May 1933; he was succeeded by his Alternate, Fraser, who

¹⁴ McGarrah's letter of 16 March 1931 to Norman; see Baffi's notes – BEA, *op. cit.*, doc. 101; *ibid.*

¹⁵ Rodd's letter of 2 September 1931 to Siepmann; see Baffi's notes – BEA, *op. cit.*; *ibid.*

¹⁶ J.P. Morgan's letter of 7 November 1932 to Lamont and Lamont's reply of 8 November 1932; see Baffi's notes – BEA, *op. cit.*, docs. 110-111; *ibid.*

¹⁷ Lamont's cable of 10 November 1932 to Morgan; see Baffi's notes – BEA, *op. cit.*; *ibid.*

¹⁸ Siepmann's note of 1 December 1932; see Baffi's notes – BEA, *op. cit.*, doc. 114; *ibid.*

resigned as President in May 1935, a year before his contract was due to expire. They both resigned as Directors in June 1935. With the election of the Dutchman Trip as President, the senior positions in the BIS were all held by Europeans until the Presidency of McKittrick, which began in 1939.¹⁹

¹⁹ See BIS, *Annual Reports*.

VI

THE INITIAL GUIDELINES FOR THE BANK'S OPERATIONS. THE PROBLEM OF MEDIUM-TERM CREDITS

1. On 26 and 27 February 1930 the *ex officio* and appointed members of the Board of the BIS met in Rome in the office of the Governor of the Bank of Italy, Stringher, and signed the private Deed of Constitution of the Bank; in April they met again in Basel and on 17 May held the first formal meeting of the Board.¹

¹ The Board of Directors of the BIS was made up of: L. Franck, Governor of the National Bank of Belgium, and E. Francqui, Vice Governor of Société Générale de Belgique, for Belgium; E. Moreau, Governor of the Bank of France, M. de Vogüé, Chairman of the Suez Canal Company, and B. Brincard, Chairman of Crédit Lyonnais, for France; H. Luther, President of the Reichsbank, C. Melchior, of M. Warburg & Co. (Vice Chairman of the BIS Board), and P. Reusch, Manager of Gutehoffnungschütte, for Germany; B. Stringher, Governor of the Bank of Italy, and A. Beneduce, Chairman of Credioip, for Italy; T. Tanaka, representative of the Bank of Japan, and D. Nohara, representative of the Yokohama Specie Bank, for Japan; M. Norman, Governor of the Bank of England, and Sir Charles Addis, of the Hong Kong and Shanghai Bank, Director of the Bank of England (Vice Chairman of the BIS Board), for the United Kingdom; and G.W. McGarrah (President of the BIS and Chairman of the Board of Directors of the BIS) and L. Fraser (Alternate of the President), for the United States.

The BIS's organisational structure provided for: a General Manager, P. Quesnay (France), an Assistant General Manager, E. Hülse (Germany), and three Directors, M. van Zeeland (Belgium), F. Rodd (United Kingdom) and R. Pilotti (Italy), together with a subdivision of internal activities into three areas: a Banking Department (initially overseen by M. van Zeeland and Hülse), a Central Banking Department (Quesnay and Rodd) and a General Secretariat (Pilotti). See BIS, *Minutes of the Meetings of the Board of Directors*, in BIS Archive, meetings of 12 May and 16 June 1930.

At this and subsequent meetings in 1930 the Board already tackled a number of general policy issues; if they encountered problems defining them they referred them to the Management or to special committees of experts.

The persons appointed in this way to examine the major issues that arose from time to time – whether it was the directors themselves, the members of the Management or the experts – encountered a variety of difficulties that often proved insuperable. Some stemmed from the provisions of the Bank's Statutes, which prohibited many possible types of operation (such as long-term investments, the acquisition of shares, etc.), others from the terms of the statutes of member central banks. Some of the problems were the result of the crisis in the financial markets that had begun in the autumn of 1929, the deterioration in the political climate (especially after Germany's attempt to annex Austria in March 1931), the desire of the monetary authorities of the various countries to keep the control of international capital movements firmly in their own hands, and the hostility of commercial banks to the creation of new mechanisms for financial intermediation.

As a result, the solutions that were eventually proposed and the actions that ensued usually proved inadequate to cope with the scale and nature of the problems or were merely symbolic gestures in a climate of growing frustration.

The issues of most significance considered in 1930 were:²

1) the form the mobilisation bonds should take: the problem was entrusted to a committee;³

2) maintenance of the Bank's liquidity: the Board was of the opinion 'that the investment policy of the Bank should be fixed with a view to maintaining as liquid a position as possible and that in no case should funds be invested at long term exceeding two years' maturity';

² See the notes Baffi drew up in reading the minutes of the 1930 meetings of the Board of Directors; in BIS Archive, 7.16 – *Baffi Papers*, RBL/B12. See also BIS, *Minutes of the Meetings*, *op. cit.*

³ The context is the first official meeting of the Board of Directors on 12 May 1930. The committee comprised Addis, Beneduce, Moret and Vocke. *Ibid.*

3) the investment currencies, which could only be those that had been stabilised *de jure*;⁴

4) the general principles for management of the Bank's assets: they were to be laid down by the Management in conjunction with a sub-committee composed of the governors of the three largest participating countries (Moreau, Luther and Norman) and the second Italian Director (Beneduce);⁵

5) international monetary problems: the Board authorised the Management 'to enter into relations with the various Central Banks, with a view to the elaboration of a programme of work to be submitted to the [...] Board for the investigation of international monetary problems of common interest'. The issues specified included: the creation and distribution of credit; gold standard policy; foreign exchange policy. Advisory committees, whose function would be 'to make suggestions to the Board, on the basis of which draft agreements could be prepared which the Board might desire to recommend for examination by the Central Banks concerned', could be appointed for each of these issues;⁶

6) the advantages the Bank could offer to central bank depositors (mobilisation of deposits, conversion of one currency into another, rediscounting, exchange of portfolio, gold clearing);

7) the organisation of clearing facilities: the President was requested to examine this question in conjunction with the relevant officials of the various central banks;

8) deposits from private banks: they were prohibited;

9) foreign exchange operations: it was decided that such operations should be conducted only with central banks;

10) medium-term credits: the President was authorised to appoint a committee under the chairmanship of Melchior 'to study, in cooperation with the Management, ways and means of organising a system of financing medium-term credits';⁷

11) the clearing of foreign currencies: the President was requested to appoint 'a committee of exchange experts of Central Banks for the purpose of examining from a practical business

⁴ *Ibid.*; meeting of 16 June 1930.

⁵ *Ibid.*

⁶ *Ibid.*; meeting of 14 July 1930.

⁷ *Ibid.*; meeting of 13 October 1930. The committee comprised Addis and van Zeeland, and Siepmann in case Addis was absent.

point of view, and of making recommendations concerning, the organisation of an exchange clearing for Central Banks and the transfer of assets from one currency to another'.⁸

With regard to this same issue, the President was authorised in January 1931 'to negotiate with the various Central Banks with a view to reaching practical solutions in this connection'.⁹

2. In 1931 one of the issues to emerge with regard to the general direction of the Bank related to the method of encouraging long-term international investment.

The problem was brought to the attention of the BIS for the first time by a document sent to the President, McGarrah, by the Governor of the Bank of England, Montagu Norman, on 2 February 1931. The document was a memorandum from Sir Robert Kindersley, who had been the Senior British Representative on the Dawes Committee and was at that time a Director of the Bank of England.

In his covering letter, Norman stressed that Kindersley's proposal was intended 'to start the wheels going round again' and added: 'I wish, subject to your approval, to submit it [...] to the Governors and perhaps to the Board at Basle next week with the idea that one or both of them will either adopt this scheme or produce a better'.¹⁰

3. In outline, Kindersley's reasoning was as follows.

After the crisis in the autumn of 1929 the United States and France had ceased to lend to the rest of the world, preferring to accumulate their balance-of-payments surpluses in the form of gold. The fall in bond prices had alarmed the investing public, causing a general aversion to long-term financial investment; this disinclination had been exacerbated by the deterioration in the political situation in Europe.

If the flow of capital from the United States and France was to resume, a security had to be created that would restore investor confidence. To that end, Kindersley suggested forming an

⁸ *Ibid.*; meeting of 10 November 1930.

⁹ *Ibid.*; meeting of 19 January 1931.

¹⁰ Norman's letter and Kindersley's note are preserved in BIS Archive, 7.16 – *Baffi Papers*, RBL/12.

International Corporation based in Switzerland or the Netherlands with a capital of between £25 and 50 million, only 10 per cent of which would be paid up. The corporation would be authorised to issue bonds to the extent of three times its subscribed capital, and the money raised in the market would be used mainly to finance investment in the public sector and in public utilities.

Kindersley suggested that the bonds be issued in the United States, France, the Netherlands, Switzerland 'but only to a moderate extent in England'. He argued that

this should have the effect (1) of diverting the existing flow of gold; (2) of re-establishing the credit of the Foreign Governments, Corporations, etc., to whom the money is lent, improving the price of their securities in all markets of the World, and the purchasing power of their nationals; (3) of restoring general confidence.

He also suggested

that the loans should be redeemable at the option of the borrowers at the end of ten years and that during that period they should if possible repay the moneys borrowed by issuing their own bonds as their credit is re-established [...] All Corporations and Companies of any magnitude as well as Banks in all the creditor countries of the World should be asked to subscribe to the capital of the Company. Most Trust Companies and Insurance Companies are large holders of the bonds of Foreign Governments and Foreign Corporations, and therefore vitally interested in seeing that the credit of these countries is not jeopardised by the present situation.

The Norman-Kindersley plan was submitted to the Board of the BIS on 9 February; taken unawares by such a wide-ranging issue, the Board received it 'sympathetically' but postponed consideration of the problems it raised to the next meeting.¹¹

4. The plan provoked contrasting reactions from the Germans and the French.

Schacht had resigned as President of the Reichsbank after his

¹¹ Baffi's notes on BIS, *Minutes of the Meetings, op. cit.*, meeting of 9 February 1931, in BIS Archive, 7.16 – *Baffi Papers*, RBL/12.

exclusion from the Second Session of The Hague Conference.¹² His withdrawal was especially lamented by Norman and Addis, with whom he had a relationship based on high mutual respect. On 10 March Addis wrote to Norman from aboard ship: 'With all his faults Schacht is a great chap and I hate to think, after all we have gone through together, of him standing aside, an unsympathetic spectator, when the BIS is being launched'.¹³

Schacht was succeeded by Luther. Despite the personal dislike between the two men, Luther adhered to Schacht's line on the resumption of long-term international loans to finance both infrastructure and exports. Shortly after the Norman-Kindersley plan had been submitted to the Board of the BIS, Luther gave a speech at the Leipzig Fair in which he said that the conditions for implementing the Young Plan were first that there should be no increase in the real burden of reparations, and secondly that Germany's national income should grow in an open system of trade. According to Luther, both of these preconditions constituted an implicit *clausula socialis* of the Plan. They had not been met, the first because of the fall in prices and the second because of protectionism in Germany's export markets and the associated fall in the level of economic activity and employment in Germany, where a quarter of the work force of 20 million were unemployed. He argued that the other parties had not fulfilled their obligations. In these circumstances, there was a moral and legal obligation to pay only private debts, including what Luther described as private debts of the Reich, among which he mentioned the servicing of the Dawes and Young Loans. According to this interpretation of the agreements, the exercise of Germany's right to postpone reparation payments under the Young Plan should not even be termed a moratorium.

¹² See: Schacht's letter of 7 March 1930 to A. Callens, Brussels; BNB documents, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B3; and other documentation on the matter in RBL/B8. Schacht explained, point by point, the reasons that had led him to give up the position in the letter he sent to the directors of the Reichsbank (according to the rules governing the German central bank under the Dawes Plan, half of the Council of the Reichsbank was composed of representatives of foreign powers). On Schacht's resignation, see also his volume *My First Seventy-Six Years*, Allan Wingate, London 1955, pp. 256 ff.

¹³ Addis's letter of 10 March 1930 to Norman; see Baffi's notes – BEA, G1/2 – 940/2, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B6.

Luther's conclusions derived from a philosophy in which he laid greater emphasis on economic interdependence than Schacht but in which the concept of a people without *Lebensraum* constantly recurred. We the German people, he averred, do not live independently on an island 'but are the "Volk ohne Raum", economically interdependent with the other peoples and politically obliged to cohabit with them'.

According to Luther, Germany did not need capital for fresh investment in industry, because productive capacity exceeded demand; what it did need was cheap credit to expand agriculture and exports, and it also needed to lengthen loan maturities in order to end the 'invisible occupation' by short-term loans. These inflows of capital should not be subject to political conditions. As to the means to be used, Luther remarked in conclusion that 'the Young Plan clearly gives the Bank for International Settlements in Basle a leading role in this connection'.¹⁴

5. After the presentation made by the British at the BIS Board meeting in February, Moret forwarded the Norman-Kindersley plan to French banking circles to discover their views. He reported the outcome of his consultations to McGarrah by letter at the beginning of March. He wrote that the plan aroused strong objections on the part of the French banks consulted.¹⁵ In his opinion their views deserved special attention, since it was envisaged that the bulk of the bonds intended for issue under the plan should be placed in France. The French banks, he went on, disagreed not with the objectives but with the means; they themselves had projects under way 'aimed at monetary stabilisation, agricultural development or the improvement of communications in several European countries'. The French market would be willing to take part in other initiatives, provided obligations previously entered into with private holders could be respected. 'Moreover, a number of French banks have joined with foreign establishments to create an institution whose concept in

¹⁴ The speech given by Luther in Leipzig on 1 March 1931 is preserved in BIS Archive, 7.16 – *Baffi Papers*, RBL/B10.

¹⁵ Moret's letter to McGarrah, and the appended note, with the objections raised by the French banks, are preserved in BIS Archive, 7.16 – *Baffi Papers*, RBL/B12.

some respects [...] resembles the programme submitted for examination by the Board’.

With regard to the possible participation of the BIS in projects of this kind, Moret noted that

since Article 22 of the Statutes prohibits any subscription of shares, the BIS is unable to participate in the capital of bodies established or to be established with a view to facilitating the redistribution of capital. Since it cannot therefore expose itself to the risks incurred by such enterprises, one could not envisage that it could any the more participate in their actual management, by appointing a number of directors, for example: if it were otherwise, the enterprises in question would lose all their commercial character and would thus cease to inspire the confidence of capitalists.

Moreover, for my part I would be reluctant to accept that the BIS were acting wisely if it gave its patronage to the formation of an enterprise over which, as I have just shown, it could not exercise effective control. If it did so, it would in effect be guaranteeing in advance the projects this enterprise undertook once it had been set up. I have no need to demonstrate the dangers inherent in such a situation.

In my opinion, the BIS should concern itself only with clearly defined operations, whether in customary banking forms or undertaken by specially created bodies. By accepting to be trustee for loans it would already be showing a special interest in certain questions.

6. The note appended to Moret’s letter was even more harshly negative. It observed that:

1) It was primarily the French bond market that the authors of the plan had in mind. However, the French public ‘is little used to lending its money for undefined purposes’. Moreover, investors liked to diversify their risks, in other words to subscribe the securities of a range of debtors, so that ‘a greater volume of French savings could be obtained by offering them greater loan variety’.

2) States and public or private bodies whose credit was sound were already able to raise finance on reasonable terms; the borrowers of the proposed Corporation or Bank would be those unable to obtain capital via the usual channels. The quality of the portfolio was not likely to improve subsequently, since debtors would invoke the early repayment option as soon as their situation allowed them to borrow elsewhere more cheaply.

3) The plan did not lay down credit limits for individual borrowers; hence, 'if a large borrower defaults, the stability of the Bank could be compromised'.¹⁶

4) The guarantees obtained might prove useless in practice: 'the creditor is powerless in the face of a State in default; he is stymied by the sovereignty of his debtor'. Even if the debtor were a local authority or a public utility it was nearly always impossible to realise the asset pledged as security.

5) Creating a reserve fund from the margin of 1 or 2 per cent between the lending rate and the bond coupon would be a very slow process; if the reserve fund were then used for operations of the same type as those being financed by the bond issue it would be exposed to the same risks as the bonds they were supposed to cover.

6) The possibility of calling unpaid capital in the event of the insolvency of debtors was also doubtful.

7) The plan was not very attractive from the point of view of prospective shareholders. In particular, 'the need for a very high level of reserves would postpone the ability to pay dividends on the capital to a very distant date, even if none of the borrowers defaulted'.

8) Banks, trust companies, insurance companies and industrial companies were either limited by their statutes as regards participation in the capital of the envisaged institution or had no interest in subscribing. Even if that were not the case and subscribers could be found, the diversity of the shareholders would make the new institution 'an extremely complex machine to organise and no less difficult to operate in practice'.

9) The French public in particular was being asked to subscribe the bulk of the bonds and thus to shoulder almost all the risks 'without giving it the means to control the use of the funds it had provided'.

10) The main reason why many borrowers were unable to obtain the capital they needed was that in the past too many of them had failed to meet their obligations towards lenders; no

¹⁶ In the note appended to Moret's letter, the new Corporation proposed in the Norman-Kindersley plan is defined as *Banque Internationale de Prêts à des Etats et Autres Entités Publiques*.

authority, not even the League of Nations, had raised its voice to protest against this attitude, particularly as regarded sovereign borrowers; this state of affairs would not be improved by the creation of an intermediary in the form of a bank

that had no means of taking legally or politically effective action. On the contrary, it is to be feared that a debtor having difficulty servicing his debt in full will prefer first to sacrifice a creditor in the shape of an impersonal international institution rather than provoking the scandal that is always caused by suspending the servicing of a bonded loan issued widely in its name among the public.

7. The March meeting of the Board of Directors of the BIS was held only a few days after the German and French positions had been set out in Luther's speech and Moret's letter. The official communiqué on the meeting stated that the Board had approved the report of the sub-committee appointed to study the problem of medium-term credits and that the Bank had decided to subscribe a number of bonds to be issued by the International Mortgage Bank in Basel.¹⁷

Besides the official communiqué, more detailed information was leaked to the press, as though 'from reliable sources'. This indicated that Luther had described the serious plight of the German economy: widespread unemployment, the withdrawal of foreign capital, especially by American, French and British investors, and the consequent restriction of credit by German banks in a vicious circle of deflation. Repeating the ideas he had already expressed in Leipzig, Luther placed the Young Plan in the context of a master design for international cooperation, one of the basic features of which was the provision of long-term capital to Germany.

The Board's response to Luther's assessment was merely the symbolic gesture of subscribing bonds issued by a mortgage institution then being established in Basel.

The unofficial information leaked to the press went on to state

¹⁷ Baffi's notes on BIS, *Minutes of the Meetings*, *op. cit.* The Board meeting in question took place on 9 March 1931; the official communiqué on the meeting is referred to in a note dated 12 March 1931, from the Quesnay Archives – AF, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B12.

that, as mortgage credit institutions already existed to finance real estate, Norman had proposed the creation of an industrial credit institution and Luther that of an international institution to rediscount export credits. Moret, while avowing support for any proposal aimed at facilitating capital movements and long-term investment, did not believe that the announcement of projects of this kind would have the desired psychological effect if they could not be put into effect because of opposition from private banks. Faced with the position adopted by Moret, the Board instructed the President of the Bank to take soundings in the financial markets to establish how they would respond to the proposals, but made no mention of this decision in the official communiqué.

The unofficial press reports mentioned that Luther had been deeply disappointed by this outcome, since in his Leipzig speech he had said that the Board of the BIS would be taking important measures in this regard at its next meeting in Basel.¹⁸

¹⁸ The press reports are referred to in the note of 12 March 1931, *op. cit.*; see note 17 on p. 94.

VII

THE ROLE OF THE BIS AS PERCEIVED BY THE EXPERTS (MAY 1931)

1. In May 1931, immediately after the close of the Bank's first financial year, two study groups composed of representatives from member central banks and from the BIS itself met in Basel. The first committee was concerned with international monetary policy, the second with credit; they would be referred to in short as the 'Currency' and 'Credit' Committees. Twenty-five central banks took part, providing a total of 71 representatives to the two committees. Of these, seventeen were governors or presidents of central banks, including those of France and Germany.

Each committee was chaired by a central bank governor and had three rapporteurs. The rapporteurs of the first committee were Vissering, President of the Netherlands Bank, Pospisil, Governor of the Czechoslovak National Bank, and Quesnay, General Manager of the BIS; those of the second committee were Bachmann, President of the Swiss National Bank, Reisch, President of the Austrian National Bank, and Hülse, Assistant General Manager of the BIS.¹

¹ According to Eleanor Lansing Dulles's reconstruction of these events, on 19 and 20 May 1931, alongside the official meetings under the umbrella of the first BIS Annual General Meeting, a series of confidential meetings were held, including those of the Currency Committee and the Credit Committee, chaired respectively by Wroblewski, Governor of the National Bank of Poland, and Popovics, Governor of the Bank of Hungary. See E.L. Dulles, *The Bank for International Settlements at Work*, Mac Millan, New York 1932, p. 243. The reports on the work of the two committees are collected in: *Meetings of Representatives of Central Banks – Currency*, I, BIS Archive, HS

2. The composition of the committees reflects the importance the initiative had in the minds of its promoters, but it also reveals some of the difficulties that stood in the way of success. The number of delegates was partly a result of the extreme fragmentation of Western Europe into sovereign states, some more recent than the Treaty of Versailles and all very different as regards level of economic development, traditions, size of money market and institutional arrangements. The twenty-five countries included five Balkan states, three small Baltic republics and the Free City of Danzig.² The United States was not represented owing to the Department of State's veto on officials of the Federal Reserve System participating in the activities of the BIS. The BIS was in need of financial resources, but many of its shareholders were themselves beset by a chronic shortage of liquid foreign exchange reserves and for this and other reasons recoiled from expanding the domestic money supply. In some a banking and payments crisis was just erupting. Against this background, the assembled representatives turned a deaf ear to the ideas proposed and to the appeals made by the two highest representatives of the BIS, Quesnay and Hülse, aimed at giving their institution increased responsibilities and greater resources so that it could play a part in international payments and in the system of international credits.

3. Three reports were presented to the Currency Committee: one by Quesnay on 'The BIS and International Payments', a second by Pospisil, Governor of the Czechoslovak National Bank, on *Conditions of Currency Convertibility* and the third by

Publications, HS4; *Meetings of Representatives of Central Banks – Currency*, II, BIS Archive, HS Publications, HS5; *Meetings of Representatives of Central Banks – Credit*, I, BIS Archive, HS Publications, HS6; and *Meetings of Representatives of Central Banks – Credit*, II, BIS Archive, HS Publications, HS7. See also what M. van Zeeland had to say on some of the items covered at the meetings of the two committees in his work *B.I.S. reconsidered. Sommaire Historique 1931-1932, Annexes I, II et III – 14 août 1944*, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B16.

² The participants were: Albania, Austria, Belgium, Bulgaria, Czechoslovakia, Danzig, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Italy, Japan, Latvia, Lithuania, the Netherlands, Norway, Poland, Romania, Sweden, Switzerland, the United Kingdom and Yugoslavia.

Vissering, President of the Netherlands Bank, on *Foreign Exchange Reserves of Central Banks*.

4. Quesnay based his remarks on Article 3 of the Statutes, which stated that one of the objects of the Bank was 'to promote the cooperation of central banks and to provide additional facilities for international financial operations'.³ In accordance with this stipulation, the Bank had not accepted deposits from commercial banks or individuals in its first year, confining itself to gathering (a) voluntary deposits from central banks, (b) governmental deposits deriving from the execution of The Hague Agreements on reparations and war debts, and (c) deposits deriving from the Bank's function as trustee for international loans. The deposits under (b) had allowed a certain degree of offsetting between debits and credits, obviating the need for conversion in the foreign exchange market, especially between the payments France and Italy received from Germany and those they made to the United Kingdom.

The BIS hoped that in due course the development of its own operations would enable it to perform a similar clearing function for deposits under (c). Quesnay's greatest ambition, however, was for the BIS to develop the clearing function under (a), since he believed that a system of settlements between central banks in which the BIS played a pivotal role would help maintain convertibility. (The possibility of a system for clearing transfers of gold had already been examined at a meeting of exchange market experts held at the Bank in November 1930).⁴ By proposing this objective that offered benefits for all, Quesnay could legitimise the request for participating central banks to make 'concessions' to the BIS: 'Every concession made to it [...] increases the utility for all the participating banks and for each one of them'.

5. In particular, Quesnay urged the central banks to deposit gold with the BIS, one of his arguments being the immunities and privileges granted to the Bank by international treaty. In his own words:

³ See Quesnay's report in *Meetings of Representatives of Central Banks – Currency*, II, *op. cit.*

⁴ In the context of the meeting of the *Board of Directors* of 10 November 1930; see note 8 on p. 88.

The retention of gold outside their premises is for a certain number of banks a new practice equivalent to a declaration of confidence on their part not only in the depository, but in the general situation as well. The BIS at present holds gold assets abroad for the account of certain depositors; these assets are deposited in its name and have in consequence under all circumstances to enjoy the special immunities provided for 'the Bank, its property and assets and all deposits and other funds entrusted to it'.

6. Quesnay also pointed to the system of immunities 'from any restrictive measures such as censorship, requisition, seizure or confiscation, in time of peace or war' to advocate the deposit of part of official foreign exchange reserves with the BIS. He argued that the advantages lay not only in greater security:

1) centralising foreign exchange reserves at the BIS 'strengthens the principle of collaboration by increasing the control of the responsible banks on markets where the funds are invested', because 'the BIS is [...] compelled by its statutes only to carry out operations which are "in conformity with the monetary policy of the Central Banks of the countries concerned"');

2) it increased the liquidity of depositor banks; 'as their exchange requirements do not arise simultaneously, the decline in the exchange reserves of one institution is frequently counterbalanced by increases in the holding of another, so that, by means of appropriate agreements, each participant might be offered the immediate disposal of his funds, although only a certain proportion of the whole group of reserves would be retained at sight'. Here Quesnay was proposing a saving of international liquidity, but without reducing the degree of liquidity of participants, by investing the pooled reserves at medium term; this would therefore involve maturity transformation between sight deposits and investments at term. The rates of interest depositor banks could earn on their sight funds at the BIS would therefore be comparable to those obtainable on time deposits.

7. Quesnay saw the growth in deposit accounts and in transfers between such accounts during the first Bank's financial year as the beginnings of the 'constitution of a central reserve of international instruments of payment'. He went so far as to suggest that participating central banks should undertake to hold

a predetermined minimum proportion of their foreign exchange reserves in this form (10 per cent, for example) and that a Centre for the management of international assets should be organised at the BIS.

He drew an analogy between the commercial banks' liquid resources, which were equal to a fraction of their deposits, and the liquid reserve the BIS would have to keep in respect of the total balances on BIS Currency Transfer Accounts (CTAs) that central banks could open with the Bank under Article 24 of the Statutes, which allowed the Bank to enter into agreements with central banks to facilitate the settlement of international transactions. A centralised system of CTAs would greatly reduce the volume of liquidity that had to be held to effect international settlements and would avoid the need for central banks to make purchases and sales of foreign exchange in the market, which tended to have a disturbing effect on exchange rates.

The means of creating CTAs had been set out by the President of the BIS in a proposal submitted to the central banks on 22 April.⁵ Banks belonging to the system would have to undertake to keep the equivalent of at least \$1 million on deposit at the BIS; accounts could be opened in dollars, sterling or Swiss francs. The BIS would guarantee conversion of the funds into any one of ten currencies at the middle exchange rate of the day. The counterpart assets held by the BIS would consist in sight deposits with central banks and rediscountable bills.

8. Quesnay wondered whether the BIS should offer different interest rates for each of the currencies in which deposits were made in order to encourage the centralisation of funds. He himself replied in the negative, for two reasons: first, the BIS normally did not reinvest on the markets in which its funds originated, where money was plentiful, since it was proposing instead to channel funds towards markets where funds were scarce; secondly, he advanced the rather abstract notion that in accepting the deposit the BIS 'was not acquiring the right to dispose of one or the other of these currencies, but of the gold value which they represent'.

⁵ A copy of the letter of 22 April 1931, addressed to Norman, is preserved in BIS Archive, 7.16 – *Baffi Papers*, RBL/12.

The BIS therefore decided to offer a single interest rate based on the average yield it obtained on its investments.

The conversion of the currencies received as deposits into those in which the Bank invested nevertheless exposed the Bank to loss and to risk. The shorter the interval between conversion and subsequent reconversion, the greater was the loss due to the normal spread between buying and selling rates on the foreign exchange market; the risk of depreciation of the investment currency was increased by the fact that the currencies of markets in need of funds, into which investments were channelled, were also those most susceptible to this risk. The BIS could have protected itself against such risks on the forward exchange market, but it rejected this possibility, preferring to create a reserve fund against exchange rate fluctuations. This decision was based on an optimistic view of the maintenance of the prevailing gold parities, with exchange rate fluctuations contained within the gold points. It was imagined that compliance with this condition would greatly limit the exchange risk borne by an institution such as the BIS, whose operational principle was to invest in capital-importing markets and at the times of greatest weakness of their currencies: in the words of Quesnay, 'when the currency of those markets approaches its lowest rate'. In this way, Quesnay added, the BIS 'has the minimum chance of loss and the maximum chance of gain'.

9. Quesnay's pronouncements were made at the very time when the Creditanstalt crisis was erupting in Vienna, which rapidly widened into a general banking and payments crisis in the countries of Central Europe and led in the autumn to the devaluation of sterling and the currencies tied to it. The gold exchange standard was going into crisis at the very moment when Quesnay was outlining a plan for centralising reserves and facilitating transferability that would have been based on the standard.

10. During the discussion Quesnay returned to the advantages of centralising foreign exchange reserves;⁶ for central banks

⁶ The discussion is referred to in *Meetings of Representatives of Central Banks – Currency*, I, *op. cit.*

holding foreign exchange, these were, in his words, 'advantages of yield, advantages of liquidity, advantages for the conversion of one currency into another'. He also saw an advantage of a different kind for the banks of issue of reserve currencies, in 'that the foreign exchange of other Central Banks concentrated with the BIS reaches their market through their intermediary, passes under their control, comes in consequence under their direction and so does not disturb their efforts to put their monetary policy into application on their market'.

Quesnay reinforced the argument by referring to Article 20 of the Bank's Statutes, which gave a right of veto to the central bank of the country in which the Bank wished to invest the funds entrusted to it. He observed that the exercise of the right of veto over the use of funds in a particular market could conflict with the desire of depositor banks to have liquid funds in the currency of that market; he suggested that the conflict could be resolved by concluding special agreements.

The Germans insisted on the need for protocols interpreting The Hague Agreements in order to specify more precisely the immunities enjoyed by the assets of the BIS in the event of war.

In the discussion on Currency Transfer Accounts, Quesnay dwelt on what he presented as advantages of the proposed system and which may be described as currency transformation and maturity transformation by the intermediary. He noted that the investments the BIS could make in an individual currency might be greater or smaller than the deposits it received in that currency, provided it could conclude agreements with individual central banks on the provision of their currency at a predetermined exchange rate or could run an exchange risk, the scale of which was minimised in the report. Part of the short-term funds it received could also be invested at medium term, relying on the probability that withdrawals would be offset by new deposits, especially if central banks undertook to maintain a set percentage of their legal cover on deposit at the BIS; in this connection he mentioned a percentage of between 5 and 10 per cent out of a cover ratio of 35 or 40 per cent. The letter from McGarrah to the central banks⁷ stated that the proposal for Currency Transfer

⁷ See note 5, § 7.

Accounts described in paragraph 7 above was based on Article 24 of the Bank's Statutes, under which the BIS could 'open accounts through which central banks can transfer their assets from one currency to another' without going through the foreign exchange market. Central banks that kept funds equivalent to at least \$1 million on sight deposit with the BIS would be entitled to hold such accounts. CTAs could be denominated in dollars, sterling or Swiss francs and holders could draw on them in any of ten currencies ('dollars, sterling, Reichsmarks, French francs, Swiss francs, lire, belgas, Dutch florins, Swedish crowns or Finnish marks'). The interest rate offered would be 1/2 percentage point above the rate the Bank paid on sight deposits, which at the time of the proposal was 1 1/2 per cent. The letter assured the central banks that the BIS would invest the CTA balances exclusively in rediscountable bills and sight deposits with central banks. It concluded as follows:

It would be understood that such accounts could only be opened in the name of Central Banks in order to allow them to obtain, without passing over the exchange market, the foreign currencies which they might have to place at the disposal of such markets where they have to assure the convertibility of their national currency; our object is, therefore, to further the cooperation of Central Banks in carrying out their currency functions; we feel sure that the new facilities will not be utilised by any of them for the purpose of speculative arbitrage operations. For this reason the BIS can, under the above conditions, only accept the deposits of Central Banks for their own account, and not funds deposited in the name of Central Banks for the account of Treasuries or of third parties. These funds could not be credited to the BIS Currency Transfer Account.

11. Important comments on the CTA proposal were made by the Director of the Bank of Poland, Karpinski, and the Assistant Secretary of the Netherlands Bank, de Jong.⁸ Karpinski considered the limit of \$50,000 a day on withdrawals from the accounts to be too low, 'since the exchange operations which might disturb the markets, and which it would accordingly be of advantage to execute through the BIS instead of through the private market, are

⁸ For the continuation of the discussion, see *Meetings of Representatives of Central Banks – Currency*, I, *op. cit.*

usually for larger amounts'. He felt it would be right to include time deposits as well as sight deposits when determining whether a central bank qualified to open CTAs; the policy of the BIS should be 'to attract time deposits rather than those at sight'.

De Jong also complained that the withdrawal limit was too low for the reason stated by Karpinski, namely that many central banks, including his own, let the market find its own equilibrium when the excess of supply or demand was not great and intervened when it was.

I am afraid that to these Central Banks it is not very helpful to be able to obtain, as envisaged in the BIS proposals, the equivalent of \$50,000 or at the most \$100,000 a day in each of ten or more different currencies. What would be very useful to these Central Banks, is the facility to obtain large amounts in one single currency in exchange for other currencies.

12. The Director of the Reichsbank, Fuchs, and the Governor of the National Bank of Belgium, Franck, also threw cold water on Quesnay's ardent hopes, although some of their remarks contrasted with those made by Karpinski and de Jong. The same generally restrictive attitude was also to be evident in the discussion of the Hülse report.⁹

Fuchs considered the proposal that the central banks undertake to deposit a set percentage of their foreign exchange reserves with the BIS as impracticable; at the same time he ruled out the possibility of the Bank covering its exchange risks in the forward market with the arguments that 'every forward market has strong speculative tendencies' and that 'the elements operating in the forward market are very frequently extremely weak'.

Franck commented that currency mismatching could leave the BIS short in a currency it was asked to provide. If it bought in the market the effect would be the same as if the central bank itself had gone to the market direct; outside the market, the currency 'is only to be found with the Central Bank controlling the currency in question. But the Central Banks want to retain control of their currency in their own hands', and could therefore not commit themselves. For that reason he was not disposed to giving the BIS wide powers of discretion. He concluded: 'We

⁹ See § 18, below.

must allow the tree to grow slowly. [...] The BIS has not all the necessary resources and I do not think that the Central Banks will place them at its disposal'.

13. Quesnay responded to the objections raised by Karpinski and de Jong about the limit of \$50,000 a day by observing that, leaving aside the hypothesis of massive exchange market interventions, there were occasions when small amounts of foreign exchange were transferred between central banks. The central banks held dollars as general liquid reserves rather than the currencies they might need from time to time and used the dollars to purchase such currencies; in the meanwhile, they were earning a lower interest rate on their dollars than they could obtain on a mix of currencies at the BIS. The use of Currency Transfer Accounts would therefore allow depositor banks to earn a better rate than that available on dollars.

Quesnay countered the objections of Fuchs and Franck on the central banks' willingness to undertake to sell their own currency if requested by the BIS by stating that:

In the course of the year we have already succeeded in concluding a certain number of agreements with Central Banks, [...] the existence of which enables us to be left in all security with an uncovered balance in certain currencies. We believe that owing to the process of concentration we incur no risk on this account; but if by chance we had been too optimistic in our appreciation of the effects of concentration, we should nevertheless find cover under the terms of the agreements concerned.

Quesnay described the nature of the agreements concluded with the central banks in the following terms:

In the first instance agreements enabling us to convert an asset in a given currency with a given maturity into an asset in the same currency with a different maturity. It is this kind of agreement which enables us, for example, to procure assets at sight by rediscounting portfolio[...].

Some of the banks which do not purchase portfolio for us, but propose that we should retain our funds with them in the form of fixed term deposits, have offered at any time to remobilise the sums deposited in money employed accounts of the kind.

For the conversion of one currency into another, [...] we have concluded a certain number of agreements in our desire to avoid affecting

exchange rates by conversion operations on a large scale. We have succeeded in making arrangements with about fifteen banks of issue whereby we can procure their currencies without needing to intervene on the exchange markets. [...] In general, the object of these agreements is to supply us with the currency of a given market against other currencies at sight [...] which the various banks include in their holdings. [...] We have also concluded other agreements enabling us to obtain from a Central Bank, against the surrender of foreign exchange, not only its national currency, but also any other currency in its possession.

Quesnay's reply did not convince Fuchs, who repeated that 'these agreements with banks of issue will be hard to obtain or will only be obtainable for sums which in general are of no great significance'. The meeting closed on that discordant note and deferred the matter to a subsequent meeting that in the event was never held.

14. The Pospisil report¹⁰ underlined the difficulties for monetary management due to three factors: the change from the gold standard to the gold exchange standard, in other words to a system in which the expansionary and contractionary effects of balance-of-payments surpluses and deficits were less immediate; the reduction in the degree of central bank autonomy; and the decline in the effectiveness of monetary measures. In many countries, the author observed, the central bank's assets consisted largely of credit to the government, which could not be adjusted downwards; with such an asset structure, the central bank had great difficulty controlling the money market and maintaining currency stability. The commercial banking system was less dependent on central bank credit, partly as a result of mergers; the system of prices and incomes had become less flexible. The weakening of the control that the central banks were able to exercise over the credit market made it necessary to adopt an active policy of exchange market intervention, the purpose of which was 'to replace the organic connection which used to exist between the development of exchange rates, the money market, the evolution of prices etc., now that this connection has been altered'.

¹⁰ See *Meetings of Representatives of Central Banks – Currency*, II, *op. cit.*

The author noted that in the event of temporary fluctuations likely to unsettle the foreign exchange market it was advisable for the central bank to intervene before the exchange rate reached the gold point. He argued that intervention should be confined to the spot market.

Forward transactions [...] entail a certain risk which should reasonably be borne by other agencies than the Bank of Issue. [...] The Banks of Issue have no reason to facilitate forward transactions in cases, for instance, where the carry forward gives rise to forward rates which do not remain within the gold point, so that the participation in such operations by the Banks of Issue would only increase distrust in the national currency.

For similar reasons it was inadvisable for central banks to engage in swap operations. Pospisil commented that the return to a gold basis had made an anachronism of the recommendation of the Genoa Protocol that the central banks develop the forward markets. He concluded that the smooth operation of the gold exchange standard necessitated strengthening the position of the central banks, a coordinated policy with regard to foreign exchange reserves and the concentration of such reserves at the BIS, which in turn would invest them in the various markets exclusively via the central banks concerned.

During the discussion of his report¹¹ Pospisil returned to the role of the BIS in mitigating the shortcomings of the gold exchange standard; he referred to 'the results of the work of the Gold Delegation of the Financial Committee of the League of Nations in regard to the principle of the concentration of reserves with Central Banks and possibly to an increasing extent with the BIS also'.

15. The subject of exchange market intervention policy, which had already been touched upon in Pospisil's report, was taken up again at greater length in the report presented by Vissering.¹²

His point of departure was the division of reserves into a minimum reserve required by law and a free reserve. The legal

¹¹ See *Meetings of Representatives of Central Banks – Currency*, I, *op. cit.*

¹² See *Meetings of Representatives of Central Banks – Currency*, II, *op. cit.*

reserve to cover the note issue served to maintain public confidence in the national currency; the free reserve was available for use as an international means of payment. Before the war the legal minimum reserve had generally been held in gold, but after the war the foreign currency component had become substantial. Vissering deplored this new practice; it 'opens the door for inflation, because it allows one and the same amount of gold to act simultaneously as a basis for credit in two or possibly in more markets'. The insistence of Vissering and other participants on the danger of inflation is extraordinary at a time when the economies of Europe and the rest of the world had been wrestling with an extremely serious deflationary spiral for almost two years.

Vissering recommended a reduction in the prescribed percentage of legal reserves rather than the inclusion of foreign currencies if economies in the use of gold appeared advisable.

Among the advantages of reducing the use of gold in international payments, Vissering listed savings in the cost of transporting the metal, the replacement of a non-interest-bearing asset in the central banks' balance sheets by an interest-bearing one, the fact that exchange market interventions had a more rapid effect than movements of gold, and the contact that foreign exchange operations established between the central bank and the money market.

The disadvantages of holding part of the reserves in foreign bills or balances with foreign correspondents included the risk of confiscation in time of war; Vissering therefore commended the provisions of Article 10 of the Constituent Charter of the BIS, which protected the Bank's assets from such a risk, but he wanted the immunities enjoyed by the Bank to be extended by international treaty to the assets of the central banks.

Two other risks were those of the depreciation of the currencies in which reserves were held and the insolvency of the issuing country.

16. The disadvantages mentioned so far were those affecting the country holding reserves in foreign currencies. Vissering noted, however, that the system also had other disadvantages of a more general kind. It made the task of the central banks of reserve currency countries more difficult, since they had to

reckon with the possibility that reserves would be converted into other currencies or into gold. Citing his fellow-countryman, Trip, he hoped that central banks would not convert their foreign balances into gold without prior arrangement.

A second disadvantage discussed by Vissering was that of the supposedly asymmetrical effects of the gold exchange standard. Whereas a movement of gold between two countries had symmetrical monetary effects, causing a contraction in the exporting country and an expansion in the importing country, a sale of foreign exchange by the central bank of one country had a contractionary effect in that country but did not increase the purchasing power in the country of issue of the currency if the currency in question had been held with a commercial bank in the second country. All that happened therefore was that title to a deposit was transferred from a non-resident to a resident. Vissering therefore correctly deduced that in order to ensure symmetry similar to that obtaining under the gold standard, foreign currency reserves had to be held with the central bank of the issuing country, or with an intermediary such as the BIS that in turn held them with the central banks.

A third disadvantage was that the psychological impact of a transfer of foreign exchange was much weaker than that of a transfer of gold; according to Vissering, this disadvantage could be eliminated by providing more complete information on movements of foreign exchange. He also discussed the adequacy of foreign exchange reserves, which he saw as depending on potential balance-of-payments disequilibria, and the question of reserve management, which he thought should not be directed towards the earning of profits. The central banks should therefore not change the composition of their foreign exchange reserves in order to maximise yield and, if they wished to switch from one reserve currency to another, they should avail themselves of the offices of the BIS, which 'will be able to render excellent services by making it possible for Central Banks to transfer their assets from one currency to another without having to carry such operations over the exchange markets'.

Vissering diverged from Pospisil with regard to exchange market intervention; whereas Pospisil wanted 'intramarginal' intervention if fluctuations were judged to be temporary, Vissering

insisted on the greater psychological effect of large purchases or sales as the exchange rate approached the gold points in order to simulate the situation under the pure gold standard.

17. During the discussion¹³ of the Vissering report Sprague, Adviser to the Bank of England, took issue with the idea of excluding foreign exchange from legal reserves, arguing that when currencies were being stabilised after the war it would have been impossible to meet the reserve requirement solely with gold. He suggested restricting the reserve function to the currencies of the major markets (the United States, the United Kingdom and France), which were better able to withstand the destabilising effects of any withdrawals. With reference to the two principal reserve currencies (the dollar and sterling), he observed that 'the foreign exchange reserves of Central Banks are rather stable, because, if one Central Bank finds it necessary to sell its holding, presumably other Central Banks will be increasing theirs'. Sprague was concerned less by fluctuations in the amount of foreign exchange reserves held in a particular currency than by the tendency for reserves to be concentrated in markets where there was already an abundance of funds; quoting the Scriptures ('unto him that hath shall be given'), he advised the BIS to convert part of its own dollars into gold or another currency in order to have a restraining effect on the New York market. In his own words:

It is a proper function of the BIS to transfer some of the funds that under the gold exchange standard would simply go to New York into other money markets. In the absence of the BIS I suppose that all of the German payments would have been made to New York; but the existence of the BIS has made it possible to transfer some part of these funds to markets other than New York. This seems to me to be altogether desirable in the interests of the world.

18. In his report to the Credit Committee,¹⁴ Hülse reported with satisfaction that the BIS had lent the equivalent of almost Sw.fr. 2 billion in its first financial year and that its lending

¹³ See *Meetings of Representatives of Central Banks – Currency*, I, *op. cit.*

¹⁴ See *Meetings of Representatives of Central Banks – Credit*, II, *op. cit.*

decisions had been based less on considerations of profit than on the principle of conformity with and hence support for the monetary policy of the central banks of the countries in which it had lent, in accordance with Article 20 of its Statutes. The choice of the central bank of each country as depository of the liquid funds of the BIS was one aspect of this policy.

Hülse also reported that the BIS had only modest resources that it could use for medium and long-term credits, directed mainly towards expanding exports; these funds comprised the Bank's paid-up capital, the compulsory deposit from the German Government, the Guarantee Fund from the French Government and voluntary deposits by Treasuries and central banks. The long-term deposits to be made under The Hague Agreements were fixed amounts and could not be increased, while the voluntary deposits of Treasuries were subject to extremely marked fluctuations. Voluntary central bank deposits also varied individually, but taken as a whole they were fairly stable owing to offsetting movements between one deposit and another; however, this relative *de facto* stability did not appear sufficient to enable the Management of the Bank to carry out large-scale maturity transformation. If the central banks wanted to promote medium and long-term lending by the BIS, Hülse argued, they would have to undertake to maintain a proportion of their foreign exchange reserves at the BIS, for example 10 per cent; in this way the BIS would have constant and guaranteed funds of around Sw.fr. 1 billion.

Hülse alluded to other ways in which the BIS could increase its deposits: the acceptance of foreign exchange deposits from commercial banks, the rediscounting of bills and the issue of bonds. None of these options had been used in the first financial year. Hülse noted, however, that the Bank had considered it appropriate to support the foundation of institutions created for the special purpose of encouraging outflows of capital from markets with an excess to those with a shortage of investible funds. These were nevertheless very timid steps: Sw.fr. 500,000 invested in the capital of an International Mortgage Bank based in Basel and the same amount in a *Compagnie Centrale de Prêts Fonciers* of Amsterdam. Hülse himself considered these shareholdings as symbolic, a mere gesture of 'moral responsibility' for the problem rather than a substantial financial commitment.

In view of the state of the Bank's resources, the Board had limited the maximum maturity of loans to two years. The German market had received most of this longer-term assistance; borrowers and the types of loan had been selected with an eye to the negotiability of the loans in the market or at the central bank. In the autumn of 1930 the Board had appointed a committee 'to elaborate general principles in regard to the extent and nature of middle term credit'. At its December meeting the Board had approved the committee's report and adopted the following guidelines: the Bank would lend via the various central banks or institutions designated by the central banks themselves; its medium-term credits would take the form of the rediscounting of bills with not more than five years to run. The choice of the rediscounting method accorded with the idea that the BIS should primarily help individual central banks to create markets in medium-term bills.

The question of medium-term credits had been re-examined by another committee in May 1931, which had recommended using Sw.fr. 250 million to purchase export bills with a maturity of no more than five years and bearing three signatures; both the central bank of the country of the vendor and that of the purchaser would be consulted before the transaction was carried out.¹⁵ This reveals the Bank's shortage of available funds and the excessive caution with which it tended to surround their use. At that time only Italy and Germany, via the *Consorzio per Sovvenzioni su Valori Industriali* in Rome and the *Golddiskontbank* in Berlin, were taking advantage of the medium-term credit offered by the BIS.

At the end of the Bank's first financial year in March 1931 lending at terms of six months or less accounted for 87 per cent of total investments.

19. The BIS was also having difficulty with short-term investments; the attempt to give priority to central banks was being frustrated by the limitations imposed by their statutes, for

¹⁵ See the report of the committee, which met on 4 and 5 May 1931 under the chairmanship of Francqui: BIS, *Minutes of the Meetings of the Board of Directors*, 18 May 1931, *Annex XI/G*, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B10. See also Chapter XII, § 4 below.

example the prohibition on their paying interest on deposits. Hülse therefore stressed the advisability of the central banks opening Money Employed Accounts at sight for the BIS.

Two other requests from the BIS to the central banks of the countries in which it was investing were better received: first, that the central bank in question guarantee the portfolio acquired or discounted by the BIS in its market, and secondly that it undertake to rediscount it.

20. The Bank's decision to pay a uniform interest rate on all currencies further limited the growth of deposits and the diversification of investments. In view of this constraint, many of the deposits received from central banks had been in the currencies of countries where funds were abundant (Switzerland, the Netherlands and France); furthermore, the BIS was obliged to invest large amounts in the United States. On the assets side, therefore, the need to avoid an exchange risk prevailed over the declared intention of supporting the countries most in need of external assistance.

The BIS was encountering difficulties on the investment side, despite its privileged relations with the central banks and the fact that the scale of its operations was already limited by the modest level of available funds. Hülse listed the difficulties as follows: a) in some countries there was no market in trade bills; b) in others the supply of bills was entirely absorbed by commercial banks, so that the central banks in question had advised the BIS against entering the market; c) in other countries there was an abundant supply of bills, but the commission of 1/8 per cent that the central banks charged the BIS for purchasing, guaranteeing and administering bills was so high in relation to current discount rates (often around 1 per cent) that the net return on the investment was almost nil or negative, given the short period for which the BIS held the bills. In this regard Hülse noted:

With our preference for portfolio, we are compelled, in view of our heavy sight liabilities, frequently to remobilise the whole or part of the sums invested a few days previously on a market, so that the commission charged by the Central Bank counterbalances the interest gain for a number of days or even entails a loss.

21. In his conclusions Hülse summarised the objectives of the BIS according to the Management's interpretation of Article 3 of the Statutes, which stated that the objects of the Bank, in addition to acting as trustee, were 'to promote the cooperation of central banks and to provide additional facilities for international financial operations'.

Translated into Hülse's terms, these provisions meant that the Bank should aim (a) to help central banks organise their money and capital markets; (b) to help them defend their currency when it was under pressure; (c) to contribute to widening the basis for international payments and improving the organisation of the foreign exchange markets; and (d) to work for a better distribution of financial resources not only geographically but also from the point of view of time through 'the conversion into funds at longer term of international short term funds'.

Hülse lamented that the BIS had been able to do very little in the last respect, in other words maturity transformation; he therefore argued in favour of an increase in its paid-up capital and renewed the call for the central banks to guarantee a 'minimum balance' on their short-term deposit accounts at the Bank. He also raised the prospect of the BIS issuing bonds.

He observed that in its first financial year the BIS had not even engaged in currency switching except on a negligible scale, partly to avoid exposing itself to exchange risks and partly because its Statutes allowed it to operate only in currencies on a gold or gold exchange standard.

22. In the discussion of the report,¹⁶ Hülse confirmed that the BIS had adopted the practice of making all payments on a market through the central bank, motivated by the desire to help the central banks organise their money and capital markets. Nevertheless, he noted that the right of veto granted to the central banks could seriously hamper the Bank's investment operations. For example, if the BIS purchased sterling bills for financing German exports, it would have to have the approval of both the Reichsbank and the Bank of England.

¹⁶ See *Meetings of Representatives of Central Banks – Credit, I, op. cit.*

The French delegate Farnier objected to the financing of exports with medium-term credit on the grounds that the BIS had no power to do so; indeed, the question was being examined by a BIS committee chaired by the Belgian Francqui and of which Farnier was a member.¹⁷ In his view the BIS could not be given a general authority for such operations by the central banks involved, without the right of veto. Hülse stressed the need to simplify the procedures; he cited the example of goods exported from Germany to the United Kingdom and financed by bills in dollars: in this instance, if the procedures were not simplified, the BIS would have to seek approval from the central banks of three countries – the exporting country, the importing country and the country in whose currency the exporter's credit was expressed.

On the general topic of medium-term credit to finance both exports and other activities (among which agriculture was mentioned specifically), Farnier remarked that the difficulty commercial banks had encountered in developing operations of this kind lay in the lack of rediscounting facilities; in his view, the BIS should therefore assume the role of rediscounter.

Hülse returned to the advisability of guaranteeing financial resources for the BIS by means of a commitment from the central banks to maintain a fraction of their reserves at the BIS; the proportion he suggested was 10 per cent. To support his case he pointed to the statistical evidence of the previous five years (1926-1931), which indicated that the central banks' aggregate foreign exchange reserves had been fairly stable. Hülse's proposal provoked violent objections; securing resources for medium-term credits by this means was held to be incompatible with the central banks' obligation to maintain their reserves in liquid form. In particular, Farnier judged the proposal to be 'extremely dangerous' and announced that he would oppose it most categorically.

Hülse invited members to express their opinions on another point. Until then the BIS had accepted deposits of foreign exchange; was it proper for it also to accept deposits expressed in the currency of the depositing central bank? This idea met with strong reservations as well; according to some it would entail the

¹⁷ See Chapter XII below, § 4.

creation of credit by the central bank and the granting of delegated powers of issue to the BIS.

On the question of short-term investments, Hülse complained that a majority of central banks had refused to open Money Employed Accounts for the BIS 'partly owing to statutory or legal impediments and partly because the banks in question were not in a position to do business on their markets with funds entrusted to them at interest'. This had forced the BIS reluctantly to open time deposits of its own with commercial banks. Hülse's pleas for a more accommodating attitude on the part of the central banks fell on deaf ears.

23. Finlayson, representing the Bank of Greece as chargé de mission of the League of Nations, made a very well-argued speech on several of the issues raised. In Europe, he observed, there was a small group of creditor nations, but 'they refuse to take goods in payment of debts and insist upon cash'. At the same time, they refused to provide financial resources to the countries in difficulties because the obstacles placed in the way of these countries' exports made servicing of the debts difficult. It was a situation of the dog chasing its own tail.

Finlayson stressed that in Greece he had encountered strong opposition from the commercial banks to the imposition of control mechanisms and had repeatedly had to call on the help of the Government. This experience of the importance of the role of government led him to hope for 'a closer liaison between the BIS and the Financial Committee of the League of Nations. [...] Whereas the BIS is only the Bank of the Central Banks, the members of the Finance Committee are in close touch with national Ministers. Therefore, they are able to put forward proposals in order to get the governments interested'.

Hülse returned to the problems stemming from the placing of BIS funds with commercial banks in the form of deposits or the purchase of bills in countries where it was unable to invest directly with the central bank. He urged the central banks to provide a guarantee against the risk of bankruptcy of commercial banks with which the BIS had invested, but met with refusals as regarded both 'moral' and 'legal' guarantees. According to the Frenchman Lacour-Gayet, 'the Central Bank should not shoulder

a responsibility which the State has not conferred upon it in its Statutes, by recommending a private bank and assuming a moral guarantee in consequence'.

Hülse then asked whether the rediscounting commitment made in certain cases by the central bank could be regarded as a moral guarantee. The German delegate, Fuchs, replied that the rediscounting commitment depended on the Reichsbank itself selecting the bills on behalf of the BIS. The scope of the rediscounting commitment remained undefined, as regarded both its form (moral or legal commitment) and its substance (selection of bills).

Hülse brought the discussion round to the business aspects of investments. The commission of 1/8 per cent paid to the central banks was extraordinarily high in relation to very low interest rates of as little as 3/4 per cent. 'We cannot always liquidate the bills held, owing to the fact that the commission makes it necessary to hold them for some considerable time [...] if we are to make any profit at all'. Hülse requested better terms for the BIS, but received no promises.

With regard to the geographic distribution of investments, Hülse recalled that the BIS paid the same interest rate on deposits in all currencies. (This rather absurd practice was changed some years later; today the BIS pays a variety of rates linked to those on Euro-market deposits.) The consequence, Hülse remarked, was that the Bank received deposits only in the currencies of countries with low market rates. The BIS therefore found itself almost compelled to transfer such funds to markets where interest rates were higher, in other words capital-importing countries. The forward exchange rates of the currencies of capital-exporting countries were normally at a premium over spot rates and these currencies tended to appreciate over time; if it wished to avoid an exchange risk, the BIS could either lend the same currencies as it had received or cover the risk if there was a forward market in which to do so, in which case it incurred a cost that in some cases cancelled out the interest rate differential.

Quite apart from the economic constraint just mentioned, forward cover was impracticable. 'As in general Central Banks do not transact forward business and we do not consider that business of the kind would be desirable, we have so far avoided the conclusion of forward operations'. Lending in the currencies

in which deposits were received also entailed a cost due to the difference between buying and selling prices that came into play in conversion operations; if the period of investment was short, the double conversion proved costly.

Hülse emphasised a second risk: if the BIS carried out any maturity transformation by investing short-term resources for longer periods it might find it did not have sufficient amounts of a currency to meet withdrawals. To guard against that risk, the BIS had obtained a commitment from a number of central banks to sell their own currency against foreign exchange, at least up to agreed limits.

24. The Bachmann report¹⁸ on *The Creation of Credit* disputed the distinction between a 'passive' credit policy confined to discounting and an 'active' policy in which market purchases and sales of both foreign exchange and domestic bills had a place; this distinction was based on the premise that in the case of rediscounts the initiative lay outside the bank, whereas in open market operations it came from within the central bank. According to Bachmann, the initiative for open market operations could and mostly did emanate from outside just as much as from within the bank, so that his preference was for an 'active' policy. He predicted that the development of business relations with the BIS would help 'standardise' the modes of operation and objectives of monetary and credit policy of the various central banks,

with the result that individual banks will be helped in the execution of their currency functions, while at the same time their position in internal credit operations will be strengthened. The truism that the Banks of Issue of the various countries can assist their national economy by international collaboration will thus become an accomplished fact.

Discussion of the Bachmann report did not produce observations of particular significance for the activity of the BIS.

25. Discussion of the third theme of the Second Committee, 'Money Rates', was based on only an outline report from Reisch and

¹⁸ See *Meetings of Representatives of Central Banks – Credit*, II, *op. cit.*

a memorandum from the Bank's own Department for Relations with Central Banks, which bears the signature of Dr. Simon.¹⁹

The Simon memorandum was dominated by an almost obsessive concern with the possible inflationary effects of the gold exchange standard, a preoccupation that was at odds with the deflationary crisis besetting the world economy at that time. Nevertheless, it also offers a wealth of observations on the fact that capital movements rather than the state of the current account were the main influence on exchange rates, domestic liquidity in the various national economies and the volume of credit. These comments appear singularly prescient of a more distant future, foretelling the experiences of Western economies in the seventies and eighties, when capital movements have played a predominant role in determining the credit situation and the exchange rate.

In his outline report Reisch emphasised the importance of information. To that end he proposed (a) 'centralisation with the BIS of monetary information and communication of such information to the various banks', and (b) 'meeting of Research Services (and preparation of a BIS bulletin)'.

The BIS memorandum dealt with the subject of the *Control of credit by central banks in the past and present*; its main source of historical information was the report of the UK Cunliffe Committee of 1918.²⁰

Simon argued that the influence of interest rates on prices had diminished owing to three factors: (1) the existence of a great number of powerful cartels and trusts, strong enough to withstand temporary losses resulting from higher costs of borrowing; (2) the increase in the ratio of fixed capital (land, buildings, machinery and goodwill) to working capital; and (3) wage rigidity: in a large number of developed countries 'the wages bill [...] is incapable of reduction owing to trade unions and the introduction of social legislation'.

The scale of international movements of bank funds was seen as a fourth factor reducing the effectiveness of monetary policy. In the words of the memorandum:

¹⁹ *Ibid.*

²⁰ See Great Britain, Committee on Currency and Foreign Exchanges, *First Interim Report of the Committee on Currency and Foreign Exchanges after the War*, His Majesty's Stationery Office, London 1935 (Cunliffe Report).

It is clear that the policy of a Central Bank can be neutralised if contrary movements are made to a large extent by foreign private banks. In this connection it is sufficient to remember the enormous inflow of European funds to the USA in 1929 which for a considerable period has hindered the Federal Reserve System from carrying out a deflationary policy.

The American situation of 1929 was part of a more general reduction in the dependence of commercial banks on credit from their own central bank. 'In countries the savings of which exceed the possibilities of investment within the country, or in countries which have developed the power of attracting foreign capital' the result had been 'to make the private banks of such countries practically independent of their Central Bank for very prolonged periods'. This reduced dependence was seen as a fifth reason for the decline in the effectiveness of variations in the official discount rate.

The memorandum contrasted the increased international mobility of capital with the reduced freedom of trade:

We can, under our present system of trade policy, no longer speak of the world as one big market [...] On the other hand, as far as the circulation of money is concerned, we are now much more entitled to treat the whole world as one financial market than we have ever been in the past.

According to the memorandum the increased interaction between the money market and the capital market worked in the same direction:

The fact that shares and bonds can be sold more easily than whole enterprises has had the effect of inducing people to invest on the capital market funds which are only available for short intervals, and would therefore in the past have been kept within the money market.

In these conditions,

huge funds invested on the capital market are apt to flow at any given moment to the money market, creating at the same time a plethora on the one side and a severe stringency on the other, a phenomenon which we are witnessing since 1930.

For the reasons explained, whereas

the influence of the bank rate on money rates in general and on the internal price level has, under modern conditions, lost much of its old vigour [...] there is no doubt that the influence of the bank rate in attracting foreign funds has [...] increased.

That being the case, an increase in bank rate brought the danger of an expansion in credit, a perverse effect that 'is bound to prevail more and more over the deflationary tendencies which were characteristic of the old system'.

This remark in itself testifies to the fact that in the midst of a deep depression the predominant concern in BIS circles was with the dangers of inflation. The note also reveals another preoccupation, which has already been mentioned and which followed the line of the analysis by the Gold Committee of the League of Nations: under the gold standard there was symmetry between the expansionary effects of an inflow of gold and the contractionary effects of an outflow; under the gold exchange standard, on the other hand, the inflationary effect in the country with a balance-of-payments surplus was not necessarily offset by a deflationary effect in the deficit country because, as has been noted, in the latter country there may be a simple transfer of bank deposits from residents to non-residents, including the central bank of the surplus country.

The note's most insistent theme was therefore that the new monetary institutions and market structures 'result in strengthening tendencies working for expansion of credit and putting obstacles in the way of deflationary tendencies'.

The remedy proposed in the note derived from this diagnosis. It comprised credit rationing, qualitative credit controls such as interest rate differentiation according to the intended purpose of the credit, the use of open market operations, the control of issues of securities by law or by means of moral suasion, the keeping of foreign exchange reserves solely with the central bank of the country issuing the currency, legislation requiring commercial banks to keep a certain variable proportion of their total deposits with the central bank, the use of this requirement to control the total volume of credit and not solely to protect depositors, and the more frequent and widespread publication of information on the credit situation and the balance of payments.

Having listed these instruments, some of which were new and others could be adapted to what he saw as the new requirements of the situation, the author of the note commented with regard to the newly-created BIS:

Perhaps the most interesting addition to the arsenal of Central Banks is the recent attempt to organise their cooperation. [...] It is rather surprising that the necessity for this cooperation should only have been more generally recognised so late, in spite of the patent fact that the policy of each Central Bank already constitutionally affects not only that bank's own market but, to a larger or smaller extent, all other money markets as well.

The factor that, in his view, had done most to focus attention on central bank cooperation was

that the weight of a Central Bank's action, which was previously exercised predominantly on the internal market where its influence was then relatively isolated, has now been shifted more and more to the attracting of funds from other markets where this action manifestly comes into collision with the policy of other Central Banks. [...] What is required under these conditions seems to be a kind of standing entente with regard to the discount policy. [...] It is rather surprising to see that this purpose of cooperation between Central Banks should have been rather overshadowed by the much discussed cooperation with regard to gold policy. [...] Mutual understanding with regard to interest rates is important not only in so far as the intention is to attract funds from one country to another, but it is of no lesser importance in the reverse case where a fencing off of foreign funds from a country seems to be desirable for monetary considerations. [...] This is where the main importance of the BIS comes in. Once consciousness of the general inter-dependence of central bank policies in all the countries of the world has spread, the text-book of central banking will be supplemented by a new volume just as in the course of centuries every country's national law has slowly been supplemented by the new text-book of international law.

No institution is better fitted than the BIS to be instrumental in accumulating and spreading knowledge and experience of the facts of international monetary relations, failing which this text-book can never be written. Nor is anybody better situated to contribute to the development of the spirit of international understanding failing which the work could not even be attempted.

VIII

AN UNDERSIZED BANK

1. The capital and governmental deposits with which the BIS was endowed at its inception were completely inadequate in relation to the size of the international market in short-term funds in which it was expected to perform a stabilising role in accordance with its Statutes; moreover, a large part of its resources were at short term and were therefore incompatible with the need for stable financing.

The second Annual Report, presented in May 1932, notes that 'It is now possible to estimate that the total amount of short-term international indebtedness which existed at the beginning of 1931 aggregated more than 50 billion Swiss francs'. However, in its opening balance sheet on 31 May 1930 the Bank's total resources had been just over Sw.fr. 302 million; growth in the course of the first financial year increased the figure to 1,901 million on 31 March 1931.

The balance-sheet total then declined rapidly; as shown in the Table 3, by March 1935 it had fallen by around two-thirds, to Sw.fr. 660 million. A small part of the fall was due to the contraction in the central banks' foreign exchange reserves and the abandonment of the gold standard by many countries, which created an operational constraint for the BIS under its Statutes; the greater part of the decline, however, was caused by the withdrawal of deposits that central banks had made with the BIS on behalf of their governments in respect of reparations and war debts, the payment of which had been suspended in July 1931 by the Hoover Moratorium and terminated a year later as a result of the Conference of Lausanne. Deposits continued to decline more slowly in subsequent years, with total resources reaching a historic

low of Sw.fr. 451 million in March 1946. The billion franc mark, which had been reached briefly in the first two financial years, was not achieved again until twenty years later, at the beginning of the fifties.

This disappointing performance kept the BIS to the dimensions of medium-sized commercial bank for the first twenty years of its existence, as can be seen from the Table, where the Bank's balance-sheet totals for the first five financial years are compared with those of the three largest commercial banks in each of the five countries that were pre-eminent in the development of domestic and international banking. Even at its peak in March 1931, the BIS was comparable in size to the large Swiss banks, smaller than the large French and German banks and a mere fraction of the size of the British and American banks.

2. The crisis in international financial relations, which broke out in May 1931 at the beginning of the Bank's second financial year, increased the need for intervention while at the same time reducing the resources available, thus accentuating a disparity that already existed.

With withdrawals of short-term funds from the countries of Central Europe snowballing, the banks of these countries drew on their deposits at the BIS to meet the demand; the central banks of other countries also reduced theirs. This latter movement gained momentum after the devaluation of sterling and the currencies tied to it (which included the Scandinavian currencies) owing to the switch towards holding official reserves in gold. In total, the central banks' foreign exchange reserves contracted by around Sw.fr. 8 billion (\$1.5 billion) between March 1931 and December 1932. It is estimated that at least Sw.fr. 30 billion of the Sw.fr. 50 billion in short-term funds in the market were liquidated between April 1931 and March 1932.

Requests for credit poured in to the BIS from central banks in difficulties, but the Bank did not have the resources to meet them; it was not only a question of the volume of funds but also one of maturities and currencies. The great bulk of its funds were at short term, and Article 26 of the Statutes prescribed that 'the Bank shall be administered with particular regard to maintaining its liquidity'. As a consequence, a very high proportion of the

Table 3. *Resources of major deposit banks in five leading countries at end – 1930 and of the BIS 1930-35*

Bank name	Capital and reserves	Deposits	Total resources	
	In millions of pounds sterling			In millions of Swiss francs
<i>I. USA end-1930</i>				
Chase National Bank	72.8	427.6	500.4	12,620.1
National City Bank	50.7	301.1	351.8	8,872.4
Guaranty Trust	61.3	260.5	321.8	8,115.8
<i>II. England end-1930</i>				
Midland Bank	29.4	395.6	425.0	10,718.5
Lloyds Bank	27.1	364.6	391.7	9,878.7
Barclays Bank	26.7	348.7	375.4	9,467.6
<i>III. Germany end-1930</i>				
Deutsche Bank und Diskonto-Gesellschaft	20.5	206.8	227.3	57,321.5
Darmstädter und Nationalbank	6.2	114.5	120.7	3,044.1
Dresdner Bank	6.7	111.0	117.7	2,968.4
<i>IV. France end-1930</i>				
Crédit Lyonnais	9.8	104.3	114.1	2,877.6
Société Générale	8.3	103.4	111.7	2,817.1
Comptoir d'Escompte	6.7	73.1	79.8	2,012.6
<i>V. Switzerland end-1930</i>				
Schweizerische Kreditanstalt	8.0	62.8	70.8	1,785.6
Schweizerischer Bankverein	8.3	56.6	64.9	1,636.8
Schweizerische Bankgesellschaft	5.3	33.7	39.0	983.6
<i>Bank for International Settlements</i>				
31 May 1930	3.1	8.9	12.0	302.6
31 March 1931	4.1	71.2	75.3	1,901.1
31 March 1932	6.0	54.2	60.2	1,126.0
31 March 1933	7.6	45.4	53.0	940.6
31 March 1934	8.8	33.6	42.4	667.5
31 March 1935	9.7	35.3	45.0	659.8

Source: The US, British, French and German banking figures are taken from R.J. Truitt, *British Banks and the London Money Market*, Jonathan Cape, London 1936; the Swiss Banking figures from *Schweizerisches Finanz-Jahrbuch*, Bern 1932, and the BIS figures from the Bank's *Annual Reports*.

Bank's resources (around 60 per cent in the early years) was invested at sight or in operations covered by a rediscounting commitment from the central bank. By contrast, the withdrawal of funds from the countries of Central Europe did not appear to be reversible in the short run, so that medium-term loans were needed. The Bank's operational freedom was also restricted by the provisions of the Statutes excluding the use of currencies not linked to the gold or gold exchange standard.

3. This triple set of difficulties forced the Bank to make various adjustments. It husbanded its resources by forming syndicates to which it contributed on a proportional basis, it requested exchange guarantees or gold clauses so that it could operate in floating currencies, and it turned down some of the requests for assistance. These various adjustments are mentioned in the Bank's second Annual Report.

Referring to the crisis that had broken out in May 1931, the Report records that

In rapid succession the Bank for International Settlements was called upon to grant emergency credits to the National Bank of Hungary, the National Bank of Austria, the Reichsbank, the Bank of Yugoslavia and a temporary advance to the Bank of Danzig. [...] To amplify its possibilities of material aid and in close collaboration with central banks, the Bank for International Settlements organized syndicates of central banks which contributed funds to the common constructive cause.

A total of Sw.fr. 740 million was lent to the first four of the banks mentioned above, with the BIS contributing Sw.fr. 211 million. The largest loan was one of \$100 million to Germany: three central banks (the Bank of France, the Bank of England and the Federal Reserve Bank of New York) each contributed \$25 million and the remaining \$25 million came from the BIS. A syndicate comprising twelve central banks and the BIS was formed to lend \$26 million to the National Bank of Hungary. At the close of the financial year in March 1932 only the advance to the Bank of Danzig had been repaid. The other credits remained outstanding; in March 1933 the BIS still had an exposure of Sw.fr. 169 million. The Annual Report rightly observed that the force of events had partly altered the activities of the Bank 'to that of

a grantor of credit during a general economic depression, instead of discharging the more normal function of a stabilizer of monetary fluctuations resulting from seasonal movements or from a transitory, localized difficulty'. The inadequacy of the Bank's resources for this new and unexpected role is revealed by the balance-sheet figures; in March 1932 the assets item 'Central Bank credits' amounted to Sw.fr. 185 million, equal to barely \$36 million at the prevailing exchange rates, an insignificant fraction of the capital movements taking place between national markets.

Gold clearing had not developed either; whereas movements of gold between central banks amounted to several billion dollars over the two years 1931-32, central bank gold deposited under earmark at the BIS amounted to only Sw.fr. 120 million in March 1932, equal to \$23 million.

4. The abandonment of sterling's gold parity on 21 September 1931 caused a sharp fall in the volume of central bank deposits with the BIS, mainly owing to the conversion of foreign exchange into gold. The Annual Report noted that with regard to sterling and the Scandinavian currencies linked to sterling it also brought into play 'the provisions of Article 21 of the Statutes to the effect that the operations of the Bank for its own account shall only be carried out in currencies that satisfy the practical requirements of the gold or gold exchange standard'. As has already been said, this impediment caused central bank deposits to decrease further. At the end of 1931 eight European countries were still on the gold or gold exchange standard; ten had switched to floating exchange rates and the others had introduced exchange controls. The shift towards alternatives to the gold standard continued in 1932 both in Europe and in the rest of the world and culminated in the imposition of the gold embargo by the United States in March 1933 and the subsequent devaluation of the dollar.

The adjustment to which the Bank resorted on the investment side was the gold clause. Thirteen central banks gave the BIS

their guaranty, not only for the credit risk in their respective markets, but also against the risk of loss through depreciation of their respective currencies. [...] These central banks in a spirit of collaboration have agreed that the investments of the Bank in their currencies on their markets shall in all circumstances retain (within the gold points) the same

gold value as that which the investments had on the date they were originally made by the Bank.

5. The third and most painful adjustment made by the Bank was to refuse assistance. The Annual Report notes in this regard that after the devaluation of sterling the Bank,

recognizing the demoralization which had developed and the inadequacy of additional grants of short-term credits, felt obliged to refuse new applications for advances which came to it from several central banks [...] and it thus suspended the policy of being a substantial new credit-giver to sundry central banks.

The Bank was not involved in the many operations to support sterling in the months before the devaluation, which were borne entirely by the central banks and markets of France and the United States.

The Bank also had to decline to participate in the plans to provide financial aid to stabilise the peseta.

The main support operations carried out in the crisis of 1931 were those shown in Table 4.

Table 4. *Major international support operations in the 1931 crisis*

Date	Operation	Amount
May 30	First BIS Syndicate credit to the National Bank of Austria	Sch. 100 million
June 6	BIS credit to the National Bank of Hungary	US \$ 5 million
9	BIS advance to the National Bank of Hungary against gold	£ 400,000
16	Bank of England credit to Austrian Government	Sch. 150 million
18-22	First BIS Syndicate credit to the National Bank of Hungary	US \$ 10 million
23	Second BIS Syndicate credit to the National Bank of Austria (not utilised)	Sch. 100 million
26	BIS Syndicate credit to the Reichsbank	US \$ 100 million
29	Bank of France credit to the Bank of Spain	£ 9 million
July 7	Goldskontbank credit in US (utilised)	US \$ 50 million
8	Second BIS Syndicate credit to the National Bank of Hungary	US \$ 11 million
13-30	BIS and Bank of France credit to the National Bank of Yugoslavia	US \$ 3 million
20	BIS and Bank of England credit to the Bank of Danzig	£ 150,000
August 1	Federal Reserve and Bank of France credit to the Bank of England equivalent of	£ 50 million
14	Hungarian Treasury bills issued chiefly in France	£ 5 million
28	American and French banks credit to the British Treasury (and the proceeds of Treasury Bills issued in Paris) equivalent of	£ 80 million
August-October	Totals of credits granted by the French Treasury to the Governments of:	
	Poland	Fr.fr. 216 million
	Yugoslavia	Fr.fr. 413 million
	Hungary	Fr.fr. 354 million

Source: BIS, Monetary and Economic Department Document CB 48, *Note on certain monetary aspects of the liquidity crisis 1931-2*, April 1932.

IX

THE WEB OF VETOES

1. The steady deterioration in political relations between the nations of Western Europe during the thirties was itself sufficient to block the emergence of any plan for large-scale monetary cooperation. The system of monetary relations fragmented, allowing alliances to develop between individual groups of countries – the sterling area, the dollar area, the gold bloc – which were managed by national authorities rather than jointly in a common forum such as the BIS could have been.

The archives reveal, however, that two powerful curbs on the development of the Bank's activities operated from the very moment of its birth, even before the divisions fomented by politics caused the breakdown of the previous system of monetary relations based on multilateral trade and fixed exchange rates.

These two curbs were: 1) the limits imposed by the Statutes, which were very strict in order to guarantee the liquidity of the Bank's assets in accordance with the nature of its liabilities, which for the most part consisted of central bank deposits; 2) vested interests, especially those of the two largest European financial centres, London and Paris, which had no intention of surrendering their prerogatives to a central body administered by international civil servants. Internationalism was a very thin veneer at that time; the slightest scratch or knock revealed the hard rock of national interests beneath, shaped by the mental images formed in the course of a history of rivalry culminating in armed struggle and perceived in sectoral terms to which even central bank governors conformed in defence of the interests of the national coteries of bankers shielded under the protective wing of their respective central banks.

2. In Chapters V (*American disaffection*) and VII (*The role of the BIS as perceived by the experts*) the reader will already have been able to appreciate the effect of these two constraining influences. This Chapter aims to illustrate their impact more fully with the help of archive material, occasionally supplemented by marginal notes from the protagonists themselves. Special attention has been paid to the archives of the Bank of England, whose files contain many notes written by Norman and Niemeyer.

3. One issue that gave rise to argument at the outset concerned the size of establishment to give the Bank. As early as April 1930, even before the arrival of McGarrah and Fraser, the question had been discussed in meetings in Paris between Quesnay and Siepmann, with Hülse, van Zeeland, Pilotti and Takisawa in attendance. It had been envisaged that the Bank would be divided into a maximum of five departments and would have a staff of 80. It had been considered whether the Bank should have a Department for Relations with Central Banks or alternatively an ‘Ambassador’ travelling to central banks.¹

Siepmann thought this scale of establishment too small, even niggardly. He used the arguments described in Chapter V, namely that the BIS should aspire to be a centre of cooperation between central banks rather than confining itself to the management of reparations. McGarrah and Fraser were reluctant to embrace Siepmann’s view, because they feared that the income of the BIS would prove insufficient to finance a larger organisation.²

4. The choice of a small organisational establishment was in fact consistent with the limited resources available for investment (capital and deposits). However, the constraining factors mentioned above further curtailed its already limited operational scope.

One fundamental option – whether or not to establish direct relations with commercial banks – was resolved in a mainly

¹ Siepmann had informed Norman about these meetings with the note *Confidential Report to the Governor on meetings held in Paris on the 29th and 30th April, and 3rd May, 1930*; see Baffi’s notes on Bank of England documents, BEA, G1/8-151/7, doc. 5, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B6.

² *Ibid.*

negative way. On this question it was the Bank of England, in the person of Siepmann himself, who upheld the principle of 'exclusive relations' with central banks. It was feared that the operations of the BIS could interfere with the control of markets by the central banks; the Bank of England was especially concerned to maintain control over the volume of funds invested in the London market. The principle was therefore adopted that individual central banks should have a right of veto over operations by the BIS on their markets. Initially the question whether the veto should mean that 'whatever is not expressly allowed is forbidden' or 'whatever is not forbidden is permitted' was left open. The latter more permissive interpretation appeared tenable, provided it was 'combined with the observance of exclusive relations by the BIS with the Central Banks [...] Therefore the BIS should have one account only, at the Central Bank'. It was considered that 'the proper place for the exercise of the Central Bank veto is the Board of the BIS, where it can be directed against the general lines of policy or its effects in a particular market'.³

A memorandum sent from Basel to the Bank of England in May 1930, probably by Rodd, states:

A different conception is that the BIS is called upon to be the arbiter between conflicting policies of Central Banks, and to resist the particular in defense of the more general interest. This is the conception which would lead to 'intervention' by the BIS on the foreign exchange markets, with a view to affecting and 'stabilising' rates of exchange.

The author of the memorandum rejects this view: 'If there is a problem with which the BIS has to deal, it is a credit problem and not a foreign exchange problem'.

In this memorandum the exclusivity of relations with the central bank was presented as a principle that could not be applied universally; more permissive solutions could be envisaged for other markets, as 'a necessity imposed by the unfortunate

³ *Ibid.* See also the decision taken at the May meeting in Basel; in BIS, *Minutes of the Meetings of the Board of Directors, May 12, 1930; The Right of Veto – Annex B.*

inability of certain Central Banks to handle the business which the BIS will require to do'.⁴

The archives show that Rodd, installed at the BIS as 'temporary head of the Central Banking Department', watched with suspicion over the Bank's adherence to the principle of exclusivity.⁵ In June he informed Siepmann by telephone and letter that the BIS had asked the Federal Reserve Bank of New York whether the BIS could 'make time deposits through them with Morgan'. Rodd considered this request 'a manoeuvre to insert the thin end of the wedge of relations with private banks'.⁶ As to the Bank of England, Siepmann notified Rodd that 'the Governor of the Bank of England is willing to place money on time deposits for the BIS, but not in their name, since their sole account must be with the Bank of England' and declared that the Bank of England was prepared to advise the Federal Reserve Bank to answer on the same lines.⁷

5. A second important option concerned the operations of the BIS in the financial market, on both the investment and fund-raising sides.

With regard to investment, as early as June 1930 there was a majority view within the BIS that the Bank should not acquire government bonds.⁸ Somewhat bizarre proposals for medium-term operations, such as financing harvests in Poland or exports from Bulgaria, were rejected, as was a loan to Japan to cover exchange risks.⁹

On the fund-raising side, the problem came into sharp focus in two contexts: 1) the mobilisation of the non-postponable portion of the annuity owed by Germany for reparations; and 2)

⁴ See Baffi's notes – BEA, G1/8-151/7, doc. 6, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B6.

⁵ See Baffi's notes – BEA, *op. cit.*, doc. 12.

⁶ See Baffi's notes – BEA, *op. cit.*, doc. 23.

⁷ See Baffi's notes – BEA, *op. cit.*, doc. 27.

⁸ See Baffi's notes – BEA, *op. cit.*, doc. 26; *ibid.* See also BIS, *Minutes of the Meetings*, *op. cit.*, meetings of 16 June 1930, 'Operations of the Bank', and of 14 July 1930 (*Annex III H*).

⁹ See Baffi's notes – BEA, *op. cit.*, docs. 80, 85 and 86, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B6.

the raising of long-term funds to finance the Bank's lending operations.

Annex III of the Report of the Young Committee had made provision for mobilisation.* Almost immediately after being appointed as President, McGarrah set up a committee composed of Addis, Vocke and Beneduce 'to advise him with regard to the general form of the bonds' foreseen in the Annex.¹⁰ Addis, elected chairman of the committee, referred to the documents of the Young Committee and the sub-committee on the organisation of the BIS, where 'International Bond' meant 'a Bond with an equivalent in grammes of gold'. This definition also applied to national bonds, 'but an International Bond would carry an additional right, namely it would entitle the holder to demand at his option any of the currencies expressed in the bonds in markets other than those of issue at the mint parity of exchange'. National bonds would also be payable in markets other than that of issue, but 'at the rate of exchange of the day'.¹¹

According to Addis, provision for the international bond had been made with a more distant future in mind, since it was feared that it might lead to a concentration of the issue on a few markets. 'As the BIS became more solidly established and exercised a greater influence over international finance, the markets might become increasingly stabilised' and concentration avoided.

The payment of coupons on national bonds 'at the rate of exchange of the day' was related only to deviations from the mint parities that could have occurred in a system of unchanged gold parities. According to Addis, when the experts of the Young

* The relevant paragraph of the Report states as follows: 'Upon the request of all or of any one of the Creditor Governments, the Bank, as trustee, if it considers such a course opportune, has the right to require the creation of, and the German Government is obligated to create, issuable bonds representing the capitalisation of any part of the portion of the annuity coupons not subject to postponement'.

¹⁰ See *Report of the Committee of Experts on Reparations (Young Committee, June 7, 1929)*, H.M.S.O., London 1929. The report by the committee chaired by Addis, dated 13 May 1930, is in BIS Archive, 7.18(12) – *Documents Pierre Quesnay*, QUE 2.

¹¹ See Baffi's notes – BEA G1/8-151/7, doc. 7, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B6.

Committee mentioned the national currencies in which bonds could be denominated they

no doubt had in their minds francs, dollars and pounds sterling in gold, as defined by the legislation of the different countries [...] This ought to be made clear by some form of words that would ensure to the holder of the bond that his rights would be unaffected by any subsequent change in the gold content of these currencies.¹²

Addis's proposals gave rise to a debate within the committee, with McGarrah and Moret also taking part, but no agreed conclusions were reached. The distinction between national and international bonds was not embodied in the terms of the Young Loan, which was issued on various markets in mid-June, a few weeks after the discussions in the Addis committee; instead the gold clause was adopted for both principal and interest, expressed in the following terms:

The principal and interest of each Bond shall be payable [...] in the currency of the country in which it is issued, the unit of such currency being defined for the purposes of these presents in all circumstances by the weight of fine gold determined by law as at present in force [...] The payment of the amounts due in the above named currencies [...] may, however, at the option of the holder, be effected on any foreign market where any of the Bonds are quoted in the currency of that country at the then current rate of exchange.¹³

6. The volume of the Bank's short-term funds in the form of central bank sight and time deposits clearly depended on the terms the Bank offered, as well as the central banks' willingness to increase the Bank's operational resources. Here too, the decisions taken initially by the Management were not conducive to an increase in deposits. McGarrah wrote to the governors

¹² See Baffi's notes – BEA, *op. cit.*, doc. 8; *ibid.*

¹³ See *Statement Regarding the German Government International 5 1/2% Loan 1930*, dated 10 June 1930, signed by Moldenhauer, Reich Minister of Finance, and countersigned by McGarrah; this is one of the documents of the final agreement establishing the conditions for the German loan and the BIS's function as trustee; in BIS Archive, 7.18(3) – *Documents Pierre Quesnay*, QUE 1.

quoting identical rates for all currencies, ranging from 2 per cent for sight deposits to 3 1/8 per cent for deposits at longer than three months.¹⁴ The decision to offer the same terms for all currencies was determined by the intention to gather funds in markets where the abundance of liquidity was depressing rates in order to transfer them to markets where the scarcity of funds was causing rates to rise. However, such a transfer involved fairly high exchange risks, because the markets where funds were scarce were also those whose currency was most liable to depreciate; the Bank was reluctant to accept risks of this kind, as stated in the case of the Japanese loan.

Even this non-selective and therefore unaggressive interest rate policy drew criticism from Norman. In the summer Addis informed Fraser that:

The Governor is rather disturbed by the fact that only about 11 per cent of the dollars held by the BIS are now with the Federal Reserve Bank or invested through them in bankers' acceptances. The Governor is inclined to say that in their endeavour to become the biggest bank on earth the BIS are paying rates, and therefore taking risks, which are unjustifiable for a Central Bank and therefore for the BIS. The more the Governor hears about the transactions of the BIS the more dissatisfied he is to find them emerging as a competitive financial house instead of as an orthodox Central Banking Institution.¹⁵

7. The web of limitations that the British, in particular, intended to weave around the activities of the BIS from the very outset is clearly evident in three memoranda¹⁶ dating from the summer of 1930 that are preserved in the archives of the Bank of England.* The positions adopted by the authors on various issues are collated below:

¹⁴ McGarrah's letter of 1 July 1930 to Norman. See Baffi's notes – BEA G1/8-151/7, doc. 66, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B6.

¹⁵ See Baffi's notes – BEA G1/8-151/7, doc. 80, in BIS Archive; *ibid.*

¹⁶ See also Baffi's notes – BEA G1/8-151/7, doc. 86a, 86c and 91, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B6 and note 17 on p. 141.

* Documents 86a, 86c and 91 in Governor's File G1/8. The first bears the initials of Siepmann (H.A.S.) and is dated 15 September 1930.

<i>Profits:</i>	No object.
<i>Big figures:</i>	No object; not to be attained, in any case, by attracting Government money.
<i>Uniform deposit rates:</i>	Principle to be maintained, irrespective of currency.
<i>Height of rates:</i>	Rates should approximate to the lowest current ones in money markets.
<i>Operating funds:</i>	To be derived from Central Banks.
<i>Banking objectives:</i>	To be achieved (1) partly by financial operations conducted with BIS resources, (2) partly through coordinated use of Central Banks' resources. With (1) the BIS cannot, and should not attempt to, exercise an important influence on exchange rates or interest rates. Equalisation of interest rates, internationally, to be obtained through mechanisms rather than resources. BIS resources should be used only to influence local conditions in the smaller markets, where limited resources can go a long way.
<i>Investment of resources:</i>	Should be governed by the same principles as apply to the investment of resources of the depositing Central Banks.

The array of suffocating restrictions listed above seems difficult to reconcile with the effective pursuance of the wider objectives that the memoranda themselves set out in the following terms:

- (i) stability of the gold exchanges;
- (ii) facility of transfer between Central Banks;
- (iii) Central Bank cooperation in monetary policy;
- (iv) the smooth settlement of international indebtedness;
- (v) the provision of international credit – including intermediate and long term credit – on proper terms;
- (vi) the better distribution and use of gold as a basis of credit;
- (vii) the conversion of short-term balances into long term investments;
- (viii) the development of international gold clearing and settlement.

8. The three memoranda mention various investments carried out by or proposed to the Bank. Taken together, they reveal how

difficult it was proving for the Bank to enter the international credit market, and that in the final analysis its involvement was only spasmodic and marginal. Some of the proposed operations warrant the unfavourable reactions displayed in the marginal notes by departments of the Bank of England and Norman himself, who often expresses himself in ascerbic and peremptory style.¹⁷ However, their reactions are so consistently negative that they appear to be aimed at something other than the merits or demerits of the questionable transactions proposed, revealing a hostile attitude to the search for ways to develop the activity of the new institution.

Some of the operations mentioned in the three memoranda and the comments expressed in the marginal notes are described below.

– (a) Golddiskontbank proposes a rediscount of bills for the supply of railway equipment to Turkey. (b) A British exporter asks the BIS to guarantee bills drawn by German traders. (c) The German Post Office requests the discounting of its own bills guaranteed by the German Government. The Bank of England considers the three operations acceptable only on condition that they are guaranteed or at least recommended by the Reichsbank.

– The BIS is asked to participate in a banking syndicate to provide a seasonal sugar credit to Poland. The Bank of England finds the proposal ‘ridiculous’.

– The BIS is asked to issue its own notes at 1, 2, 3 and 5 years; the central banks grant it credit lines. Norman comments: ‘no part of duty of a central bank’.

– It is proposed that the BIS should obtain three-month deposits from central banks, with an implied undertaking that they will be renewed for a total of two years, the risk of non-

¹⁷ Baffi sought to pinpoint who the memoranda were from and to whom the marginal notes were attributable in order to clarify Governor Norman’s position on the operations of the BIS. On this subject, see the correspondence between Baffi and Keyworth, Curator of the Bank of England Museum, who responded to Baffi’s request for elucidation by sending him the memoranda, purported to have been drafted by Siepmann with Norman’s comments in the margin (some by hand, others typed by departments of the Bank of England), together with the letter of 24 September 1930 with which Siepmann had sent to Addis the documentation in question. See BIS Archive, 7.16 – *Baffi Papers*, RBL/B22.

renewal being covered 'for a consideration' by an international group of private bankers. Norman: 'Immoral'.

– The BIS is invited to form a subsidiary investment company to handle medium-term credits. Norman: 'Improper'; the annotation continues: 'Nothing to be said for setting up a subsidiary to do business which is improper for the parent. If existing agencies are not already present for performing such functions, the right way for the BIS, if necessary, is to help organise for such business to be done by someone else'.

– The BIS is asked 'by the Sveriges Riksbank on what terms they would be prepared to accept time deposits subject to the condition that they should be callable in certain unforeseen circumstances'. Here too Norman brands the proposal 'immoral'.

– The BIS has made a deposit with the Swiss National Bank 'who pay long term rates and employ the money at long term, but allow the BIS to call the money at any time'. Norman peremptorily orders the arrangement to be cancelled.

– Wishing to make a deposit with the Bank of Finland, the BIS has bought Finnish marks for £200,000. The Bank of Finland has deposited the pounds with the BIS as part of its reserves and at the same time has placed the Finnish marks with private banks at 4 per cent on behalf of the BIS. The Bank of England notes: 'In private life this usually ends in the criminal courts. It amounts to hiking cheques. It is an increase in the circulation in Finland against a loan of sterling. The loan of sterling is all right but not the reciprocal transaction. Why this hocus-pocus?'.

– The BIS is asked to deposit dollars at a rate of interest with the Bank Polski, which takes the dollars into its reserves and creates several times the equivalent amount of credit to finance the stockpiling of agricultural products until prices recover; on the strength of this increase in its reserves, the Bank Polski reduces its rate. The Bank of England comments: 'No reason why with the consent of the *two* Central Banks concerned the BIS should not deposit foreign exchange with the Bank Polski. But no Central Bank should countenance the two immoral proposals tacked on at the end'.

– An arrangement is planned whereby 'the BIS time deposits made with the Bank Polski may be mobilised, at the option of the

BIS, during the period for which they were originally made'. Norman notes: 'Further immorality'.

– Should the BIS rediscount bills to finance exports of tobacco from Bulgaria, or form a group of central banks to do so? The Bank of England notes: 'The BIS should not rediscount nor arrange a group, because this is pure commercial business in competition with private bankers'.

– A proposal is made for 'the BIS to buy dollars spot from the Bank of England and to resell them forward for a fixed date subject to their retaining the option to complete the forward deal before that date at the (same) agreed rate'. The Bank of England notes: 'This is equivalent to a sight deposit of dollars by the Bank of England with the BIS against the security of sterling. The only purpose can be to make good a deficiency of dollars due to the BIS having got into a short position for the sake of profits. We would not agree'.

– A proposal is made for 'the BIS to buy sterling for dollars from the Bank of England spot and to resell them three months' forward at an agreed rate, the sterling in the meantime to be lent by the BIS for the sake of the interest profit, in Continental markets'. Referring back to the preceding proposal, the Bank of England notes: 'This is the reverse transaction – a deposit of sterling against the security of dollars. We would never agree to this'.

X

THE WIGGIN-LAYTON COMMITTEE (AUGUST 1931)

1. In May 1931, while the two committees of experts were meeting in Basel,¹ the first act of the European monetary drama of 1931 was unfolding in Vienna. The crisis immediately spread to Germany, undermined international financial relations – in which the City of London had a very keen interest, being a large creditor of the Central European countries – and destabilised the pound sterling.

Luther's disappointment at the failure of the Board of the BIS to establish a system of long-term credits for Germany at its meeting in March of that year has already been mentioned in Chapter VI. In succeeding months Luther continued to put the case for long-term credit without political strings, both to the French and British Governors and to the French Minister of Finance Flandin.* His position was the same as that of the Reich Government, but he met with opposition from Flandin.

Luther suffered a further rebuff at the Board meeting in July, which ruled out the possibility of a loan from the BIS itself or from the central banks associated with it;² he informed the

¹ The Currency Committee and the Credit Committee; see Chapter VII above.

* See K.E. Born, *Die Deutsche Bankenkrise 1931*, Piper, Munich 1967.

² The circumstances under which the appeal was made to the BIS and the succession of meetings between the German representatives and those of the creditor countries in an attempt to stem the financial crisis are described by E.W. Bennett in *Germany and the Diplomacy of the Financial Crisis, 1931*, Harvard University Press, Cambridge 1962, pp. 239-240. See also the correspondence, in July 1931, of Governor Harrison, who at the time was

German Government, which considered the other paths open to it. A loan from private banks to the Reichsbank seemed out of the question: such a loan was not permitted under current US legislation and in the United Kingdom funds were not available in the capital market. That left France, but French bankers, whom Luther had met on 10 July, pointed out that French public opinion was opposed to such an operation on account of the state of political relations between the two countries.³

The lack of external sources of finance meant there was no alternative to a suspension of payments, even for trade debts. President Hoover, who had already proposed a one-year moratorium on the payment of reparations from July onwards,⁴ now suggested to the British Government that a conference be called to deal with private loans to Germany.⁵ The British Government, led by the Labour Prime Minister MacDonald, took up the suggestion and invited representatives of the governments of the United States, Belgium, France, Germany, Italy and Japan to meet in London, together with their British counterparts. The British Government suggested that the German representatives – Brüning and Curtius – travel to London via Paris in order to meet

strongly recommending that Germany formulate a precise financial plan; in *Harrison Papers* – FED, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B1.

³ See Bennett, *op. cit.*, pp. 229-230.

⁴ The American President's proposal, announced on 20 June 1931, of a one-year suspension of all payments in respect of intergovernmental debts was opposed by France, which after a series of talks succeeded in negotiating an agreement on 6 July 1931, obtaining assurances that Germany would continue to meet part of her financial obligations (one of the conditions of the Franco-American agreement was payment of the unconditional annuity by Germany, which, however, would be reinvested in Germany by the BIS). Hoover's proposal, reviewed in the final agreement with the other countries concerned, was formalised in the London Protocol of 11 August 1931, whose essential points are summarised in the second BIS Annual Report; see BIS, *Second Annual Report, 1932*, pp. 25-26. On the terms of the Hoover moratorium, see 'Société de Banque Suisse', Bulletin no. 5/1931, in BIS Archive, 7.18(3) – *Documents Pierre Quesnay*, QUE 5, and the letter of 9 July 1931 from the French Minister of Finance, Flandin, to McGarragh, appended to the minutes of the meeting of the Board of the BIS on 13 July 1931, in BIS, *Minutes of the Meetings of the Board of Directors*. See also C.P. Kindleberger, *The World in Depression. 1929-1939*, The Penguin Press, London 1973, pp. 154-155, and Bennett, *op. cit.*, pp. 174-178.

⁵ *Ibid.*, pp. 246-247.

Laval, the French Prime Minister, and Flandin in an attempt to reach a preliminary agreement.

At the meeting with the Germans on 19 July Flandin offered them a ten-year loan of between \$500 and 1,000 million, to be issued in France, the United Kingdom and the United States, but in reality mainly in France. However, the offer was subject to severe political conditions; Germany was asked to renounce the rights it enjoyed under existing treaties and other agreements, such as the right to revision of the Young Plan, to renounce the idea of a customs union with Austria, and so forth.⁶

When Germany refused, the idea of the loan was carried to the London Conference, but it made no progress there either. The Conference closed with the recommendation

that 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-term credits into long-term credits.⁷

2. The BIS gave immediate effect to this recommendation; the Committee met in Basel in early August and presented its report on the 18 of the same month.⁸

The composition of the Committee reflected that of the Bank's Board of Directors. Ten persons were appointed from the ten countries then represented on the Board, namely the United States, France, Germany, the United Kingdom, Italy, Japan, Belgium, the Netherlands, Sweden and Switzerland. The representatives of

⁶ *Ibid.*, pp. 265-270.

⁷ The Conference ran from 20 to 23 July 1931. A copy of the Declaration of the London Conference with the recommendation, signed by MacDonald on 23 July 1931, is appended to the minutes of the BIS Board meeting of 3 August 1931; in BIS, *Minutes of the Meetings*, *op. cit.* On the preparations for the London Conference, see also Harrison's note of 21 July 1931, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B1, *Harrison Papers*, and BIS, *Second Annual Report, 1932*, pp. 20-21.

⁸ See BIS, *Minutes of the Meetings*, *op. cit.*, meeting of 3 August 1931. The Committee's report was published by the BIS, in *Report of the Committee Appointed on the Recommendation of the London Conference 1931*, Basle 1931, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B11.

France (Moreau), Germany (Melchior), Italy (Beneduce), Japan (Tanaka) and Belgium (Francqui) were also members or former members of the Board of the BIS, so that they viewed with the greatest reservation any proposal that would commit the BIS to granting medium-term credit that could jeopardise its liquidity. These appointments flew in the face of the request made at the London Conference by the German Chancellor, Brüning, that some agency other than the BIS should be responsible for choosing the members of the Committee in order to avoid confusion with the Special Advisory Committee⁹ foreseen under the Young Plan.

The conflict of interests with regard to reparations and the political tension between Germany and its European creditors once again led to the chairmanship being given to the American member, Wiggin, who at that time was Chairman of the Board of Directors of Chase National Bank.¹⁰ The Englishman Sir Walter Layton was elected to act as rapporteur; Layton, who was editor of 'The Economist', was undoubtedly the best versed of all the members in the problems of international monetary economics.

3. The Committee began its work on 8 August and concluded it ten days later after nine meetings. All of the meetings were held at the BIS, Melchior's proposal of a brief trip to Berlin to make direct contact with the German authorities having been considered but rejected. During the course of its work the Committee kept in touch with the British and American

⁹ Regarding Brüning's opinion, see the report on the Financial Committee's meeting of 12 August 1931, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B11. Had there been a request to suspend the transfer of Germany's conditional annuities, the Special Advisory Committee would have had to examine whether the economic crisis being experienced was serious enough to warrant a payments moratorium. See *Report of the Committee of Experts on Reparations (Young Committee, June 7, 1929)*, H.M.S.O., London 1929, part 8 and Chapter XI below.

¹⁰ Harrison deemed it important to specify to the President of the BIS in a letter dated 31 July 1931 that Wiggin would carry out his assignment as an independent member of the Committee and not as representative of the Federal Reserve System; see BIS Archive, 7.18(3) – *Documents Pierre Quesnay*, QUE 5. On Wiggin's selection, see also Harrison's note of 29 July 1931, in *Harrison Papers – FED*, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B1.

committees of banks negotiating a standstill agreement on bank loans to Germany.¹¹

The burden of the discussion and documentation fell mainly on Melchior, who performed his task with characteristic skill and good grace.

Melchior's approach to the examination of the two issues stated in the Committee's terms of reference was based on four premises: (1) that there was no immediate need for new credit to finance German imports, which were bound to contract as a result of Germany's current policy of deflation; (2) that it was impossible to establish whether loans would be needed to finance the budget, which for the time being had been brought back into balance, since it was difficult to estimate future revenue; (3) that it would be inadvisable to grant credit to increase the Reichsbank's foreign exchange reserves: an international rediscount credit would have quickly become an embarrassment to the Reichsbank when it fell due; and (4) that it would be useful to grant credits with a maturity of at least two years to raise the level of economic activity by means of investment in private industry and the railways.

The emphasis Melchior placed on the duration of credit created an immediate difficulty. The very idea of direct involvement in granting credit for longer than six months was repugnant to a committee in which nine of the ten members were representatives of central banks and commercial banks (only Beneduce was from a medium and long-term credit institution); it could not be reconciled with the nature of the liquid funds they administered and in some cases also ran counter to their statutes. The only solution would have been to issue securities on the capital market, but this path was also blocked by the crisis of confidence in Germany's solvency, the fall in the prices of bonds of the Dawes and Young Loans and the tense political atmosphere.

In these circumstances, the Committee's main inclination was to concern itself with the problems likely to arise in the foreseeable future, the next six months. 'By this means, the critical

¹¹ The reports on the Financial Committee's meetings are preserved in BIS Archive, 7.16 – *Baffi Papers*, RBL/B11. On the standstill agreement, see note 16 on p. 151.

period would be overcome, and it would then be possible to investigate the final needs of Germany in a clearer atmosphere'.¹²

But even this temporal limitation did not resolve the difficulties preventing the drafting of concrete proposals. It was observed that the reduction in German imports would create difficulties for the rest of the world and would trigger the imposition of prohibitive tariffs. The maintenance of a discount rate of 15 per cent was considered 'intolerable' for the German economy. It was also felt that on balance the confiscation of German assets abroad would be inadvisable; for the most part they were illiquid and served to support German exports.¹³

4. Force of circumstances led the Committee to consider that the only way out of the impasse was to revise the burden of reparations by widening the Committee's terms of reference, forming an *ad hoc* committee or convening the Special Advisory Committee foreseen by the Young Plan; the last course of action was possible only if requested by the German Government.

The Committee debated whether it would be advisable to include in its report a recommendation to convene the Special Advisory Committee; such action was not viewed favourably by Melchior. A majority opinion emerged that 'it would be beyond the terms of reference of the Committee to make any proposal as regards the summoning of the Advisory Committee. It would, however, be proper [...] to report that it was impossible to raise a loan at the present moment'.¹⁴

The final sessions of the Committee were concerned with coordinating with the work of the two committees of creditor commercial banks. The banks did not intend to grant their German debtors a standstill longer than the duration of the credits that the central banks would grant to the Reichsbank. The Committee proposed that these credits should have a maximum maturity of six months or, if statutory difficulties arose, three months, with an implied commitment to renew them for a further three.¹⁵ Before

¹² Meeting of 9 August 1931; in BIS Archive, 7.16 – *Baffi Papers*, RBL/B11.

¹³ *Ibid.*, meeting of 10 August 1931.

¹⁴ *Ibid.*, meeting of 12 August 1931.

¹⁵ *Ibid.*, meeting of 16 August 1931. As regards the course of the discussion between the private bankers on granting a standstill on German debts, see also

concluding its work, the Committee waited to hear news of the agreement reached between the negotiators of the standstill; this came through after midnight on 18 August.¹⁶ The report was sent to the President of the BIS, but it was not immediately sent to the Chairman of the London Conference, MacDonald, partly because some members (the French, in particular) considered that the Conference was 'dead' and partly because it was the BIS that had appointed the Committee.¹⁷

5. The Committee's report began by describing the macro-economic conditions in which Germany's payments crisis had broken out: 'a condition of exceptional world depression marked by a severe fall in wholesale prices on the international markets of the world, by a drastic reduction in international trade, [and] by very widespread unemployment in industrial countries'.¹⁸ It went on to note that 'no permanent improvement in the German situation can be looked for until the causes of the general depression have been removed' and that at the same time there could be no general recovery from the depression until the situation in Germany improved, given that country's importance in world trade. An aggravating condition specific to Germany was its external indebtedness; despite the wide margins of error in

what McGarrah reported to Harrison at the time, in particular in the letter of 17 August 1931, in BIS Archive, 7.18(2) – *Papers McGarrah/Fraser*, MCG3.

¹⁶ *Ibid.*, meetings of 16 and 18 August 1931; in BIS Archive, 7.16 – *Baffi Papers*, RBL/B11. The final document of the agreement established that credits would be frozen for a duration of six months from September 1931, with subsequent extensions, as stipulated between the committee representing German banks, the Reichsbank, Golddiskontbank and the committees of the creditor banks of 11 countries: the United States, Belgium, Czechoslovakia, Denmark, the United Kingdom, France, the Netherlands, Italy, Norway, Sweden and Switzerland. See *Agreement made between a Committee Representative of Banking Institutions in Germany, etc., 1931*, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B11.

¹⁷ However, it would be McGarrah, as President of the BIS, who would that same day (18 August) send the report of the Committee, appointed on the recommendation of the London Conference, to MacDonald, accompanied by a letter he had written; see the meeting of 18 August 1931, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B11.

¹⁸ See *Report of the Committee, op. cit.*

estimating the debt, the Committee considered the data supplied by the Germans to be reliable.

These indicated that in the seven years from 1924 to 1930 Germany's external indebtedness had increased to 25.5 billion Reichsmarks and had grown faster than its foreign assets by 18.2 billion Reichsmarks.

The net inflow of funds, together with an aggregate surplus of around 3 billion Reichsmarks from shipping and other services, had enabled Germany:

(a) to pay interest on her commercial debt amounting during the seven years to RM 2.5 milliards;

(b) to add to her holding of gold and foreign devisen to the extent of RM 2.1 milliards;

(c) to pay reparations amounting to RM 10.3 milliards; and

(d) to pay for a surplus of imports over exports (including deliveries in kind) to the extent of RM 6.3 milliards.

At the end of 1930 Germany's outstanding foreign debt totalled 25.5 billion Reichsmarks, or 15.8 billion after deduction of 9.7 billion on account of German investments abroad.

About 5.3 billion Reichsmarks of German investments abroad were at short term, but Germany's short-term liabilities amounted to 10.3 billion.

Of the latter figure, 7.2 billion Reichsmarks consisted of bank debt, two-fifths towards the United States and one-fifth towards the United Kingdom. Against liabilities of 7.2 billion Reichsmarks, German banks held liquid foreign assets of 2.5 billion Reichsmarks.

As a result of the withdrawal of foreign funds, Germany's short-term foreign debt had decreased from 10.3 billion Reichsmarks at the end of December 1930 to 7.4 billion at the end of July 1931. In addition to this withdrawal of 2.9 billion, there were other outflows due to 'selling by foreigners of long-term investments in Germany, mortgage bonds, etc., and purchasing by Germans of long-term or short-term investments abroad'. Including these items, the net outflow in the seven months was around 3.5 billion Reichsmarks; around 2 billion Reichsmarks was met out of the Reichsbank's reserves, around 1 billion out of the commercial banks' foreign assets and the remainder out of other German assets abroad. On

the other side of the coin, around 630 million Reichsmarks had been placed at the disposal of the Reichsbank by the BIS, central banks and an American syndicate via Golddiskontbank.

Even supposing that the adverse movement of the first seven months of 1931 were reversed, the report observed, there was no avoiding the conclusion that 'if the piling of Pelion on Ossa continues and the obligations of each year are added to the debt, there must be a steadily increasing charge under the heading of interest (including amortisation) on the commercial debt', and that Germany would be increasingly vulnerable to crises if part of the additional debt were borrowed at short term.

6. After having stated this inescapable consequence, and set it on one side as a question for the future, the report tackled two immediate problems:

Firstly, whether it is possible to prevent a further withdrawal of capital from Germany and to replace the short-term credits that become due; and secondly, whether it is necessary to replace from foreign sources all or part of the capital which has already been withdrawn.

On the first point, it should be remembered that the Committee made contact with the banking groups negotiating with Germany on the terms on which existing short-term credits would be maintained. At the invitation of the Committee, representatives of these groups and of German banks met in Basel on 14 August. After five days of study they agreed on a plan to extend the credits for six months from the date of signature of the agreement, subject to an arrangement being made with regard to the central bank credits. The commercial bank credits were to be guaranteed by Golddiskontbank and any disputes were to be settled by a committee set up by the BIS. The agreement did not directly cover the debts of the Länder and municipalities, totalling 355 million Reichsmarks.

On the second point, that is to say the consequences of the withdrawal of capital from Germany and the possibility of replacing it, the report set forth and discussed two courses of action Germany could take. The first was to make further sales of German assets abroad and the second was to increase Germany's export surplus. The report ruled out both, arguing as follows:

(1) The short-term foreign assets of German banks had already been reduced by 40 per cent 'and it is to be remembered that considerable banking balances abroad are needed for the normal conduct of international trading operations. Of the other short-term assets, some are needed for current trade and others are not easily realisable'. Similarly, it would not be easy to realise long-term assets, which amounted to around 5 billion Reichsmarks; moreover, 'they include enterprises such as branches of German industries established in foreign countries on account of tariffs or as a means of carrying on German trade'.

(2) Taking 1929 as a benchmark, a year when the current account had been in equilibrium, the attainment of an export surplus of 3 billion Reichsmarks for the year 1931 would entail reducing imports from 13.6 to 6.3 billion Reichsmarks, in other words by half, and preventing exports from falling by more than 4.3 billion, in other words from 13.6 billion Reichsmarks in 1929 to 9.3 billion in 1931. For Germany to achieve such a large surplus in relative terms on a volume of trade that was substantially lower than in 1929 'would involve a serious dislocation of her economic life'. It would be a 'policy of continued impoverishment and high unemployment brought about by restricted credit'. Such a policy would accentuate the worldwide economic depression and would provoke protectionist measures by other countries that would further reduce international trade. The Committee therefore considered it 'highly undesirable in the general interest that Germany should be compelled to adopt so drastic a solution'.

The Committee therefore concluded that it was in the general interest:

- (1) that the existing volume of Germany's foreign credits should be maintained, and
- (2) that part at all events of the capital which has been withdrawn should be replaced from foreign sources.

However, if the additional capital required were provided in the form of short-term credits Germany's difficulties would be aggravated when they became due in six months' time when the prolongation of existing credits expired. Hence the Committee considered that 'any additional credits provided should be in the form of a long-term loan and that such parts of the existing short-

term debt as may suitably be treated in this way should be converted into long-term obligations’.

7. The report then tackled the second, and politically more delicate, part of the Committee’s mandate, namely ‘the possibilities of converting a portion of the short-term credits into long-term credits’. The Committee attacked the problem by a process of successive approximation, at the end of which a positive response was made quite explicitly conditional on alleviating the burden of reparations.

The Committee endorsed the opinion of the London Conference that foreign investors’ lack of confidence in Germany was not justified by the economic condition of the country, especially as regarded the public finances and the trade balance. However, the low prices of German securities on the stock markets of the world demonstrated that a lack of confidence existed and made it impossible to place long-term German loans abroad.

What was the cause of this lack of confidence? Above all the political risk, in other words the tension in relations between Germany and the other European powers. However, the burden of Germany’s foreign obligations was also a factor.

So long as these obligations, both private and public, are such as to involve either a continuous increase in a snowball fashion of the foreign debt of Germany or alternatively a disproportion between her imports and exports on such a scale as to threaten the economic prosperity of other countries, the investor is unlikely to regard the situation as stable or permanent [...] We feel certain that the Government representatives at the London Conference, in taking the responsibility of recommending the bankers of the world that they should take concerted measures to maintain the volume of the credits they had already extended to Germany, fully realised that their proposal was not a solution of the problem but a means of gaining time, during which steps for re-establishing the credit of Germany might be taken.

The Committee considered it essential that before the six-month extension of short-term credits to Germany expired the governments should give the world the assurance that political relations were established on a basis of mutual confidence ‘and

that the international payments to be made by Germany will not be such as to imperil the maintenance of her financial stability’.

8. The report presented the case of Germany as the most forcible illustration of the fact that the world had been endeavouring to pursue two contradictory policies in permitting the development of an international financial system entailing heavy payments by debtors to creditors while at the same time erecting barriers to the international movement of goods. This criticism was directed especially at the largest creditor country, the United States, which had been pursuing a protectionist policy since 1921. Every financial remedy would be unavailing unless there were a radical change in this policy of obstruction. After appealing for a liberalisation of trade policies and protesting its lack of competence to offer suggestions of a political nature, the report concluded in terms which, in the light of the preceding analysis, constituted a thinly veiled call for a reduction in the burden of reparations: ‘We therefore conclude 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’.

XI

THE BENEDUCE COMMITTEE (DECEMBER 1931)

1. On 19 November 1931 the Reich Minister of Finance, Dietrich, sent the President of the BIS a Memorandum from the German Government (under Chancellor Brüning) requesting the convening of the Special Advisory Committee for which paragraph 119 of the Young Plan provided, arguing that as early as the beginning of June

the German Government became convinced that, in spite of the most severe retrenchment in Government expenditure and repeated increases in the burden of taxation, it would be incapable of continuing the payment of the annuities under the New Plan.

The Memorandum recalled the initiative taken in June by President Hoover of the United States in proposing a moratorium for all intergovernmental debts and reparations. The hope that this proposal would bring about a decisive turn in the world economy had not been realised; accordingly, the British Government had called the London Conference in July. The recommendations of the Conference had led to an extension of the rediscount credit accorded to the Reichsbank, to the Basel Standstill Agreement and to the report of the Wiggin Committee.¹ All of these measures were preparatory in nature, however. The Standstill Agreement, for example, stated that the contracting parties had approved the settlement pending a more permanent

¹ On these events, see Chapter X above.

solution of the problem of Germany's short-term foreign debt.² In the intervening months, the Memorandum continued, Germany's economic and financial situation had become exceedingly critical, to the point that the German Government had decided to call for the convening of the Special Advisory Committee and to make the declaration required by the Young Plan that 'they have come to the conclusion in good faith that Germany's exchange and economic life may be seriously endangered by the transfer in part or in full of the postponable portion of the annuities'. The Memorandum added that such a declaration did not do justice to the situation then obtaining, since the economic condition of the entire world had been fundamentally altered by a crisis without parallel. In conclusion, it urged that the Committee complete its work as quickly as possible 'in order that a Conference of those Governments which are competent to take the decisions then to be reached may at once be held'.³

2. The BIS acceded immediately to the request of the German Government by forming a committee of seven members nominated by the seven central banks entitled to appoint *ex officio* directors of the Bank under Article 28 of the Statutes. Four of the seven persons designated in this way – the Italian Beneduce, the Belgian Francqui, the German Melchior and the Japanese Nohara – were also members of the Board. These seven ordinary members coopted four additional members.⁴

The Committee met at the BIS from 8 to 23 December and appointed four sub-committees, which submitted reports on 1)

² See the copy of the Standstill Agreement preserved in BIS Archive, 7.16 – *Baffi Papers*, RBL/B11; see also Chapter X, § 4 above.

³ The contents of the Memorandum from the German Minister of Finance were notified to all the representatives of the BIS. See BIS Archive, 7.16 – *Baffi Papers*, RBL/B11. The document was appended to the Committee's final report on its work; see *Report of the Special Advisory Committee, December 1931, Annex I*, published by the BIS, in BIS Archive, *ibid*.

⁴ The three other ordinary members nominated by the central banks were: W. Layton (Bank of England), C. Rist (Bank of France) and W.W. Stewart (Federal Reserve Bank of New York). The four coopted members were: R.G. Bindschedler, H. Colijn, G. Diouritch and O. Rydbeck. See *Report of the Special Advisory Committee, op. cit.*

statistics regarding the servicing of Germany's external debt, as to both interest and amortisation; 2) German assets abroad; 3) the German budget; and 4) the Reichsbahn. It made use of extensive statistical documentation provided from official German sources.

The Committee presented its report, signed by the eleven members, on 23 December.⁵

3. The diagnosis that the Committee set out in the report was approximately the following: the crisis that had been afflicting the world economy for two years had had especially devastating effects on Germany. Germany had suffered a massive withdrawal of foreign credits, which had crippled the German banking system and made it necessary to impose stringent exchange controls. These in turn had accentuated the depression in economic activity. The crisis had led to the issuing of the Emergency Decree of 8 December containing measures without parallel in modern legislation.⁶

Germany was particularly susceptible to the crisis owing to the high level of its short-term liabilities, which could be estimated at the end of July at almost 12 billion Reichsmarks, of which 8 billion were banking liabilities. In the first seven months of the year Germany had suffered a withdrawal of short-term credit totalling 2.9 billion Reichsmarks. A further 1.2 billion of credits not covered by the Standstill Agreement had been withdrawn in subsequent months.

The outflow of short-term funds had been financed partly by

⁵ See *Minutes of the Meetings of the Special Advisory Committee*, meeting of 23 December 1931, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B11; see also *Report of the Special Advisory Committee*, *op. cit.*

⁶ On the German emergency decrees, see also below in this chapter. From July 1930, in an attempt to address Germany's crisis, the Brüning government had resorted to a series of deflationary emergency decrees aimed above all at defending exports and rebalancing the public accounts. The Decree of 8 December 1931 imposed unprecedented price and wage cuts, leading within three months to a lowering of the cost of living to approximately 8 per cent. See E.N. Peterson, *Hjalmar Schacht for and against Hitler. A Political Economic Study of Germany 1923-1945*, The Christopher Publishing House, Boston 1954, pp. 140-141.

the trade surplus. However, the surplus was due in part to the low level of domestic demand, and it was doubtful whether it would continue in view of external factors, including tariffs, exchange control measures in other countries, quotas and keener foreign competition due to the depreciation of sterling and other currencies.

The total outflow of foreign exchange in 1931 as a whole on account of reparation payments, servicing of the external debt and the withdrawal of foreign capital could be estimated at 7,200 million Reichsmarks, compared with a surplus of 3,000 million on the current account of the balance of payments. Hence there was a deficit of 4,200 million Reichsmarks to be financed by drawing on German assets abroad, rediscount and other official credits and the use of the Reichsbank's reserves. These had fallen from 2,685 million Reichsmarks at the end of 1930 to 1,161 million on 15 December 1931, despite the fact that during the intervening period the Reichsbank had obtained 630 million Reichsmarks under rediscount credits granted to it by the BIS and the central banks and to Golddiskontbank by an American banking consortium.

As a result, the percentage cover for the note issue had fallen from 58 per cent at the end of April to 25.6 per cent in mid-December, and to 11.7 per cent if the 630 million Reichsmarks in rediscount credits were excluded.

The commercial banks had resorted to central bank credit to meet the withdrawal of deposits. The Reichsbank's domestic bill holding had consequently increased from 1,520 million Reichsmarks at the end of April to 4,213 million on 15 December.

The scale of Germany's efforts to deflate in order to protect its external position was demonstrated by 1) the fall in the wholesale price index from 140 in November 1928 to 106 in November 1931, 2) the reduction in wages to the level of early 1927 under the Emergency Decree of 8 December, 3) the fall in the industrial production index from 100 in 1928 to 66 in September 1931, 4) the unemployment of around one-quarter of the work force (5 million out of 21 million in December 1931) and 5) the raising of interest rates, in the case of bank loans to prime customers from 8 per cent in 1930 to 12 per cent.

The fall in prices and economic activity would have reduced tax revenue by 40 per cent; it had been kept broadly unchanged

by greatly increasing tax rates and there was no scope for further increases. Sweeping reductions in expenditure had been made, but at the same time the Government had had to meet the increased cost of unemployment relief.

The decline in economic activity was reflected in the gross receipts of the Reichsbahn, which had fallen by 28 per cent between 1929 and 1931; as a result, the Reichsbahn's earnings were no longer sufficient to cover its liabilities in respect of reparations and debt charges.⁷

4. This comprehensive diagnosis was given in the first chapter of the report. The second chapter sought to identify the causes of the crisis. It observed that never in the previous hundred years had there been a crisis in which wholesale prices had fallen by 30 per cent, as they had in the last crisis, and that 'no effort to maintain prices – by whatever means it may have been attempted – has hitherto attained any success'.

The report went on to note that the reduction in the purchasing power of the mass of consumers had had an adverse effect on the operating profits of firms producing goods and services and had had repercussions on the liquidity and solvency of banks. This situation had in turn provoked a crisis of confidence in the banks and a consequent withdrawal of foreign capital from Central Europe. The exchange value of the currencies of some of these countries had been maintained in nominal terms only by means of exchange controls and by suspending part of their payments to foreign creditors, thus aggravating the crisis of confidence. To this monetary crisis was being added a trade crisis due to the widespread adoption of import restrictions.

⁷ Part of the reparations account annuities were covered by the Reichsbahn's contribution, a source of funding already built into the payment mechanism set up under the Dawes Plan and subsequently reused as per the criteria revised by the Young Plan. Although the agreements based on the Hoover proposal had come into effect in July 1931, the Reichsbahn was still required to make part of the payment, which had been recalculated using new methods and thereby reduced. See *Report of the Committee of Experts on Reparations (Young Committee, June 7, 1929)*, H.M.S.O., London 1929, part 8 (a); see also *Documentation from Official German Sources supplied to the Special Advisory Committee*, pp. 339-340; in BIS Archive, 7.16 – *Baffi Papers*, RBL/B12.

The report referred to some of the conclusions already reached by the Wiggin Committee to reiterate the point that a policy of trade restrictions was incompatible with the growth in foreign lending such as had been witnessed between 1924 and 1929, since ultimately the loans could be serviced only by exporting goods and providing services.

In the case of Germany, capital inflows of around 18 billion Reichsmarks had been partly offset by reparation payments amounting to about 10.3 billion. The part that had been used to finance investment had led to an increase in fixed capital, achieved using foreign funds lent technically at short term. A good part of the total investment had consisted in public sector infrastructure projects financed by borrowing at home and abroad. As a consequence, the withdrawal of these funds threatened not only the exchange rate but also the liquidity of German banks.

Overall, the Committee showed that it felt Germany was the victim of an adverse world economic cycle; it was critical of certain aspects of German policy, such as the financing of infrastructure investment with short-term funds and the lack of financial responsibility by local authorities, which were financed by transfers of a predetermined percentage of the tax revenues of the Reich.

5. The report emphasised that from July 1930 onwards the German Government had directed fiscal policy towards defending the stability of the currency by issuing a series of emergency decrees aimed at increasing tax revenues and reducing expenditure; among other things, these had reduced the salaries of public servants by more than 20 per cent, increased unemployment insurance contributions and reduced benefits. Government policy had also led to reductions in prices and private sector wages and in interest on long-term loans. Controls over banks' activities had been increased and lending by savings banks to municipalities had been restricted. Foreign exchange transactions had been centralised at the Reichsbank and all purchases of foreign exchange required prior authorisation; it had been made compulsory to sell all foreign exchange holdings to the Reichsbank. In the opinion of the Committee, 'the steps taken

to defend and to maintain the stability of the currency and the budget show [...] a resolute desire on the part of the German Government to meet the situation'.⁸

6. On the basis of its analysis, the Committee reached the conclusion

that Germany would be justified in declaring – in accordance with her rights under the Young Plan – that in spite of the steps she has taken to maintain the stability of her currency she will not be able in the year beginning in July next to transfer the conditional part of the annuity.

The Committee went further, however:

The Committee would not feel that it had fully accomplished its task and justified the confidence placed in it if it did not draw the attention of the Governments to the unprecedented gravity of the crisis, the magnitude of which undoubtedly exceeds the 'relatively short depression' envisaged in the Young Plan.⁹

The Young Plan, the Committee observed, with its rising series of annuities, had contemplated a steady expansion in world trade, not merely in volume but also in value, which in time would have reduced the relative burden of the annuities. The opposite had happened; world trade had declined in volume and by even more in value and the real burden not only of the annuity but also of all the payments fixed in gold had increased greatly. In these conditions, 'if the crisis by which Germany has been overwhelmed were not remedied, it would spread to the rest of Europe, destroy the credit system so painstakingly built up and create profound repercussions in other parts of the world'.

At this point the Committee echoed and confirmed the conclusions already reached by the Wiggin Committee: the

⁸ See *Report of the Special Advisory Committee, op. cit.*

⁹ The contingent nature of the depression was the condition provided for by the Young Plan to enable Germany to call for a moratorium on the payment of the conditional annuity. With this 'safeguard' provided for in the Plan, Germany would be able to address her economic problems without shouldering the burden of paying part of the reparations. See *Report of the Committee of Experts, op. cit., part 8 (e)*.

worsening of the crisis that the latter had feared had indeed come about, threatening economic disaster and jeopardising political stability. This assertion by the Beneduce Committee came a year after the success of the National Socialist Party in the elections of September 1930. In the words of the report: 'The economic decline which has taken place in the last two years, the increasing distress which it has brought in its train, have produced a general political instability from which an anxious world is suffering more and more'.

When governments came to examine the problem of German payments, they would have to take account of a number of points:

- 1) 'transfers [...] on a scale so large as to upset the balance of payments can only accentuate the present chaos';
- 2) 'the release of a debtor country from a burden of payments which it is unable to bear may merely have the effect of transferring that burden to a creditor country which, in its character as a debtor, it, in its turn, may be unable to bear';
- 3) 'the adjustment of all inter-governmental debts (Reparations and other War Debts) to the existing troubled situation of the world [...] is the only lasting step capable of re-establishing confidence'.

The second and third points were clearly directed at the US Government, which was loath to admit a link between the payment of reparations and the payment of war debts.

The Committee concluded with an appeal to governments: 'We appeal to the Governments on whom responsibility for action rests to permit of no delay in coming to decisions which will bring an amelioration of this grave crisis which weighs so heavily on all alike'.¹⁰

The next two years were to see the rise of National Socialism to power, a deepening of the economic crisis, the spread of bilateralism in trade relations and the abandonment of the gold parity of the dollar. We cannot know whether at least some of

¹⁰ The validity of the Special Advisory Committee's report was subject to its official recognition by the BIS in its capacity as Trustee of Creditors, as envisaged by the Young Plan. The Bank decided on 11 January 1932 to adopt the report, informing the governments concerned via McGarrah's letter of 4 January; BIS Archive, 7.16 – *Baffi Papers*, RBL/B11.

these disasters could have been avoided if the call for immediate action had been heeded. It was not: the Lausanne Conference was not convened until seven months later.¹¹

¹¹ The third BIS Annual Report, in May 1933, summarised the main events which, after the completion of the Special Advisory Committee's work in December 1931, led to a reconsideration of the Bank's role compared with that assigned by the Young Plan. The Lausanne Conference was held between 16 June and 9 July 1932 at the invitation of the governments of Germany, Belgium, France, the United Kingdom, Ireland, Italy and Japan. The Final Act of the Conference recognised the principles focused on by the Beneduce Committee and laid down the basis for settling the entire legacy of payments from the war as a condition for establishing a new international economic and monetary order. In Lausanne, the BIS was given the mandate to deal with issues connected with the renegotiation of reparations and the task of participating in preparations for the new world economic and financial conference on the reform of the monetary system, which would take place in London in June 1933. See BIS, *Third Annual Report, 1932-33*, pp. 23 ff.; the Final Act of the Lausanne Conference and the resolutions deriving from the new tasks assigned to the Bank were recalled at the 11 July 1932 meeting of the Board of Directors of the BIS. See also Chapter XII, § 8 below.

XII

THE SCHACHT AND FRANCQUI PLANS

1. The greatest contribution of ideas during the preparation of the Young Plan and the drafting of the Statutes of the BIS in Paris, Baden-Baden and The Hague from Hjalmar Schacht and Emile Francqui.

The division and antagonism between the two men were due to the unresolved territorial and financial disputes between Belgium and Germany (Eupen and Malmédy, the Belgian mark claim, reparations), but they both had a strong creative imagination and a mastery of the mechanisms of international finance and they were both motivated by the aim of developing international trade. They believed that credit acted as a catalyst, especially in relations with the less industrialised European countries that Delaisi called 'Europe B'¹ and with other continents, and held that the development of such relations should be promoted by means of investment in infrastructure financed by credit, at a time when the crisis had reduced the demand for productive investment in European industry to virtually nil.

In their proposals, both Schacht and Francqui allotted a substantial role to the BIS, as did Norman and Kindersley.

The crisis had affected the entire system of international payments: the settlement of trade transactions, international movements of private capital and even the system of exchange rates and convertibility obligations. Since the promotion and maintenance of an orderly system of settlements were among the objectives assigned to the BIS by its Statutes, it is not surprising

¹ See F. Delaisi, *La révolution européenne*, Toison d'Or, Brussels 1942, pp. 266-267.

that the architects of recovery plans should have given the Bank a pivotal role in their attempts to halt the disintegration of the previous order. At that time the staff of the Bank itself was also formulating proposals aimed at finding the means to combat the crisis while remaining consistent with the limitations laid down in the Statutes.

2. In his book *My First Seventy-Six Years*,² Schacht mentions that during the meetings of the Committee of Experts in Paris he suggested to Young that one of the tasks of the new Bank should be to finance the development of countries that were not yet industrialised. He set out his ideas in a document or Plan, of which he made two editions and which he sent to Young and some other members of the American delegation: Randolph Burgess, Walter Stewart and Shepard Morgan. Some years later Morgan, who was economic adviser to the delegation and a former Finance Director of the Office of the Agent General for Reparation Payments in Berlin, gave a copy to a German economist, Rolf E. Lücke.*

It seems that in the conversations with Young that led him to draft his Plan Schacht had insisted on the need to use credit to increase the openness of non-European markets for German exports, partly in the interests of peace. For that purpose, the Plan suggested the creation of a clearing house, which in the second edition became an International Settlements Bank. It would be set up by the governments of the seven countries principally concerned with the problems of reparations and war debts, the same countries that a year later were to subscribe the capital of the BIS. The German Government would provide the Bank with non-interest-bearing German Government bonds worth 5 billion Reichsmarks, which would become the property of the bank itself. The bank would open balances in its books in favour of central banks, governments, public authorities and other publicly guaranteed borrowers up to the value of the bonds, or indeed up to twice their value as reserves were accumulated. The recipients

² See Schacht, *My First Seventy-Six Years*, Allan Wingate, London 1955, pp. 248-250.

* This description of events follows Lücke's, published under the title *The Schacht and the Keynes Plans* in the Banca Nazionale del Lavoro 'Quarterly Review', vol. 38, 1985.

of credits would be able to use them only to make transfers to the holders of similar accounts at the bank.

In Lüke's account, based on his conversations with Shepard Morgan, the Plan was not favourably received because it incorporated a mechanism for creating credit which it was feared might have inflationary consequences. This, Lüke comments, 'was the same 'inflationary' argument which is regarded as being responsible for the failure of the Keynes Plan 14 years later'.

In his memoirs Schacht laments that the BIS did not venture into long-term credit and indicates a second reason for this omission: the French concern to confine the activities of the BIS mainly to the transfer of reparation payments.

3. Francqui produced more than one plan; he adapted them according to the turn of economic and political events and the nature of his interlocutors, who included President Hoover of the United States.

At the time of the Dawes Plan Francqui had been Minister without portfolio in the Belgian Government. Together with Camille Gutt, he had contributed to the preparation of the Young Plan as a Belgian member of the Committee of Experts.

Francqui had played an essential role in steering the Committee's proposals towards the creation of a bank that could be appointed trustee of the creditor governments in respect of German reparations.

In order to depoliticise the problem of the transfers, Francqui envisaged that the bank would be set up by central banks rather than governments. Its institutional objectives would include the development of international financial transactions and exchange rate stability, desirable objectives in themselves and likely at the same time to make it easier for the debtor country to fulfil its obligation to pay reparations. Together with the ideas of Schacht, whose primary aim was to develop mechanisms for financing German exports, these lines of thinking largely determined the shape of the Statutes of the BIS.

Although absent from Baden-Baden, Francqui had been very active in preparing the two Hague Conferences. He had held meetings at the highest level with British and French statesmen in Brussels, London and Paris to negotiate a number of issues:

the functions of the new Bank, whose role as an institutional link between reparations and war debts was in danger of being compromised by the American denial of any connection between the two problems; the Bank's location, for which the Belgians continued to propose Brussels in the face of German opposition; and finally Belgium's claims for reparations and the repayment of occupation marks.* When the BIS was established Francqui became a member of the Board of Directors, resigning in 1934 when he entered the Theunis government.³

4. Paragraph 43 of the Young Committee's Report stated that the transfer of reparations would require not only the restriction of Germany's imports but also an expansion of her exports. In view of that, the experts wrote, 'we envisaged the possibility of a financial institution that should be prepared to promote the increase of world trade by financing projects, particularly in undeveloped countries, which might otherwise not be attempted through the ordinary existing channels'.

In paragraph 74 they wrote:

In the natural course of development it is to be expected that the Bank will in time become an organisation, not simply, or even predominantly, concerned with the handling of reparations, but also with furnishing to the world of international commerce and finance important facilities hitherto lacking.⁴

The promotion of world trade and investment in underdeveloped countries was therefore among the objectives the experts assigned to the BIS, but it was contingent on the possibility of generating adequate flows of medium and long-term finance, and thus either raising long-term funds or transforming short-term deposits into long-term investments.

* Francqui's activities during this period are documented in detail in L. Ranieri, *Emile Francqui ou l'intelligence créatrice*, Éditions Duculot, Paris 1985. Ranieri had access to Francqui's archives.

³ The documents 'assembled by Baffi on the initiatives of the Belgian representative are preserved in the 'Francqui' dossier, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B12.

⁴ See *Report of the Committee of Experts on Reparations (Young Committee, June 7, 1929)*, H.M.S.O., London 1929.

The problem was discussed by the Board of Directors of the BIS at its meetings in early 1931;⁵ at the April meeting it was referred to a select committee that met in Brussels in May and June under Francqui's chairmanship. The other participants in the May meeting were Beneduce for Italy, Farnier for France, Kindersley for the United Kingdom and Melchior for Germany; Beneduce was absent from the June meeting and Addis attended in place of Kindersley.⁶

At its meetings in early May the Committee took stock of the various national institutions providing medium and long-term export finance, working on the premise that there was a problem in increasing the flow of such credit; it found that in Europe there were already around ten institutions in existence and that others were being created. In the view of the Committee, the BIS should 'support this movement, amplify it by its intervention and coordinate it'. To that end 'it would be desirable for the BIS to act as a central organisation for these institutions, where they might, if necessary, rediscount part of their middle term portfolio'.

The Committee suggested that the rediscounted paper should not have more than five years to run and that the BIS should provisionally set aside Sw.fr. 250 million for such operations. It also expressed the opinion that 'the adoption of a policy of the kind by the Board of the BIS would have the effect of multiplying the creation of institutions specialising in the financing of international trade'.

The Committee also foresaw that the allocation of Sw.fr. 250 million might subsequently prove insufficient; it suggested three possible courses of action to deal with this eventuality: (a) to call up a further tranche of the capital of the BIS; (b) to increase the subscribed capital of the Bank; and (c) to promote the creation of a new institution to which it would transfer its rediscount portfolio. The Committee also envisaged the possibility of exceeding the five-year maturity limit.⁷

⁵ See Chapter VI, above.

⁶ See BIS, *Minutes of the Meetings of the Board of Directors*, meetings of 9 March, 18 and 19 May and 8 June 1931, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B10.

⁷ See BIS, *Minutes of the Meetings*, *op. cit.*, meeting of 18 May 1931. See also *Report of the Committee created to examine the question of middle term credits. Annex XI/G, Brussels, May 4th and 5th*, *ibid.*

5. Under this ambitious programme, which became known to the press, the BIS would therefore have become a body for rediscounting both short-term paper for central banks and medium-term paper for export credit institutions, but the proposal did not win the approval of the Board, which considered it at its meeting on 18 May. At its further meetings in early June the Committee therefore opted, by a majority decision, to give responsibility for medium-term financing to a new organisation. The majority in the Committee (Francqui, Addis and Melchior) considered that the Directors and senior managers of the BIS should 'use their influence, each in his own sphere, with a view to facilitating the foundation of an organisation' that would have been known as the International Credit Bank. The new institution would have had the following features:

- its capital would have been Sw.fr. 500 million (the same as that of the BIS), 20-25 per cent paid up (again comparable to the proportion of 25 per cent in the case of the BIS);

- the shareholders would have been private banks, which would have subscribed the capital via their respective central banks;

- its objects would have been to stimulate a flow of international medium-term credit, either granted direct or via other types of intervention in financial operations directed towards the same end;

- it would have raised financial resources as the need arose by issuing international bonds worth between 3 and 5 times its subscribed capital;

- it would have established a continuous relationship with the BIS for purposes of mutual information, but without in any way engaging the responsibility of the BIS.

The French member, Farnier, dissociated himself from these conclusions, arguing that:

- the BIS should not give its patronage to the creation of an institution over which it could exercise no control;

- neither the subscription of the capital nor the issue of bonds would be possible in France.⁸

⁸ See BIS, *Minutes of the Meetings, op. cit.*, meeting of 8 June 1931. See also *Annex XII/D, Committee Meeting held in Brussels, June 3th and 4th, ibid.*

6. On 20 June 1931, only a few days after these fresh proposals from the Francqui Committee had been submitted to the Board, President Hoover called for a one-year moratorium on all intergovernmental debts. This led to the convening of the London Conference, whose final protocol in August provided for a moratorium for one year from July.⁹ In September it was agreed to suspend the payment of private debts for six months, until the end of February 1932.¹⁰

This dual suspension created an entirely new situation as regarded the plans for medium-term export finance as well. There arose the problem of assigning priorities to three different purposes to which the new credit flows could be applied: exports, the resumption of payments of intergovernmental debts or the unfreezing of commercial and banking credits.

7. The French Government had presented its own plan for reviving the movement of long-term capital to the Commission of Enquiry for European Union of the League of Nations a few days before the Brussels meeting.¹¹ The French plan stressed the scale of financial resources that could be raised for this purpose in the French market and placed the accent on the involvement of the League of Nations in the implementation of the plan, but did not specify the means to be used. Francqui, as the Belgian member of a sub-committee of economic experts set up by the Commission, had an opportunity to present his own plan in that forum as early as June;* this provided for the creation of an international medium-term credit institution.¹² In subsequent months, the sub-committee's report reached the Commission with a recommendation to the Council of the League of Nations to

⁹ See Chapter X, § 1 above.

¹⁰ On the Standstill Agreement, see Chapter X, § 4 and Chapter XI, § 1 above.

¹¹ See the note on the *Plan for Financial and Economic Reconstruction*, dated 16 March 1931, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B10.

* On the development of Francqui's proposal, see L. Ranieri, *op. cit.*, and M.L. Gérard, *Un projet belge pour le redressement économique de l'Europe: la Banque internationale de crédit à long et à moyen terme*, in 'Revue économique internationale', Octobre 1931.

¹² See BIS, *Minutes of the Meetings*, *op. cit.*, meeting of 8 June 1931. See also *Annex XII/D*, *op. cit.*, *ibid.*

have the Francqui plan examined as quickly as possible. The Council entrusted the task to the Financial Committee, with the collaboration of Francqui himself.

In the meantime, however, Francqui had been adapting his plan to suit the new situation of three different and competing objectives created by the dual moratorium.

In October he went to the United States, where he met President Hoover. In the version presented to the American President the institution became the trustee of an operation to convert short-term commercial and bank credits to Germany into medium-term notes issued to creditors, who would have been able to mobilise them at credit institutions in their own countries. The notes would have been guaranteed by the German Government or by major German industries and by the Reichsbank; the institution would have regulated the assignment of notes to creditors and would in turn have been able to guarantee them.

This plan for the conversion of short-term credit conflicted, however, with what the French considered to be their primary interest: the resumption of reparations. The priority they gave to this objective made them hostile to any diversion of financial resources to other purposes, such as the settlement of short-term debts.

Francqui was backed by the British, who were interested in recovering the short-term credits and ready to accept the cancellation of reparations.

8. The conclusions reached by the Beneduce Committee led to the calling of the Lausanne Conference, which was originally scheduled for January 1932 but could not convene until June owing to two ministerial crises in France, involving the Laval government in February and the Tardieu government in May.¹³

¹³ The solution reached in the Lausanne Agreement (16 June to 9 July 1932) was to resolve fully the reparations issue by reducing German payments to an amount of 3 billion marks in the form of bonds while insisting Germany fulfil her obligations under the Dawes Loan of 1924 and the Young Loan of 1930; the transitional arrangements provided for the continuation of the moratorium on payments owed by Germany until the entry into force of the Agreement, whose ratification was, however, subject to the settlement of the European powers' debts vis-à-vis the United States. In the event, the issue

Francqui's attention shifted towards the problem of reparations, with his proposal to Tardieu and Brüning to replace the unconditional annuity with 10 billion Reichsmarks in bonds issued by the Reichsbahn at a variable interest rate linked to an index of prosperity of the German economy.

When this proposal also failed, the Belgian delegation to the Lausanne Conference, of which Francqui was a member, put forward yet another plan based on the idea of mobilising the real assets owned by German public utilities by transferring them to a company whose capital would have been raised in the international markets. For countries other than Germany, the new Belgian plan provided for the establishment of an institution managed by the BIS that would have raised finance by issuing certificates guaranteed by gold reserves vested in a common fund.

These various plans for international financial cooperation – some brilliant, some adventurous and others ahead of their time – could not, and would not, find favour in the prevailing political climate of ardent nationalism.

dragged on for a long time and the Agreement was never ratified, thus allowing Germany to escape its obligations. See BIS, *Third Annual Report, 1932-33*, pp. 23-25, and BIS, *Fifth Annual Report, 1934-35*, p. 73. On the subject of the Lausanne Conference, see Chapter XI, § 6 above.

ABBREVIATIONS

AF	Archives de France
ASBI	Archivio Storico della Banca d'Italia
BEA	Bank of England Archives
BIS	Bank for International Settlements
BNB	Banque Nationale de Belgique
COBRI	Organisation Committee for the Bank for International Settlements
FED	Federal Reserve Bank of New York
art.	article(s)
b.	envelope
cap.	chapter(s)
<i>op. cit.</i>	quoted work
doc.	document(s)
fasc.	fascicule
MCG	McGarrah
QUE	Quesnay
RBL/B	Red/Blue Boxes
vol.	volume

EDITORIAL NOTE*

by Gabriella Raitano

Paolo Baffi's research into the history of the Bank for International Settlements

This text is the first part of Paolo Baffi's extensive research into the history of the BIS, the only part he was able to set down in manuscript form before he died in August 1989.

It is a document which Baffi considered essentially complete, the opening instalment of his research. Baffi worked on the task entrusted to him from January 1980 to July 1989. In the course of this lengthy period, he devoted a large portion of his efforts to locating historical material from primary sources with reference to the years from the end of the 1920s to the end of the 1970s, the period to be covered in the history of the Basel-based Bank.

The publication of Baffi's text is also intended to bear testimony to this collection of papers, which, once available to scholars for consultation, will be another rich seam for historians to mine. The wealth of historical documents assembled by Baffi is not limited to those he used for the manuscript of his history of the first years of the BIS and extends to subsequent years, forming a fund of archival material which, although made up mainly of copies, exists in its own right. Shortly before his death, Baffi wrote a long letter to Raymond Fin, the then Head of BIS

* I wish to thank Piet Clement and Edward Atkinson for their assistance in archival research at the Bank for International Settlements. Within the Bank of Italy I am especially grateful to Elisabetta Loche and Anna Rita Gresta, archivists in the Historical Research Office.

Archives who had helped him with his research, in which he entrusted his papers to Fin's care and added, 'il me semble de retenir un intérêt légitime dans la non-dispersion du matériel de quelque importance historique que j'ai assemblé pendant ces longues années plutôt que dans son ultérieure valorisation'.¹ It was his wish that the recommendations contained in the letter also be brought to the attention of 'des personnes qui voudront continuer ce travail'.²

The importance which Baffi attached to the documentary work and the difficulties involved in tracking down information are reflected in the composition of his collection of papers, which is preserved in Basel.

The Baffi collection comprises 36 files. Some binders contain his copious correspondence with figures from the world of finance and scholars he had met at the BIS or other international institutions. 'Mon éternel problème des sources',³ the search for additional information to resume his analysis of monetary phenomena and rekindle memories that might be of help in reconstructing events still insufficiently investigated by historians, is the subject of the correspondence, which makes up a fair portion of the collection. With his correspondents, Baffi tended to focus on his own interpretation as well as to encourage debate outside the specific area of his research. That he valued the personal nature of these exchanges, enriched as they were by new contacts, emerges very clearly from these letters, which are imbued with a genuine human warmth. His correspondents include Michael J. Balfour, Edward M. Bernstein, Sir George Bolton, Michel Camdessus, Cameron Fromanteel Cobbold, W. Peter Cooke, Werner Dannemann, Guillaume Guindey, Gottfried Haberler, Valéry Janssens, Frédéric-Edouard Klein, Rolf E. Lücke, Christopher W. McMahon, Scott Pardee, Leopoldo Pirelli, Louis Rasmisky, Gordon W. Richardson, Lionel Robbins, Robert Roosa, Günther

¹ 'There seems to me to be a legitimate interest in not breaking up the material – of some historical importance – which I have assembled over these long years, rather than in its subsequent utilisation'. Paolo Baffi to Raymond Fin, 31 July 1989, in BIS Archive, 1.1(8) – *History of the BIS*.

² 'People who may wish to continue this work', *ibid*.

³ 'My never-ending problem of sources'. Paolo Baffi to Michel Camdessus, 11 June 1986, in BIS Archive, 7.16 – *Baffi Papers*, RBL/B22.

Schleiminger, Frank Southard, Robert Triffin and Paul Volcker. Various exchanges of letters bear witness to the close collaboration with Frank M. Tamagna, who was entrusted with part of the research into relations between the BIS and the United States, which was to round off the research as a whole.

Much of the correspondence was conducted with historical archivists for purposes of documentary investigation, or with academics and officials of financial institutions in possession of sources useful to the research. In addition to Raymond Fin, one of his close collaborators at the BIS, Baffi consulted, among others, David Bush, Carl Backlund, Christine Cumming, Corradino De Novellis, Margaret L. Greene, John M. Keyworth, Denise Neumann and Wolfgang Rieke. Rosaria Giuliani Gusman served as Baffi's permanent assistant, often acting as intermediary in his relations with his various contacts.

The bulk of the Baffi collection consists of a set of historical documents, for the most part copies of the originals selected from the various archives consulted, assembled as a miscellany of sources of information on themes related to the history of the BIS. The papers were arranged in files and boxes following Baffi's own classification by chronology and subject. In many cases, the archive papers are accompanied by excerpts from literary works, press articles, bibliographical references, relevant legislation, copies of official acts, reports on international academic congresses, BIS Annual Reports and supplementary information. Also preserved in the Baffi collection are the wealth of statistics – the results of the work done by Anne Mati and of Renato de Mattia's special contribution on the development of the BIS's balance sheet – which were to have provided the figures underpinning the analysis of the Bank's business. Part of the collection consists of the work of Tamagna and Geminello Alvi, whose help Baffi enlisted at certain stages of his research. Various items attest to Baffi's ongoing dialogue at the BIS with Giampietro Morelli regarding the project's progress and to his working relationship with Paolo Omodeo Salè, while some of the boxes contain the material collated by Michael Dealtry, who was encouraged by Alexandre Lamfalussy to carry on the research after Baffi's death.

The archive material is often supplemented by Baffi's jottings clarifying the various organisational stages of the research, airing

solutions and doubts as to how to interpret the facts observed, and notes on and summaries of the literature consulted – a complex of sources that adds value to the material available and reflects the effort that went into bringing it all together.

This publication is completely faithful to the text left to us by Paolo Baffi; corrections have been confined to typographical errors and clerical errors such as incorrect names and dates. Baffi had wished the results of his work on the history of the BIS to be made available for academics interested in the subject. He was, however, unable to finish editing the script and revising parts of the final version for publication due to his state of health, which made it very difficult for him to undertake any activity.

The manuscript was almost totally lacking in footnotes and source indications. References to the archive documents and literature have been inserted wherever there was a clear specific link with the content of the text. In some instances, to help the reader, it was also considered useful to provide basic notes on matters which, although already extensively dealt with in other studies, relate to now distant events.

Most of the documents cited in the footnotes can be found in the Baffi collection in Basel; only in a few cases is reference made to other collections utilised by Baffi at the BIS and the Bank of Italy. The Baffi collection's copies of archive documents do not always indicate the classification number from the original archive. For this reason, and given the great difficulty of working back to the initial archive source, it was decided to use the Baffi collection's classification system. Original classification references have, however, been given when citing Bank of England documents which are not available as copies at the BIS and can only be identified on the basis of the notes (included in the collection) taken by Baffi in the course of his archive research in London.

The collection does not contain an exhaustive bibliography prepared by Baffi himself. However, the great many bibliographical references it contains relative to the history of the BIS have been brought together in a single general list that indicates the works consulted by the author in all his research and not just that for the period covered in this publication. It was decided to keep this material together in order to avoid diminishing its overall usefulness by breaking it down into shorter periods.

The works cited in the footnotes appear in a separate list. Those marked with an asterisk refer to citations already contained in Baffi's manuscript. Analogously, the footnotes inserted by Baffi are marked with an asterisk to distinguish them from those added by the editor.

LIST OF THE HISTORICAL ARCHIVES CONSULTED*

Archives de la Banque Nationale de Belgique: Secrétariat de la Direction de la BNB.

Archives of the Federal Reserve Bank of New York: Harrison Papers.

Archivio Storico della Banca d'Italia: Fondo Beneduce.

Bank for International Settlements Archives: 7.16, *Baffi Papers*; 7.16, *Foundation*; 7.18(2), *Papers McGarrab/Fraser*; 7.18(3), *Documents Pierre Quesnay*.

Bank of England Archives: BIS Staffing; Correspondence Montagu Norman; Montagu Norman Diaries.

Direction des Archives de France: Archive Pierre Quesnay.

Institut für Zeitgeschichte, Munich: H. Schäffer Diary, Schäffer documents.

Per Jacobsson Foundation: Per Jacobsson Diaries.

* Refers only to the archives consulted by Baffi in relation to the present publication, and not the broader archive investigations undertaken by the author (see also the *Editorial note*).

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* This is an indicative list drawn up on the basis of material from the Baffi Fund. All the works kept there have been included, in the belief that Baffi considered them of interest for consultation. Some are the volumes that Baffi himself collected; others can be found in copies of parts of the publications he consulted, summaries, notes and bibliographies prepared for particular aspects of the research.

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APPENDIX

Table A1. *Presidents of the Bank, Chairmen and Vice Chairmen of the Board of Directors and General Managers from 1930 to 1933**

Financial year	Presidents of the Bank	Chairmen of the Board of Directors	Vice Chairmen of the Board of Directors	General Managers
1930-31 and				
1931-32	Gates W. McGarrah	Gates W. McGarrah	Sir Charles Addis Carl Melchior	Pierre Quesnay
1932-33	Gates W. McGarrah	Gates W. McGarrah	Alberto Beneduce Carl Melchior	Pierre Quesnay
1933-34	Leon Fraser	Leon Fraser	Alberto Beneduce L.J.A. Trip	Pierre Quesnay

* See, Bank for International Settlements, *The Bank for International Settlements and the Basle Meetings. Published on the occasion of the Fiftieth Anniversary 1930-1980*, Basle 1980.

Table A2. *Members of the Board of Directors from 1930 to 1933**

Presidents or Governors of central banks	Other members of the Board of Directors	Alternates
Belgium		
L. Franck (1930-33)	E. Francqui (1930-33)	P. van Zeeland (1930-33)
France		
E. Moreau (1930-31)	Marquis de Vogüé (1930-33)	C. Moret (1930-31)
C. Moret (1930-33)	Baron Brinard (1930-33)	C. Farnier (1930-33)
Germany		
H. Luther (1930-33)	C. Melchior (1930-33)	W. Vocke (1930-33)
H. Schacht (1933)	P. Reusch (1930-33)	
Great Britain		
M.C. Norman (1930-33)	Sir C. Addis (1930-32) Sir O. Niemeyer (1932-33)	H.A. Siepmann (1930-33)
Japan		
	T. Tanaka (1930-32)	
	D. Nohara (1930-33)	
	S. Shimasuye (1932-33)	
Italy		
B. Stringher (1930)	A. Beneduce (1930-33)	V. Azzolini (1930-31)
V. Azzolini (1930-33)		P. Troise (1931-33)
Netherlands		
G. Vissering (1931-32)		
L.J.A. Trip (1931-33)		
Sweden		
I. Rooth (1931-33)		
Switzerland		
G. Bachmann (1931-33)		
United States		
	G.W. McGarrah (1930-33)	
	L. Fraser (1933)	

* The Chairmen and Vice Chairmen of the Board of Directors of the BIS are shown in Table A1.

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The idea that the new organization might not only provide technical assistance in the settlement of German reparations but also become the institutional forum for cooperation among central bankers met with resistance from some countries and came up against the complex problems in financial, economic and political relations between the end of the 1920s and the start of the 1930s, as the Great Depression loomed.

The events surrounding the initial activity of the Bank for International Settlements testify to the laborious efforts of its founders to define the Bank's field of action and the tools with which to overcome the problems connected with transfers and attain common objectives of monetary and financial stability. But as Baffi makes clear, the decision to create the BIS marked the start of the systematic and institutionalized cooperation among central banks that was to become increasingly effective and important especially after the Second World War.

