

THE HISTORY OF THE BANK FOR INTERNATIONAL SETTLEMENTS,
1930 to 1958

by

KEVIN OZGERCIN

A dissertation submitted to the Graduate Faculty in Political Science in partial
fulfillment of the requirements for the degree of Doctor of Philosophy,
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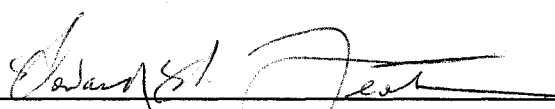
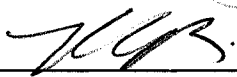
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Abstract

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by

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This dissertation aims to fill a wide gap in the literature on international financial institutions by presenting an analytical history of the Bank for International Settlements (BIS) between 1930 and 1958. It argues that analysis of the evolution of the BIS offers a powerful vantage point from which to comprehend deeper changes in the global political economy over the course of the twentieth century. Examination of the BIS provides insight into not only how and why the current system for governing global finance is not entirely novel but also how and why the activities of the central and commercial bankers who supported the BIS from the late 1920s to the late 1950s have influenced the development of global finance in recent decades. This dissertation is based on a wide range of previously unstudied archival sources, including documentation from the BIS Archive, BIS member central banks and private collections.

Preface

Max Weber impressed upon social scientists the problem of value judgments in causal analysis. For Weber, using clearly defined and openly debated methods and concepts were seen as reducing the influence of values in social science. Citing “problems of interest,” he urged scholars to clarify their relation to their subjects and objects of study. I see value in this technique.

My interest in international political economy as well as the role of international financial institutions dates back to my undergraduate studies in Politics, Economics and Society at the State University of New York at Old Westbury in the early 1990s. As national economies and financial systems became increasingly integrated throughout the 1990s, and as the sensitivity of one national economy or financial system to developments in others seemed to be intensifying, my own interest in the mechanisms available for governing international financial markets grew. The events surrounding the Asian financial crisis of 1997-98 stimulated my interest in international financial institutions in particular. It was during this period that I began to study the Bank for International Settlements (BIS) more intensely. Preliminary research made clear to me that although the BIS predated such visible financial institutions as the International Monetary Fund, the World Bank, and the Group of 8, the BIS was the least well known and least studied international financial institution.

Intent on filling this wide gap in the literature on international political economy, I decided to focus my dissertation on the BIS. After my research proposal was approved by the Political Science Department of the City University of New York Graduate Center, I began archival research on the BIS. Given that J. P. Morgan and his associates performed important roles in the founding of the BIS between 1929 and 1930, I spent two months in

the autumn of 2001 at the Pierpoint Morgan Library in New York City, where I studied the J.P. Morgan Papers and J.P. Morgan European Bank Papers. In the spring of 2002 I spent about three months researching the BIS in the Archive of the Federal Reserve Bank of New York, the international correspondent of the Federal Reserve System. There, I discovered hundreds of “highly confidential,” “secret,” and “strictly confidential” documents in files related to the BIS. From July 2002 to July 2003, an IIE Fulbright fellowship helped me gain a much deeper and more accurate understanding of the BIS by traveling to Basle, Switzerland, where the BIS is located. As a result of considerable political pressure from the Clinton Administration and the World Jewish Congress, the BIS quietly opened its Archive to researchers in 1998, sixty-eight years after it had opened for business. In addition to my work in Basle I spent a brief but rewarding period of time studying BIS files at the Bank of England in London. As important as the BIS Archive is to studying the history of the bank, my experience at the Bank of England confirmed my belief that extremely important collections of documents on the BIS are to be found outside the BIS Archive, in institutions that have maintained close relations with the bank since 1930. While the BIS Archive contains many duplicates of correspondence between, for example, member central banks and the BIS, there are many other letters and internal memoranda and reports on the BIS that cannot be found in Basle. These documents form an indispensable source of information, not just for understanding BIS operations over time, but also for understanding the thinking and motives of key central and commercial bankers and government officials who have maintained relations with BIS officials.

The Per Jacobsson Collection housed at the *Handschriftenabteilung* [Department of Manuscripts] of Basle University Library deserves special attention. As Economic Advisor to the BIS from 1931 to 1956, Per Jacobsson occupied a unique position both in the BIS and in

international finance more broadly. Few individuals in the Western world had quite the quality or level of access to central banking, commercial banking and government circles as Per Jacobsson. Before joining the BIS, Jacobsson had worked for the Economic, Financial, and Transit Department of the League of Nations, beginning in the early 1920s. After being a towering figure in the BIS for twenty-five years, Jacobsson left the BIS in 1956 and spent the last seven years of his life in Washington, D.C., where he was the third Chairman of the Board and Managing Director of the International Monetary Fund. Intellectually, Jacobsson was a classical European liberal thinker who spent most of his life championing the cause of a free market economy.

When Per Jacobsson left the BIS in 1956, he took with him his massive collection of writings. In his will Jacobsson bequeathed all his books, pamphlets, written and received letters, manuscripts, documents, diaries and notes to his daughter Dr. Erin E. Jacobsson. Upon Per Jacobsson's death in 1963, his daughter established a foundation, *Stiftung Per Jacobsson*, located in Basle. The foundation was charged with the responsibility of assuring that if Erin Jacobsson were to die before the year 2000, her father's wishes with regard to his collection of papers, especially their location and confidential nature, would be assured. Basle University, the university that granted Jacobsson an honorary doctorate in 1950, was appointed as custodian of the collection.

In 1974 Dr. Erin Jacobsson altered the statutes of the *Stiftung Per Jacobsson*, reducing the life of the foundation from 2000 to 1980. She did this with the intention of making her father's collection of papers freely accessible to "*bona fide*" students after that date. From 1963 to 1980 the collection was completely inaccessible to the public. Only Jacobsson's daughter could grant access. When the terms of the *Stiftung* came to an end in 1980, Erin

Jacobsson turned over the keys to the collection, which only she had possessed, to the administration of Basle University Library's Department of Manuscripts.

During the 1970s Erin Jacobsson traveled from her home and university life in England to Basle to consult her father's papers for academic work, namely the preparation of the only existing biography of her father, which she completed in 1979.¹ According to her wishes, from 1980 onwards the Jacobsson collection was to be accessible to *bona fide* students. However, Erin Jacobsson instructed Dr. Edmund Wiss, who was responsible for the collection, not to publicize its opening. Likewise, the BIS asked the collection's custodians to be selective in granting access. Journalists were especially barred from viewing the collection. Consequently, only one person was granted access to the Per Jacobsson Collection between 1980 and 1983 – a BIS staff member.

In 1984, the BIS wrote a letter to the library requesting that the collection be transported from the Library's Department of Manuscripts to the BIS Archive and placed under its control. However, the Library's archivists refused the BIS's request, saying that that it was the intention of Per Jacobsson for his papers to remain in the public domain. The archivists decided that "it was not their place as representatives of a public institution to correct history."² Since 1980, only a small number of researchers have been able to access the collection.

In 1998, after the question of the fate of gold looted by Nazi Germany received renewed world-wide attention, Dr. Piet Clement and Mr. Edward Atkinson, Head of Library and Archive Support and Archives Assistant of the BIS respectively, wrote a letter to the head of the Department of Manuscripts, Dr. Martin Steinmann, requesting permission to go

¹ Erin E. Jacobsson, *A Life for Sound Money: Per Jacobsson* (New York: Oxford University Press, 1979).

² Interview with Dr. Edmund Wiss, March 4, 2003.

through the collection from top to bottom. When Clement and Atkinson met with Martin Steinmann and Edmund Wiss of the library, they were told that the library needed a “procedure” to ensure “the integrity of the collection.” The procedure was intended to ensure “that no papers would be removed from the collection while they worked on it.”³ Clement and Atkinson never returned after that day.

The importance of the Per Jacobsson Collection to chronicling the history of the BIS, including dealings with Nazi Germany, Switzerland and the United States during the Second World War, can hardly be exaggerated. While I draw on a wide range of sources, this dissertation represents the first attempt I know to construct an account of the history of the BIS by drawing on Per Jacobsson’s reports, correspondences and diaries.

³ Interview with Dr. Edmund Wiss, March 4, 2003.

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I would like to remember my parents, Ahmet Vedat Özgerçin and Patricia Ann Ozgercin, who taught me the value of hard work. Their memory continues to be a source of inspiration to me. Special thanks to my wife, Shelly Ann, whose love and understanding have imbued my work with a greater sense of purpose. Close friends and family also formed an important source of encouragement. I am particularly grateful to Howard H. Lentner for serving as my Dissertation Supervisor and for being such a supportive, insightful and trusted mentor over the past several years and to Frances Fox-Piven and Leo Panitch for being constant sources of inspiration and insight. Stephanie Golob, Benjamin Rivlin and Thomas Weiss provided me with helpful feedback in connection with my dissertation defense. Thanks to Eric Helleiner, Irving Leonard Markovitz, Louis Pauly, Larry Peterson, and Tony Porter for commenting on Chapter 2. I am grateful to Georg Kreis, Swiss Historian and Director of the EuropaInstitut in Basle, who provided me with quiet office space in the elegant villa that houses the institute. During my year in Switzerland I also benefited from several stimulating discussions with Gian Trepp, an investigative journalist and writer, who published a controversial yet telling book on the BIS during the Second World War. I also benefited from several conversations about Swiss banking history and archival collections with Mario König, a Swiss social historian. Thanks to Blake Eskin, an American writer, for introducing me to Simon Erlander, a Swiss historian and journalist, who drew my attention to Trepp and König.

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Chapter 1

Introduction

As scarcely known as it is today, the Bank for International Settlements (BIS) has been tagged with the phrase “the central bankers’ central bank.” While the BIS has served as an exclusive club for central bankers for nearly seventy-five years, and has contributed tremendously to European monetary unification, the phrase underestimates what the BIS has contributed to global finance since it was established in 1930. On January 8, 2001, at an Extraordinary General Meeting held at the bank’s headquarters in Basle, Switzerland, BIS shareholders decided to end the bank’s seventy-one-year policy of allowing private individuals and banks to own stock in the BIS. In justifying this move, the BIS announced that its investment activities ought not to be designed to “maximize the return on the financial investment of its shareholders but rather to utilize its resources in fulfilling its public interest mission.” The bank continued: “[t]he restriction of its shareholdership solely to central banks is therefore necessary to enable the BIS better to attain these objectives, all the more as the existence of a small number of private shareholders whose interest is essentially financial is no longer in conformity with the international role and future development of the organization.”¹ Consequently, in 2001, the BIS decided to exercise its statutory right to forcefully buyback the portion of its shares that were owned not by member central banks but by private investors. While the forced buyback of shares held by the public has largely been a formality, thereby not resulting in a fundamental change in the bank’s internal and external operations, the move offers a window for understanding not just the BIS’s evolution, but also historical antecedents of today’s global financial system.

¹ The BIS press release announcing the forced buyback of privately-owned shares in the BIS can be found at: <http://www.bis.org/press/p010108.htm>.

It is widely believed today that the multilateral system for regulating markets and harmonizing government monetary policies, as well as the disciplining effect of free and open capital markets on national economic policies, have their origins in the post-World War Two experiment in international economic institution building and the seemingly sudden empowerment of financial capital since the 1970s. However, analysis of the genesis of the BIS offers a unique vantage point from which to comprehend deeper changes in the global political economy over the course of the twentieth century. Analysis of the BIS provides insight into not only why the current system for governing global finance is not entirely novel but also how and why the activities of the central and commercial bankers who supported the BIS from the late 1920s through the late 1950s, have helped to shape the neoliberal financial order that has obtained in recent decades.

As this dissertation will demonstrate, the activities of the BIS and its supporters from 1930 to 1958 foreshadowed and facilitated the reemergence of particular international monetary arrangements and ideas that have become hallmarks of today's global financial order. From the time of its inception, the BIS has represented a force for classical liberal, and later neoliberal, ideas in international financial affairs. Prominent among these ideas is the view that there should be minimal government intervention in the economy and that central bankers and prominent commercial bankers have important roles to perform in managing a free and open multilateral order. Indeed, basic features of today's global political economy – solidarity among central bankers as regulators of global finance; belief in the importance of private financial experts in the setting of standards and rules governing global finance; matured capital markets; high capital mobility; independent central banks; disciplined monetary policy; multilateral coordination of state monetary policies; and the dominance of liberal, and now neoliberal, ideas in international financial affairs – have their

roots in the classical liberal era before the Great Depression, which culminated in the creation of the BIS.

Founded on the eve of the Great Depression, between February 1929 and January 1930, the BIS represents a particular mode of global financial governance: a partnership between central bankers and prominent commercial bankers sitting side by side and sharing a common interest in fostering world economic growth and stability. As an interface between states and markets, the BIS was founded on the classical liberal model of central bank activism that had widespread legitimacy during the 1920s. The widespread acceptance of liberal ideology in international financial affairs at the time of the BIS's founding reflected the dominance of bankers, central as well as commercial, in orchestrating international responses to financial crises. The economic shock of the Great Depression, which engendered the Keynesian revolution of the early 1930s, marked an important turning point in the development of the global political economy during the twentieth century and, in turn, the development of the BIS. The authority and legitimacy of bankers, along with the liberal policies that they advocated and practiced, waned, as governments responded to the mounting economic and social turmoil by reasserting their full authority over domestic and foreign economic policymaking. The classical gold standard, coupled with the belief that peace and economic prosperity were best built on the foundation of free and open capital markets, quickly became discredited. Meanwhile, the BIS was the embodiment of classical liberal ideas in the area of finance.

As this dissertation will show, the discrediting of the BIS as an instrument of central bank cooperation in the early 1930s coincided with deeper changes in relations among governments, central banks and prominent international bankers. The economic shock of the Great Depression encouraged a fundamental rethinking of the role of government in the

economy and how relations among these three groups of actors should be structured. The diminution of the authority and power of bankers in the regulation of global finance, as well as the rise in stature of treasury representatives, occurred not only in the enlarged government control over the international movement of capital, but also in the brokering of international monetary agreements. While before the Great Depression this activity almost exclusively fell under the purview of central bankers, the emergence of government treasuries in managing international finance beginning in the early 1930s was exemplified by the Tripartite Agreement of 1936. It was in this case that the treasuries of France, Britain and the United States brokered an agreement to stabilize the value of the franc, the pound and the dollar. From that point forward, treasury officials solidified their control over international financial decision-making. Accordingly, the latitude for independent central-bank cooperation through the agency of the BIS, which had already been limited throughout the 1930s, became even more circumscribed. This trend was compounded by the outbreak of war in Europe in 1939, when the monthly meetings of central bankers were suspended for the duration of hostilities.

As with all major wars, there was a concerted, if contentious, international effort during the war to reestablish international economic and financial relations afterwards. These negotiations culminated in the United Nations Monetary and Financial Conference at Bretton Woods in July 1944. Dominated by treasury representatives, particularly from the United States and the United Kingdom, the Bretton Woods Conference gave rise to a international monetary order that was considerably different from the classical gold standard. Through their treasuries, governments were granted the right to place controls on the international movement of capital, capital markets were to have virtually no role in determining the value of currencies, and new institutions were created and linked to

treasuries, not central banks, so that governments could collaborate politically in managing international economic and financial relations in accordance with their national developmental goals.

Despite the considerable degree of authority and influence over international financial policymaking that central bankers surrendered to treasury officials in the domestic and international setting, by no means were bankers, central and prominent commercial bankers alike, insignificant actors in government decision-making. Rather, as analysis of the evolution of the BIS reveals, the bankers gradually regained their authority and influence in national economic policymaking in the advanced industrialized countries beginning in the late 1940s. In addition, the reemergence of bankers in the functioning of the broader international financial system from the early 1950s onward resulted in the resurgence of the BIS as an effective factor in international finance. Over the course of the 1950s, the gradual resurrection of financial orthodoxy in domestic and international economic policymaking coincided with the BIS's increased role in facilitating the restoration of convertibility among European currencies by the end of 1958. The return to convertibility in Western Europe in the middle of the 1950s, in turn, marked an important turning point not only in the evolution of global finance during the twentieth century, but also in the history of the BIS.

Inspired by the desire to build a free and open international financial order, the founders of the BIS clearly had in mind broader system-management functions for the BIS. Intergovernmental disputes over war debts and reparations arising from the First World War provided the occasion, but by no means the sole purpose, for creating an international financial institution in the BIS. Rather, the BIS's founding bankers possessed a profound understanding of the need for well-organized and efficient international institutions, whose *raison d'être* would be management of the destabilizing effects of expanding world markets for

trade and finance. Indeed, the BIS was intended to promote and facilitate the stable development of a modern global financial system. It therefore comes as little surprise that, in today's world of highly active and integrated financial markets, the BIS not only remains the principal center for central bank cooperation; it also serves as the principal center for the creation of standards and rules for promoting market discipline and stability.

In a world ever more committed neoliberal policies in the area of global finance, including market-determined exchange rates, the stability of financial markets has become an increasingly pressing issue. Examining the origins, evolving mandates and impact of international financial institutions like the BIS provides a powerful vantage point from which to explore deeper changes in the world economy. It is not coincidental that the International Monetary Fund, the World Bank and a number of other formal and informal institutional arrangements currently are at the heart of policy and academic debate on the new “architecture” of international finance. That the BIS has been largely overlooked in academic and policy debate is true; that this situation has resulted from the BIS's lack of importance is not. The remarkably low profile the BIS has kept historically, the premium central bankers place on secrecy in conducting their financial operations, and the lack of public access to BIS officials and BIS-related documentation account for that.²

Lastly, it is important to be clear about the aim of this dissertation. *The aim of this dissertation is to write an analytical history of the Bank for International Settlements from 1930 to 1958, not a history of international finance during that period.* I therefore draw on historical events selectively in the pages that follow, taking the BIS as the primary object of analysis.

² I include here the BIS files of member central banks and the private collections of bankers who have worked with or at the BIS. Many BIS member central banks have begun loosening restrictions on their files on the BIS.

Literature Review

A traditional literature review on the BIS is complicated by the fact that despite being the oldest international financial institution and the principal center for central bank cooperation, remarkably few studies of it exist. Indeed, while the BIS is regularly mentioned in passing in studies of international financial institutions and international political economy more generally, it has not been the object of in-depth, academic study for several decades.³ This situation stands in stark contrast to the relative overabundance of studies of such post-Second World War institutions as the International Monetary Fund and the World Bank. The dearth of studies on the BIS has resulted from the lack of public access to the bank's archive between 1930 and 1998. But it has also resulted from the BIS's long-standing policy of avoiding publicity of any kind. That BIS operations remain undetectable to so many, and that the bank generally remains an enigma even to specialists of international finance, comes as no surprise. In banking – central as well as commercial – principles of trust, confidence, discretion and secrecy are highly and widely valued. This dissertation thus aims to fill a wide void in the empirical literature on international financial institutions.

Of the limited number of full-fledged academic studies that exist on the BIS, most constitute official histories, written by current or former BIS officials or commissioned historians and economists.⁴ Based largely on BIS Annual Reports, these studies typically provide a technical overview of the organization, covering its functions, management and

³ See, for example, Frank Costigliola, "The Other Side of Isolation: Establishment of the First World Bank, 1929–30," *Journal of American History*, 61 (December 1972); Henry Hans Schloss, *The Bank for International Settlements Reconsidered* (Ann Arbor: Michigan University Press, 1970); Henry Hans Schloss, *The Bank for International Settlements: An Experiment in Central Bank Cooperation* (Amsterdam: North-Holland, 1958); Roger Auboin, *The Bank for International Settlements, 1930-1955* (Princeton: Princeton University Press, 1955); and Eleanor Lansing Dulles, *The Bank for International Settlements at Work* (New York: MacMillan, 1932).

⁴ At the time of this writing, the BIS is preparing a volume on its history for its 75th anniversary in May 2005. The volume is officially being written by Professor Gianni Toniolo. Informally, Dr. Piet Clement is assisting Professor Toniolo in preparation of the volume.

departments. In addition to being official histories, these studies tend to be based on the assumption that economics and politics are separable.⁵ In other words, they study the BIS primarily from a financial and economic vantage point, and they discount, or ignore entirely, the impact of the interaction of economic and political activity on the BIS. By contrast, this dissertation departs from the premise that politics and economics are so closely intertwined, particularly in the international sphere, that the two areas of activity need be considered inseparable. To attempt to understand the BIS by dealing with economics and finance independently of politics is to risk missing the most insightful and significant causes and consequences of BIS operations. As we will see, analysis of the BIS between 1930 and 1958 is quite illustrative in this regard. Finally, of those studies that do not represent official histories, not one is based on research at the BIS.⁶ This dissertation, in contrast, is based on a wide range of primary sources, including documentation from the BIS, BIS member central banks and private collections.

Despite the absence of an academic literature on it, the BIS poses important analytic issues for the study of international political economy. Why are international financial institutions created? Why do institutions take a particular form or design? Are states always the leading actors in creating and maintaining such institutions? Why are particular

⁵ See, for instance, Gunter Baer, "Sixty-Five Years of Central Bank Cooperation at the Bank for International Settlements," in Carl L. Holtfrehrich, eds., *The Emergence of Modern Central Banking from 1918 to the Present* (Aldershot: Ashgate, 1999); Piet Clement, "The Bank for International Settlements during the Second World War," in British Foreign Office, *Nazi Gold: The London Conference* (London: The Stationary Office, 1997), pp. 43-60; Bank for International Settlements, *The First Fifty Years of the Bank for International Settlements* (Basle: BIS, 1980); and Roger Auboin, *The Bank for International Settlements, 1930-1955* (Princeton: Princeton University Press, 1955).

⁶ James Baker, *The Bank for International Settlements: Evolution and Evaluation* (Westport: Quorum Books, 2002); Paul Eatwell and Lance Taylor, *Global Finance at Risk: The Case for International Regulation* (New York: The New Press, 2000); Beth A. Simmons, "Why Innovate? Founding the Bank of International Settlements," *World Politics*, 45 (1993), pp. 361-405; Frank Castigliola, "The Other Side of Isolation: Establishment of the First World Bank, 1929-30"; Guiseppi Papi, *The First Twenty Years of the Bank for International Settlements*. Rome: Bancaria, 1951); Paul Einzig, *The Bank for International Settlements* (London: Macmillan, 1932.); John Ford Darling, *A New International Currency: The Bank for International Settlements* (London: London General Press, 1929).

institutions created rather than others? Why do states restructure or reform existing institutions? What explains the interests and goals of international financial institutions?

Contemporary approaches to international political economy rely heavily on Weberian conceptions of the state and authority. The existence of centralized authority in the form of a government in the national setting, and the absence of such a global agency in the international domain, is seen as justification for viewing these spheres as being fundamentally discrete and politically dissimilar.⁷ “The monopoly of legitimate physical violence within a given territory,” for Weber, “is the primary virtue of the state.”⁸ It follows that as states claim legitimate authority, they can rely on their citizens habitually to abide by established laws, lest they be subjected to physical coercion.

Historically, states have been presumed to be the sole source of legitimate, public authority in the international system. Consequently, much research and theorizing of international political economy presumes states to be the primary actors in the international arena. While this theoretical assumption has yielded some important insights, it has also resulted in an overemphasis on state behavior and interstate relations and an underemphasis on the activities of other non-state actors. Meanwhile, much of international relations scholarship has tended to oversimplify states, treating them as rational unitary actors with fixed preferences and beliefs.⁹ However, in recent decades, there has been a more obvious

⁷ Kenneth N. Waltz, *Theory of International Politics* (New York: McGraw-Hill, 1979), pp. 102-116.

⁸ From Max Weber, “Politik als Beruf,” translated in Bernard E. Brown, eds., *Comparative Politics: Notes and Readings*, 9th ed. (Orlando: Harcourt, 2000), p. 147.

⁹ Richard Ashley has pointed out that liberal institutionalism, like realism, is by its nature utilitarian and rationalistic. Richard K. Ashley, “The Poverty of Neorealism,” in *Neorealism and Its Critics* (New York: Columbia University Press, 1986), pp. 255–300. See also, Kenneth N. Waltz, *Theory of International Politics* (Reading, MA: Addison-Wesley, 1979); John Mearsheimer, “The False Promise of International Institutions,” *International Security*, 19 (Winter 1994–95), pp. 5-49; Arthur Stein, Coordination and Collaboration: Regimes in an Anarchic World,” in David A. Baldwin, ed., *Neorealism and Neoliberalism: The Contemporary Debate* (New York: Columbia University Press, 1993), pp. 29–59.

and growing disconnect between empirical evidence and academic treatment of authority in international financial affairs. The assumption of anarchy and its effects on state behavior has been problematized.¹⁰ Studies have shown non-state actors performing authoritative roles in the international system, challenging traditional conceptions of state sovereignty. According to Hall and Biersteker, these actors “perform the role of authorship over some important issue or domain,” and “[t]hey claim to be, perform as, and are recognized as legitimate by some larger public...as authors of policies, of practices, of rules, and of norms.”¹¹

Much of the literature on the state itself conceptualizes sovereignty in terms of control, or the ability of states to control activities within and across national frontiers.¹² Defining sovereignty in terms of authority, Janice Thompson coined the phrase “meta-political authority,” to say that “states do not simply have ultimate authority over things political; they have the authority to relegate activities, issues and practices to the economic, social, cultural and scientific realms of authority.”¹³ Yet, the primary shortcoming of rationalist interpretations of authority has been their tendency to view authority as a

¹⁰ Alexander Wendt, *The Social Construction of International Politics* (Cambridge: Cambridge University Press, 1999); Thomas J. Biersteker and Cynthia Weber, eds., *State Sovereignty as a Social Construct* (Cambridge: Cambridge University Press, 1996); Alexander Wendt, “Anarchy Is What States Make of It: The Social Construction of Power Politics,” *International Organization*, Vol. 46 (Spring, 1992), pp. 391-425; and Helen Milner, “The Assumption of Anarchy in International Relations: A Critique,” *Review of International Studies*, 17 (1991), pp. 67-85.

¹¹ Rodney Bruce Hall and Thomas J. Biersteker, “The Emergence of Private Authority in the International System,” in Rodney Bruce Hall and Thomas J. Biersteker, eds., *The Emergence of Private Authority in Global Governance*. (Cambridge: Cambridge University Press, 2002), p. 4.

¹² Stephen Krasner, *Sovereignty: Organized Hypocrisy* (Princeton: Princeton University Press, 1999); Eric Helleiner, “Electronic Money: A Challenge to the Sovereign State?,” *Journal of International Affairs*, 51 (Spring 1998), pp. 387-409; Saskia Sassen, *Losing Control: Sovereignty in the Age of Globalization* (New York: Columbia University Press, 1996); Peter Evans, “The Eclipse of the State? Reflections on Stateness in an Era of Globalization,” *World Politics*, 50 (October 1997), pp. 62-87; David M. Andrews, “Capital Mobility and State Autonomy: Toward a Theory of International Monetary Relations,” *International Studies Quarterly*, 38 (1994), pp. 193-218.

¹³ Janice Thompson, “State Sovereignty in International Relations: Bridging the Gap Between Theory and Empirical Research,” *International Studies Quarterly*, 39 (1995), pp. 214.

phenomenon that is “monopolized,” exercised by private-sector actors only when it is implicitly or explicitly delegated by states.

The dominance of this approach has led many to overemphasize the role of states in shaping outcomes in the international system. Even though states have historically exercised legitimate authority in national settings, it does not logically follow that the existence of state authority in the international system precludes the exercise of authority by actors other than states. Analysis of the founding and subsequent operations of the BIS demonstrates that theoretical gains in the understanding of international financial institutions and the nature of international relations can be made by allowing for the operation of authority outside the parameters of the state.

A growing number of authors are attempting to conceptualize the emergence of nonstate actors in international affairs. Some have pointed to the existence of “private authority.”¹⁴ States, as Thompson asserts, may very well even possess “ultimate authority.” But insofar as states defer to or consult with market actors in devising public policies or effecting desired outcomes in markets, such behavior itself attests to the existence of authority outside the parameters of the state. As this dissertation aims to show, there is vast historical evidence of private-sector actors performing public functions and of governments complying with normative appeals for such action based on the belief that doing so is legitimate.

The authority of private bankers is particularly observable in the area of banking and finance. Historically, commercial banks have regularly been central to the process of

¹⁴ Private authority should not be conflated with private power, which in relational terms connotes influence. The basic difference between the two concepts is that private authority is based on the combination of *power* and *legitimacy*. This definition of private authority draws on that of Hall and Biersteker, eds., p. 4. Also see Cutler, Haufler, and Porter, eds., *Private Authority and International Affairs*.

rescheduling government debt.¹⁵ In addition, state behavior often reinforces the market actors as authoritative. As Hall and Biesteker explain, “[w]hen state leaders proclaim that ‘the forces of the global market’ give them little room for maneuver or independent policy choice,” not only are they “ceding claims of authority to the market; they are creating the authority of the market.”¹⁶ Importantly, private authority does not necessarily undermine government authority or policies. Rather, it often complements the efforts of governments in various aspects of economic governance.

Furthermore, globalization processes are seen as empowering private-sector actors, even in setting international standards.¹⁷ Although studies have demonstrated the existence of different forms of governance without the support of states, many associate this phenomenon with changes in the world economy since the 1970s.¹⁸ As we will see in the pages that follow, even though the Great Depression fundamentally reoriented relations between governments and central banks and leading private banks by diminishing the authority of bankers in international finance, the establishment of the BIS clearly illustrates how private-sector actors exercised legitimate authority in international affairs decades earlier than the 1970s.

¹⁵ Strange, “Territory, State, Authority and Economy.”

¹⁶ Hall and Biersteker, “The Emergence of Private Authority in the International System,” p. 6.

¹⁷ Ibid.; and Michael King and Timothy Sinclair, “Private Actors and Public Policy: A Requiem for the New Basle Capital Accord,” *International Political Science Review*, 24 (July 2003), pp. 345-362.

¹⁸ Rodger Tooze and Christopher May, eds., *Authority and Markets: Susan Stranges’s Writings on International Political Economy* (New York: Palgrave/Macmillan, 2002); A. Claire Cutler, Virginia Haufler, and Tony Porter, eds., *Private Authority and International Affairs* (Albany: State University of New York Press, 1999), various chapters; Susan Strange, “Territory, State, Authority and Economy: A New Realist Ontology of Global Political Economy,” in Robert W. Cox, ed., *The New Realisms: Perspectives on Multilateralism and World Order* (Tokyo: United Nations Press, 1997); and Susan Strange, *The Retreat of the State: The Diffusion of Power in the World Economy* (New York: Cambridge University Press, 1996).

The dominant functionalist approach argues that states establish international institutions in response to international crises to realize joint gains.¹⁹ At the same time, whereas some writers emphasize the independent, autonomous role of the BIS and epistemic communities of experts who assemble there to devise prudential regulatory policies, others like Robert Gilpin argue that institutions like the BIS serve the national interests of the most powerful and wealthy states in the international system.²⁰ These explanations are not so much incorrect as they are incomplete because of their tendency to oversimplify the behavior of states and institutions in the global financial system. First, they privilege international factors over domestic ones, treating factors related to national economic sectors and domestic political institutions and interests as afterthoughts.²¹ Recently, however, Gilpin acknowledged that he and others had previously neglected the domestic dimension in studying the global political economy.²² Second, mainstream theories treat states as unitary actors with fixed preferences and beliefs. This dissertation problematizes such tendencies by starting from the premise that states are composed of a number of different institutions whose interests and goals are often in contradiction to one another. In analyzing the BIS, not only will we find that private sector actors were influential in the creation and subsequent operations of the BIS, but also that central banks and treasuries were often at loggerheads over various policy issues related to the BIS. This is not to say that private bankers have historically influenced the operation of the BIS as an

¹⁹ Robert Keohane, *After Hegemony: Cooperation and Discord in the World Political Economy* (Princeton: Princeton University Press, 1984).

²⁰ Paul Eatwell and Lance Taylor, *Global Finance at Risk: The Case for International Regulation* (New York: The New Press, 2000); and Robert Gilpin, *Global Political Economy: Understanding the International Economic Order* (Princeton: Princeton University Press, 2001), p. 3.

²¹ See, for example, David Skidmore, ed., *Contested Social Orders and International Politics* (Nashville: Vanderbilt University Press, 1997).

²² Gilpin, *Global Political Economy*, p. 3.

international financial institution. Nor is it to say that central banks and treasury officials of BIS member countries were consistently at odds with one another over policy issues concerning the BIS. The point is that in attempting to provide the reader with a comprehensive and accurate analysis of the BIS, this dissertation departs from mainstream international relations scholarship in that it engages in thick description and historical analysis at the expense of parsimony.

By pursuing an angle of enquiry that focuses on relations between governments and central banks and leading commercial banks this dissertation aims to contribute to a growing interest in unpacking state behavior in the sphere of international finance. Indeed, the history of international relations strongly suggests that in governing international markets, states are systematically subject to pressure from domestic interest groups, particularly through close consultation between policymakers and sectoral elites. At least in the area of international finance, empirical and theoretical gains can be made by focusing on the role that domestic financial politics play in influencing the governance of global financial markets. Given the close interpenetration of central and commercial bankers in its activities, the BIS is an ideal object for an inquiry along these lines.

Outline of the Dissertation

This dissertation is organized as follows. Chapter Two examines the main actors, interests and circumstances surrounding the creation of the BIS between 1929 and 1930. It attempts to answer the two most basic theoretical questions that arise from studying international institutions: why are international institutions created? And why do they take the particular forms that they do? When the BIS was created, there was a well-established norm of private actors performing important public functions in connection with the

management of international finance. Central bankers of the advanced industrialized countries, who were especially dominant in international finance in the 1920s, believed in the separation of economics and politics in financial policymaking, and political authorities by and large accepted the normative appeals of bankers as right and legitimate. Under these circumstances, the authority of central and private bankers was considerable. Given the multiple links between private finance and central banks, and the predominance that these sets of actors exercised in the negotiations concerning the BIS's establishment, they succeeded in linking the BIS to central banks, as opposed to treasuries, which were viewed by bankers as being influenced by politics. The creation of the BIS therefore witnessed the institutionalization of close collaboration between central bankers and prominent commercial bankers of the countries that were financially associated with the German reparations obligations arising from the First World War.

Chapter Three analyzes the development and role of the BIS during the 1930s. It finds that the reorientation of relations among governments, central banks and financial firms resulting from the economic shocks of the Great Depression of the early 1930s negatively influenced the development of the BIS in the 1930s. Whereas the BIS was created at a time when central bankers and prominent international financiers were, as they had been during the 1920s, still dominant figures in international finance, the Great Depression severely discredited bankers and the orthodox financial model of central bank activism they advocated. Ultimately, the authority of bankers and their model of central bank cooperation diminished. This development, in turn, discredited the BIS as an instrument of monetary cooperation, with governments responding to deteriorating political, economic and social conditions by scaling back the autonomy of central banks and reasserting their authority over the full range of national economic policies. Chapter Three also relates that, despite the

circumscribed manner in which it operated during the 1930s, the BIS succeeded in developing a niche for itself as the principal center for central bank cooperation. The bank succeeded in maintaining a sense of identity, purpose and solidarity among central and commercial bankers. The BIS also succeeded in developing sophisticated systems for simplifying transfers from one currency to another, settling international payments between governments and international organizations, and clearing international payments in gold without the actual physical transfer of the metal. These systems, which were increasingly valued by central banks as the 1930s progressed, would become crucially important to the economic reconstruction of Western Europe as well as the broader functioning of the international financial system following the Second World War.

Chapter Four examines the activities of the BIS during the Second World War and assesses whether its management followed the strict policy of neutrality that had been declared by the BIS Board of Directors once the war had begun in September 1939. It argues that while there is ample evidence of BIS management activities and transactions that could be judged as reproachable, there is also overwhelming evidence showing that on the whole the bank did not privilege its traditional clients in either the Axis, Allied or neutral camps. All in all, by maintaining normal business relations with its traditional customers – member central banks and a select group of leading financial firms – the BIS was by and large neutral. The BIS's wartime activities are explained by the desire of BIS officials to survive the war, to safeguard the financial interests of the bank's creditors and shareholders, and to ensure a position for the institution in the postwar international monetary system.

Chapter Five details the struggle among central and private bankers and treasury officials, especially in the United States, to abolish the BIS after the Second World War. In particular, this chapter chronicles the United States government's reversal of its policy to

enforce the Bretton Woods resolution to liquidate the BIS. It identifies several reasons why the BIS survived attempts to abolish it after the war. First, reports in the United States and Britain that the BIS was pro-Nazi during the war proved to be exaggerated in government decision-making circles. Second, solidarity among orthodox central bankers and prominent commercial bankers in the United States and Western Europe accounted for a strong and effective opposition to Keynesian-minded treasury officials who wished to do away with the BIS because they thought it would compete with the new international institutions created at Bretton Woods. Finally, and perhaps most important, the BIS and its supporters in the United States and western Europe persuaded the United States government that the BIS could duly serve its strategic interests in western Europe in the postwar period, especially in regard to European economic reconstruction. Given the slow development of the Bretton Woods institutions and the American policymakers' belief that they needed to act quickly to prevent the spread of communism in Europe, the United States Treasury, which had sponsored the resolution to abolish the BIS, changed its position and enlisted the support of the BIS in connection with the Marshall Plan.

Finally, Chapter Six analyzes the role of the BIS in advocating and facilitating the restoration of convertibility among major currencies in Western Europe between 1947 and 1958. This chapter narrates that during the decade after the war, the BIS's goal of promoting the speedy return to convertibility was restricted by the political context of the Bretton Woods financial order, particularly by the bitter campaign between embedded liberals and classical liberals, who disagreed about the speed and method of achieving convertibility. Despite considerable political constraints, the BIS encouraged a shift toward orthodox monetary policies throughout Western Europe beginning in the late 1940s, and it contributed to the gradual liberalization of European financial markets in the 1950s. Chapter

Six shows that the BIS encouraged and facilitated these processes by (1) hosting monthly meetings of central bankers in Basle; (2) conducting site consultations in key member countries with influential central bankers, commercial bankers and government officials; (3) espousing a doctrine of “sound” credit and monetary policy through its reports and correspondence with national decision-makers; and (4) operating the European Payments Union, which provided a system for liberalizing Western Europe’s finance and restoring convertibility of its major currencies with the dollar. It is to the establishment of the BIS that we now turn.

Chapter 2

War Reparations, Private Authority and the Founding of the Bank for International Settlements

“It [the BIS] must not become merely an agency for the collection and distribution of Reparations on behalf of the interested governments....It must be a sufficient business institution and not an eleemosynary institution. It must make money; it must be fairly paid for its services. It must be contemplated that it would receive suitable sums as deposits from governments and/or central banks.”¹

- Jackson Reynolds, President, First National Bank of New York and Chairman of the Organizing Committee of the Bank for International Settlements, Baden-Baden, Germany, October 25, 1929.

This chapter examines the establishment of the BIS from 1929 to 1930. In her seminal article on the founding of the Bank for International Settlements, Beth Simmons applied dynamic contracting theory in arguing that, despite pronounced international political conflict during the interwar years, the BIS's creation can be explained as “a function of the benefits that lenders and borrowers expect to gain from smoother and more efficient capital market operation.”² According to this approach, “the impulse to innovate...flows from the structural inability of states to make credible commitments under anarchy.”³ Also, the costs of enforcement and default to citizens of creditor states force governments to consider

¹ Pierpoint Morgan Library, J. P. Morgan Papers, Box 178/3 “Summary of Conversation of 25 October, 1929”; J. P. Morgan Papers, Box 178/3, Morgan to Young, October 25, 1929.

² Beth A. Simmons, “Why Innovate? Founding the Bank for International Settlements,” *World Politics*, 45 (April 1993), 361-405. For other treatments of the BIS's establishment, see Frank Costigliola, “The Other Side of Isolation: Establishment of the First World Bank, 1929-30,” *Journal of American History*, 59 (December 1972), pp. 602-20; Henry Hans Schloss, *The Bank for International Settlements Reconsidered* (Ann Arbor: Michigan University Press, 1970); Eleanor Lansing Dulles, *The Bank for International Settlements at Work* (New York: Macmillan, 1932).

³ Simmons, p. 372.

making “side payments to assure the rescheduling agreement.” Such “side payments may include not only debt concessions [to government debtors] but also organizational and financial support for international institutions.”⁴ Thus, for Simmons, government support for the BIS’s founding represents a “side payment” or “the price of private cooperation” to central bankers and private international bankers for securitizing Germany’s reparations debts.⁵

Simmons clearly demonstrates that the BIS was conceived and designed by dominant international and central bankers who sought to stabilize international markets and saw the BIS as a catalyst in this regard. In fact, archival sources strongly support this thesis. Still, Simmons’ explanation is only partial, for dynamic contracting methodology glosses over important historical developments that influenced the BIS’s founding. Apart from “incorporating the interests of debtor, private creditors, and creditor governments,” dynamic contracting theory does not explain why there was such a high level of private-sector participation.⁶

Do the vested interests of private bankers in German debts and in stable capital markets alone explain why these actors were so instrumental in creating the BIS? Why was such a specific type of institution as a limited share company with access to central bank funds yet not subject to formal government oversight created? Various rationalist theories would lead us to expect that the BIS’s establishment was ultimately explainable from a cost-benefit analysis from the point of view of governments, with private-sector involvement and actions simply being factored in as a cost or benefit from the government actors’ point of

⁴ Ibid., p. 373.

⁵ Ibid., p. 400. In this chapter, securitization and commercialization are used synonymously. Government debt is transformed into an asset that can be bought and sold on the market as bond shares, the proceeds of which are used to eradicate government debts.

⁶ Ibid., p. 373.

view. The evidence shows this model to be inadequate. By introducing private authority as a concept, it is possible not only to explain why governments complied with normative appeals for private-sector involvement in creating the BIS, but also why they believed doing so was right and legitimate. Not one study of the BIS has made a basic connection between long-term trends in institution-building at the international level and the conditions under which it was established.⁷ Only by placing the creation of the BIS in a longer historical perspective is it possible to fully comprehend why, during a period punctuated by interstate conflict, governments supported the founding of the BIS. In fact, its founding marked the culmination of an era in which private-sector actors performed public functions by proposing and designing new international institutions.⁸

International Financial Governance Before and After the First World War

In the classical liberal era before the First World War, international financial collaboration was largely left to private initiative. Central banking predominantly is a twentieth century phenomenon.⁹ Even though a small number of central banks were established before the twentieth century with monopoly rights over the issuance of money, these institutions did not perform the function of lender of last resort, a central purpose of central banking. Explicit government deposit insurance developed later than the lender-of-last-resort function of central banks. As Gorton and Huang show, private bank coalitions

⁷ For example, see Baffi and the BIS; Eichengreen, *Golden Fetters: The Gold Standard and the Great Depression, 1919-1939* (New York: Oxford University Press, 1995); Simmons, esp. pp. 361-364; Costigliola.

⁸ See Craig N. Murphy, *International Organization and Industrial Change: Global Governance Since 1850* (New York: Oxford University Press, 1994), particularly pp. 1-10.

⁹ Only eighteen central banks existed by 1900. See Forrest Capie, "The Evolution of Central Banking," in Gerard Caprio, Jr. and Dimitri Vittas, eds., *Reforming the Financial System: Some Lessons from History* (Cambridge: Cambridge University Press, 1997).

have historically been replaced by nationalized central banks and government deposit insurance schemes, marking an important development in the evolution of national central banks during the twentieth century.¹⁰ Thus, the modernization of central banks is a relatively recent historical development.

Prior to and during the evolution of central banks major banking houses regularly performed public functions, responding to financial crises by providing key credits and loans to central banks and governments as part of currency stabilization projects.¹¹ In the European context much is known about the role played by the Rothschilds. In United States, the House of Morgan regularly performed the role of lender of last resort, as in the financial crisis of 1907, well before the establishment of the Federal Reserve System in 1914. J. P. Morgan was also a banker for the British and United States Treasuries.

The significance of private-sector actors was not limited to banking and finance but reflected a well-established norm in the international system. In 33 international institutions studied by Murphy that were created between 1865 and 1914, private-sector actors provided financial sponsorship, organizational resources and political leadership in establishing new institutions to cope with the unprecedented problems created by the expanding industrial system. International cooperation among aristocrats was facilitated by the European conference system which “helped mute conflicts among the powers.”¹² In short, before World War I there was a well-established norm of private actors regularly

¹⁰ Gary Gorton and Lixin Huang, “Banking Panics and the Origin of Central Banking,” Wharton Business School, the Wharton Financial Institutions Center Working Paper Series, 02-31 (August, 2001), pp. 1-42.

¹¹ BIS Archives, MCG 7/49, 7.18(2), Fraser to Reynolds, May 30, 1930.

¹² Murphy, pp. 48-49.

performing public functions, particularly in fostering and regulating financial and industrial development and promoting the international expansion of the regulatory role of states.¹³

The First World War completely disrupted international financial and economic relations, both between governments and private institutions, inside as well as outside the sphere of countries directly involved in the war. The Treaty of Versailles fundamentally redefined international relations for generations to come by redrawing territorial boundaries, legitimizing military occupation, imposing schedules and conditions for demilitarization. Attempts to reconstruct international finance, culminating in the creation of the BIS, were broadly related to the Versailles Treaty's attempt to rewrite international relations, with the reparations issue ensuring that political and financial questions would be directly connected. Before the war, governments had regularly sought political ends by economic and financial means; following it, however, financial considerations dominated foreign policy-making.¹⁴ Moreover, in the 1920s, leading central and private bankers tried with a gathering sense of urgency to construct a world economy. As Pauly shows, the achievement of peace among nations hinged on the attainment of a classical liberal international consensus in the form of a workable gold standard, stable exchange rates and more open capital markets. "The effort failed," writes Pauly, "and it failed catastrophically."¹⁵

¹³ Robert Cox argues that the "internationalization of the state" involves the transformation of the state into "an agency for adjusting national economic practices and policies to the perceived exigencies of the global economy." See Robert Cox, "Global Perestroika," in Robert Cox with Timothy J. Sinclair, *Approaches to World Order* (Cambridge: Cambridge University Press, 1996), p. 306. I use it differently: that certain internationalist-minded state and nonstate actors sought in the 1920s to define and institute specific ways in which state institutions could and should manage the world economy.

¹⁴ See, for example, Frank C. Costigliola, "Anglo-American Financial Rivalry in the 1920s," *The Journal of Economic History*, 37 (December, 1977), p. 911; Eichengreen, pp. 127-28.

¹⁵ See Louis W. Pauly, *Who Elected the Bankers? Surveillance and Control in the World Economy* (Ithaca: Cornell University Press, 1997), p. 35.

Despite the devastation of World War I, the state system was strengthened in the years that immediately followed it. In the area of finance treasury officials and central bankers came to the fore. In every country a group of financial diplomats developed.¹⁶ Meanwhile, the enhanced importance of economic questions bolstered the belief that businessmen, not politicians or bureaucrats, possessed the flexibility and technical expertise required to stabilize markets. Policy-making elites openly announced that fiscal degeneration and economic downturns could only be avoided, and world peace and prosperity could only be achieved, by forces entirely divorced from politics, through “the healing power of assistance of private finance and commerce.”¹⁷

Many trace the origins of central bank cooperation to the BIS’s founding.¹⁸ But as Charles Kindleberger points out, central bank cooperation predated the BIS.¹⁹ A considerable amount of coordinated international financial assistance occurred before 1930, by central banks and private individuals like the Rothchilds, Morgans and Warburgs, governments, and cities like Hamburg. The Bank of England and the Bank of France assisted each other as lenders of last resort in financial crises in 1825, 1836-39, 1856, 1866, 1890, and 1907, and the Federal Reserve Bank of New York provided the Bank of England

¹⁶ See Richard Hemmig Meyer, *Bankers’ Diplomacy: Monetary Stabilization in the Twenties* (New York: Columbia University Press, 1970), esp. pp. 3, 13-14; Paul Einzig, *Bankers, Statesmen and Economists* (New York: Books for Libraries Press, 1967) and *Behind the Scenes of International Finance* (London: Macmillan, 1932).

¹⁷ Herbert Hoover to Benjamin Strong, August 30, 1921, Herbert Hoover Papers, Herbert Hoover Presidential Library, Box 284, cited in Costigliola, “Anglo-American Financial Rivalry in the 1920s,” p. 912.

¹⁸ This view is espoused by a number of publications by one-time BIS officials. See Paolo Baffi, *The Origins of Central Bank Cooperation: The Establishment of the Bank for International Settlements* (Rome, Laterza & Figli, 2002); Gunter D. Baer, “Sixty-Five Years of Central Bank Cooperation at the Bank for International Settlements,” in Carl-L. Holtfrerich, James Reis, and Gianni Toniolo, eds., *The Emergence of Modern Central Banking from 1918 to the Present* (Aldershot: Ashgate, 1999); Roger Auboin, *The Bank for International Settlements, 1930-1955* (Princeton: Princeton University Press, 1955).

¹⁹ See Charles Kindleberger, “Introduction,” in Paolo Baffi, pp. xxv-xxxiv.

with financial assistance in the 1920s. All of this was “episodic” and far from institutionalized.

Throughout the 1920s Bank of England Governor Montagu Norman encouraged greater contact and consultation among central banks on an official and personal level. Periodically, he met with Benjamin Strong, Governor of the Federal Reserve Bank of New York, Hjalmar Schacht, President of the German Reichsbank, and Emile Moreau, Governor of the Bank of France. Central bankers valued these meetings, because they gave them an opportunity both to influence one another’s monetary policy and to exchange views. However, these meetings attracted an undesirable amount of publicity, risking a possible fluctuation in exchange rates and verbal and financial speculation. For the central bankers, secrecy and confidentiality were indispensable criteria in building bonds of monetary solidarity.

Meanwhile, many came to see the creation of more coherent international monetary order, with central bank collaboration as its centerpiece, as a precondition for reconstituting world trade and finance. This movement was not unprecedented, as before World War I various proposals had been made. After the war, however, the rate and scope of such proposals intensified and broadened. For instance, the Genoa Conference of 1922 endorsed the international gold exchange standard and called for continuous cooperation among central banks to maintain it.²⁰ Bankers particularly wanted to economize gold movements by developing an international clearing union predicated on nondiscrimination, convertibility and symmetry in adjustment obligations between surplus and deficit countries. The First World War thus represented an obvious threshold; the political decision to spare gold money in domestic and international transactions signaled the extension internationally of the

²⁰ Stephen V. O. Clarke, *The Reconstruction of the International Monetary System: The Attempts of 1922 and 1923* (Princeton: Princeton University, 1973), pp. 4-18.

regulatory role of the state. Yet even though the institutional designs of the 1920s embodied all of the important functions of institutions established at Bretton Woods in 1944, little institutional development resulted. Domestic political constraints, incompatible conceptual frameworks and international political disputes over debts and reparations bedeviled this effort.²¹

The historical development of the BIS can hardly be discussed in isolation from the aggressive imposition of reparations obligations on Germany by the victors of World War I in the Treaty of Versailles. During the 1920s German war reparations fueled political conflict among European governments, impeded European economic reconstruction, exacerbated budgetary crises, and made foreign currency stabilization very difficult. As a result, by 1929, many European and North American central and private bankers roundly advocated the need for a new debt settlement.

Furthermore, the issue of inter-Allied debts, particularly those owed to the United States government, became functionally associated with the issue of German reparations: the ability of France, Britain, Belgium or Italy to repay their debts to the United States depended on Germany's ability to make regular installments on its war reparations, which, in turn, depended upon uninterrupted lending from American banks, the largest collective holder of surplus capital at that time. The interconnectedness of these two classes of debts represented a ticking bomb in the world economy: any wholesale repudiation of debt by a leading debtor government, above all Germany, would threaten the solvency of leading creditor banks, cripple the international credit system and stifle world commerce, as the Great Depression subsequently demonstrated. Throughout the 1920s the issue of German reparations confounded creditor governments and the largest international banks, which had

²¹ Eichengreen, pp. 9-12.

an important stake in international financial stability and were treated by governments as possessing the requisite authority and capital wealth to achieve a durable settlement.

Thus, internationalist-minded politicians, but above all central and private bankers from Europe and North America, were driven by a normative commitment to private-sector solutions to building world peace and prosperity, Europe economic reconstruction and stable international markets. The BIS promised central bank collaboration and the international extension of the regulatory role of the state. However, whereas Pauly argues that “leading states” in the 1920s attempted to construct a global economy, it was internationalist quasi-state central banks, not relatively inward-looking governments, that comprised “the state” in the international arena.²² Central banks typically collaborated with prominent internationalist-minded financiers to develop, as in the case of the BIS, a more stable international financial order. Moreover, the form of state that was internationalized in the BIS’s founding differed in basic respects from that which was internationalized in the Financial Committee of the League of Nations. While both institutions promoted financially orthodox policies, the institutional designs of the two agencies allowed for one agency, the BIS, to be more insulated from governments (i.e., treasuries). Although the experience of reparations and the Great Depression discredited the classical liberal model (and central bankers) in government policy-making circles in the 1930s, during the 1920s international financiers exerted a significant degree of authority in international financial policymaking.²³

²² Pauly, p. 35. Also see, Jeffrey Frieden, *Banking on the World: The Politics of American International Finance* (New York: Harper & Row, 1987), esp. chs. 1-2.

²³ On the discrediting of central bankers in the 1930s, see Harold James, *The End of Globalization: Lessons from the Great Depression* (Harvard University Press, 2001).

Central Bank Independence and German Reparations

Germany's obligation to pay war reparations was formalized in the Treaty of Versailles, and by May 1921 a staggering reparations bill of 132 billion gold marks, or US\$31 billion, was imposed on Germany.²⁴ Given United States government inflexibility regarding war debts owed to it by its allies, the French, British, Italians and Belgians could not reach a compromise and, thus, pressed Germany for reparations. However, a little over a year later Germany defaulted on its payments and was granted a one-year moratorium. France and Belgium responded by instituting their own method of debt collection, seizing Germany main industrial center, the Ruhr, in January 1923. The German government, in turn, protested this move by declaring a policy of "passive resistance." Devastating hyperinflation and a rapid deterioration in the German economy and living standards resulted. Faced with mounting pressure from parties on the left and the right, the German government ended its policy of passive resistance in September 1923. A new currency – the Rentenmark – replaced the mark, but the Germany economy already lay in ruins.

The Dawes Committee, which was led by American banker Charles G. Dawes, was created to resolve this problem. It deferred part of Germany's reparations obligation and reduced its debt service payments.²⁵ The success of the Dawes Plan hinged on a foreign loan to Germany, publicly endorsed and privately marketed in New York. In return for this loan, the German government agreed to reform its central bank under Allied supervision and earmark money from transportation, excise, and custom taxes for reparations payments.²⁶ Initially, the Dawes Plan was successful, as it "unleashed a wave of foreign lending by the

²⁴ Keynes argued that the reparations scheme would not only destroy the German economy but would damage the financial recovery of other nations in Europe. John Maynard Keynes, *The Economic Consequences of Peace* (London: Macmillan, 1920).

²⁵ The Dawes Plan set Germany's annuity at RM2.5 billion.

²⁶ The Reparations Commission employed over 150 foreign agents in Berlin.

United States that inundated international financial markets for the next four years.”²⁷ Yet as lending to Germany decreased, its annual payments became unbearable.²⁸ German nationalists strenuously criticized the Dawes system as a humiliating form of foreign domination, and international bankers associated it with Germany’s economic woes and general instability in international financial markets. From the bankers’ perspective, politics confounded economic stabilization, and Germany’s war reparations had to be securitized.²⁹ Finally, in late 1928, Agent General for War Reparations S. Parker Gilbert persuaded creditor governments to restart German reparations negotiations.³⁰ This led to the formation of the Young Committee, which called for the elimination of all Dawes Plan institutions and the establishment of the BIS.

Although the Young Committee of bankers intended to depoliticize reparations, this goal proved illusory. During the year-long series of negotiations in 1929 that gave birth to the BIS, different state institutions of Germany’s creditors were deeply divided over questions related to the BIS. Political institutions of these governments struggled with central banks and a small number of prominent international bankers for influence over these questions. The degree of political influence of government institutions over the central and commercial bankers varied from country to country. This variation, in turn, was the

²⁷ Eichengreen, pp. 150-51.

²⁸ Lending by US banks to Europe rose from 526.6 million in 1924 to 629.5 in 1925, and was 484.0 million in 1926, 557.3 in 1927, and 597.9 in 1928. In 1929 the volume of lending fell to 142.0 million. Source: United States, Department of Commerce (1930), in Eichengreen, p. 151

²⁹ Documentary evidence strongly support this conclusion, which is reiterated in the final report of the Young Committee: “The operations of the institution will be assimilated to ordinary commercial and financial practice. Its organization will be outside the field of political influences.” See Pierpoint Morgan Library, J. P. Morgan Papers, Box 179/5, “The Bank for International Settlements: Committee of Experts Report (Part 6),” June 7, 1929; J. P. Morgan Papers, Box 179/5, “Course of the Proceedings,” [no date]; Simmons, p. 364.

³⁰ On September 16, 1928 businessmen and state officials approved a committee of independent financial experts to propose a new settlement to German reparations. The Young Committee’s official name was The Expert Committee on War Reparations.

direct result of varying degrees of independence that each central bank possessed. The degree of private authority and central bank independence co-varied from delegation to delegation, with the former and latter being higher in Britain and the United States than in France, Belgium and Germany. With the sole exception of France, in the case of Britain, Germany, the United States, Belgium, Italy and Japan, the balance of policymaking power between treasuries and central banks favored the latter. International commercial banks from each country were even less likely than central banks to adopt their government's policy, seeing themselves instead as independent financial authorities. Thus, in each of the main delegations, despite ceding authority to private bankers, governments, led by treasuries, sought to exert political influence over the central and private banking representatives, especially concerning the kind of institution they were creating in the BIS.³¹ One British financier captures this tension in a report to the Bank of England:

Our bank negotiators have suffered the usual vicissitudes due to the conflict of ideas as to what kind of a bank it was we were endeavoring to set up. In my judgment we have secured for the Governments the due measure of influence and initiative to which they are entitled, and at the same time obtained for the Bank, with due safeguards against their abuse, the requisite freedom and elasticity to enable it to act as a nucleus of central banking co-operation in devising a common policy and common measures for preventing monetary crises and undue fluctuations in the value of gold.³²

The most acrimonious conflicts of interest centered on the kind of institution the negotiators were creating. While central and private bankers wanted the BIS to be more than a reparations agency, these groups did not see eye to eye on all issues. Central banks feared that the BIS might interfere with their monetary objectives, as BIS operations in gold and

³¹ Neither could the bankers isolate themselves from political considerations in selecting a site for the BIS. Given the political sensitivity of this question, negotiations about its location were left for last.

³² Bank of England Archive, Addis Papers, ADM16/1, Addis to Norman, October 31, 1929.

foreign currency potentially overlapped with similar central bank operations.³³ Besides, by entrusting funds to the BIS for short-term lending, central banks did not want to create a super-bank of sorts that could out-compete existing banks in the various financial centers. In the end, governments granted only limited support for certain bankers' more ambitious idea of creating a "bank of central banks," explicitly denying the BIS the power to create a unit of international currency and limiting its capacity as an international lender of last resort.

Broadly, then, whereas political leaders wanted the BIS to be a reparations agency answerable to treasuries, central and private bankers desired a private-banking institution that was insulated from government interference and answerable only to central banks.³⁴ While there was some compromise on all sides, the final design of the BIS predominantly resembled the preferences of central and private banks. Even though it embedded safeguards for governments, the BIS was founded with a legal status of a limited share company. By ensuring that the BIS's primary source of funding was based not on government quotas but on central bank funds its founders created an international institution that was insulated from national politics. Thus, at its founding a distinguishing characteristic of the BIS was that its capital subscribers were central banks and private individuals and banking institutions, not national governments.

As indicated above, German reparations were a constant source of political, economic and financial instability during the 1920s. Germany's adversaries sought reparations from it for different reasons, namely to cover their own postwar reconstruction costs and debts. Inter-Allied debts amounted to an astounding sum of \$26 billion. As debt

³³ Pierpoint Morgan Library, J. P. Morgan Papers, Box 178/3, Leffingwell to Morgan and Lamont, March 12, 1929.

³⁴ Although central bankers constitute the heart of the Board of Directors, they did not wish to get involved in the day-to-day management of the BIS. See Basle University Library, *Handschriftenabteilung* [Department of Manuscripts], NL 324, Jacobsson Diaries, A I 110, November 4, 1956.

negotiations were beginning in Paris in February 1929, Keynes captured the interconnection between inter-Allied debts and German reparations:

If Germany were to pay the whole amount of the reparations due from her under the Dawes scheme, and if the Allies were to use these proceeds to pay what they in their turn owe to the United States under the latest settlements, it would mean that about two-thirds of the proceeds of German reparations would have to be handed on to the United States.³⁵

This linkage exacerbated divisions within and among Germany's creditor governments, but especially the United States, where successive postwar administrations denied any functional link. European governments also amassed an enormous amount of private debt during the war, further complicating the international payments system. In the 1920s the continuous payment of German reparations and inter-Allied debts, the balancing of government budgets and the stability of national currencies all depended on government access to private loans and credits. This situation, in turn, strengthened power and authority of private-sector actors in debt settlement and postwar economic reconstruction.

Faced in late 1929 with the growing likelihood of cancellation of a portion of Germany's debt, the governments of France, Belgium, Britain and the United States made two compromises to Germany and its private creditors. The first was a diminution in Germany's reparations obligations from the Dawes Plan figure of RM2.5 billion to the Young Plan amount of RM1.9 billion.³⁶ The second was the decision to support the creation of the BIS. Saddled with reparations payments, war debts and spiraling inflation, European governments knew that returning to the gold standard required economic stabilization and that access to foreign capital was a prerequisite. The two countries whose resources had been

³⁵ *Foreign Affairs*, February 1929, p. 79.

³⁶ As an aside, Germany's government bonds, which securitized its World War I reparations obligations, are due to mature in 2008. This was conveyed to me in during a conversation with Dr. Piet Clement, Head of Archives and Research Support, Bank for International Settlements, Basle, Switzerland.

least drained by the war were the United States and Britain. As a consequence, private-sector actors from these countries gained tremendous influence in international economic affairs, making their degree of private authority in Germany's debt talks considerably higher than their counterparts.³⁷

German Reparations and the BIS from the Perspective of the United States, Britain, France and Germany

United States The authority of private bankers engaged in creating the BIS was perhaps most pronounced in the case of American international bankers. As leading suppliers of foreign direct investment, loans and credits to Germany throughout the 1920s, these bankers championed the BIS as a profit-making institution.³⁸ The chief "preoccupation of a necessity," according to the American bankers, "was to share in the creation of a bank which was to be a useful business enterprise."³⁹ The BIS also promised social and political benefits, as some European bankers had hoped that the BIS would help ease their "vexing...social

³⁷ Clarke, chapters 1-3; and John B. Goodman, *Monetary Sovereignty: The Politics of Central Banking in Western Europe* (Ithaca: Cornell University Press, 1992), pp. 27-29.

³⁸ See footnotes 1, 45, 59, and 91.

³⁹ Pierpoint Morgan Library, J. P. Morgan Papers, Box 178/3, Morgan to Young, October 25, 1929. American private-sector representatives involved in founding the BIS included: J. P. Morgan, Owen D. Young (Chairman, General Electric), Jackson Reynolds (President, First National Bank of New York), Melvin Traylor (President, First National Bank of Chicago), Thomas Lamont (J. P. Morgan and Company), and Leon Fraser (First National Bank of New York), Thomas Perkins (Boston banker). Other bankers included: Walter Burgess, Dean Jay, Shepard Morgan, David Sarnoff, and Walter Stewart.

questions.”⁴⁰ The American bankers plainly announced the BIS in United States as “a powerful barrier against the spread of Bolshevism.”⁴¹

European central and private bankers clearly understood that a profit-making BIS would guarantee the unimpeded participation of the American financial community.⁴² However, Simmons notes that the American bankers’ goal of making the BIS a useful business enterprise “ran counter to the idea of a non-profit ‘bank of central banks’” and was initially opposed by the Federal Reserve Bank of New York (FRBNY) and other central banks.⁴³ European bankers even repeatedly criticized the New York bankers for their profit motive.⁴⁴ The FRBNY also feared that the BIS operations would compete with American, especially New York, banks, arguing that “it [profits] must not be the dominating motive, and the amounts are most problematical.”⁴⁵

Given the US government’s isolationist stance, general detachment from reparations, and reliance on private expert action throughout the 1920s, it denied any official link

⁴⁰ Morgan and Lamont to J. P. Morgan and Company, March 11, 1929, Lamont Papers, 178/18, cited in Frank C. Costigliola, *Awkward Dominion: American Political, Economic, and Cultural Relations with Europe, 1919-1933* (Ithaca: Cornell University Press, 1984), p. 211.

⁴¹ Owen D. Young Speech, June 11, 1929, 462.00R296/3000, Record Group 59, United States National Archives, cited in *ibid.*, p. 211.

⁴² Morgan to Reynolds, October 29, 1929, J. P. Morgan Papers, PML, 34/5. Also see Pinsent’s diary of Addis’s report of the Heads of Delegations Meeting, October 25, 1929, T160 386, F11282/03/1 and Treasury Documents, PRO/L, in Simmons, p. 381.

⁴³ Simmons, p. 381.

⁴⁴ *Ibid.*, p. 381.

⁴⁵ Federal Reserve Bank of New York (FRBNY) Archive, BIS File, 797.3, “Notes on the Capital of the Bank,” March 13, 1929. The FRBNY noted that the bankers’ plan “suggests too great of power conferred on private stockholders,” that private ownership of BIS shares “introduces the pressure of profits as opposed to the motive of public service,” and that “[o]wnership by powerful banking interests is no better window dressing than government ownership.”

between the Federal Reserve System and the BIS.⁴⁶ As the FRBNY expected central banks to influence the BIS, it sought other means of protecting itself from the implementation of policies which “might not be in the best interests of the New York market or consistent with other American interests.”⁴⁷ They wanted BIS management to feel some sense of responsibility to the Federal Reserve Banks with and through which they would be operating. The FRBNY supported the BIS’s founding on the assumption that, when organized and operating, the two institutions would develop close relations and the former would exercise some rights concerning the latter’s operations, particularly in the United States.⁴⁸ According to them, as “a big factor in international exchange operations” in the coming years would involve the need for dollars in various countries, “a large part of the operations of the Bank for International Settlements will have to be in or with this market.”⁴⁹ Thus, while it wanted the power to veto BIS business operations in the New York market, the FRBNY also wanted the BIS to take on international banking functions that transcended the much narrower role of reparations settlement.⁵⁰ Seeing no bar in the way of American legislation, the FRBNY concluded that it “can and should” establish financial relationships with the BIS under powers conferred to it under the Federal Reserve Act, “somewhat along

⁴⁶ “Section XII” of the first plan for the BIS “makes full provision covering the substitution of a private American banking house for the Federal Reserve System in every aspect of the plan.” See FRBNY Archive, BIS File, 797.3, “The Bank for International Settlements and the Federal Reserve Bank of New York.”

⁴⁷ FRBNY Archive, BIS File, 797.3, “Views and Comments Relative to Provisions of Experts’ Report Concerning Bank for International Settlements and Its Possible Relations with Federal Reserve Bank of New York” [hereafter “Views and Comments”], August 19, 1929.

⁴⁸ Ibid.; FRBNY Archive, BIS File, 797.3, Harrison to Moreau, August 13, 1929; FRBNY Archive, Harrison Papers, 3013, Harrison to Schacht, August 13, 1929; FRBNY Archive, BIS File, 797.3, Burgess to Harrison, July 25, 1929.

⁴⁹ Memo, “Views and Comments,” p. 2.

⁵⁰ This included transactions in gold and securities, open market transactions, deposits, exchanging information on developments in different financial markets, trustee functions and arranging central and commercial bank credits.

the lines of those established with other banks of issue throughout the world.”⁵¹ It did, however, agree to keep key agencies in Washington abreast of developments in its relations with the BIS.⁵²

Still, the FRBNY had concerns about organizing the BIS as a profit-making institution. It was particularly concerned with avoiding “competitive influences for deposits of the BIS in this and other markets in this country...thus avoiding undesirable or perhaps hurtful operations.”⁵³ Consequently, it insisted that all BIS transactions affecting the New York market be made with its consent.⁵⁴ Beyond assisting in the execution of certain international financial transactions, FRBNY officials saw in the BIS an important medium for central bank contact and cooperation, transforming them from “fortuitous” to “more certain and automatic.”⁵⁵ As regards the location of the BIS, the FRBNY chose not to take a position.⁵⁶

According to the United States government, the function of the American bankers led by Owen Young and J. P. Morgan was to defend American financial interests in the broadest sense. Washington assumed that the other powers would endeavor to link Allied war debts with reparations and attempt to reduce both figures. In this connection, the State Department and Treasury expected the American bankers to explain to their European counterparts that Germany’s obligations had to be fixed without any modification of

⁵¹ Memo, “Views and Comments,” p. 2.

⁵² FRBNY Archive, BIS File, 797.2, “J. E. Crane to Files,” by J. E. Crane, February 27, 1930.

⁵³ Memo, “Views and Comments,” p. 3.

⁵⁴ FRBNY Archive, BIS File, 797.3, Burgess to Harrison, July 25, 1929.

⁵⁵ FRBNY Archive, BIS File, 797.3, Harrison to Moreau, August 13, 1929; FRBNY Archive, BIS File, 797.3, Harrison to Schacht, August 13, 1929; Memo, “Views and Comments.”

⁵⁶ FRBNY Archive, BIS File, 797.3, Harrison to Moreau, November 29, 1929.

prevailing inter-Allied arrangements.⁵⁷ However, the American international bankers regarded themselves not as defenders of American war debt policy, or as agents of the American government, but as independent actors. When halfway through the deliberations in Paris Treasury Secretary Andrew Mellon attempted to persuade the private-sector representatives to act in conformity with official United States policy, Young and Morgan threatened to walk away from the talks.⁵⁸ The private bankers assumed that the question of European debts to the United States had been answered with the debt funding agreements of 1922 to 1926, and believed that new creditors' needs for funds to satisfy war debt obligations fell within Germany's capacity to pay. In any case, the commercial bankers involved in the debt negotiations from 1929 to 1930 had a substantial interest in devising a scheme that maximized Germany's chances of paying its debts, reparations or private.

Thus, when British and American treasury officials attempted to place the BIS under the control of treasuries, the American bankers serving on the Organizing Committee in Baden-Baden were "greatly disturbed" and "embarrassed by the interference of their Governments: the result was that the idea of the Bank qua bank was being ignored ...[in favor of] the Reparations' aspect of the Bank largely because of the double loyalty of the Treasury officials." They felt that it was their duty "to form a great Bank," and they were infuriated by the fact that "the chief preoccupation of [their] colleagues seemed to be with a Bank as a Reparations Agency."⁵⁹ The American bankers had grand visions for the BIS,

⁵⁷ Pierpoint Morgan Library, J. P. Morgan Papers, Box 178/3, Young to Kellogg, October 26, 1928; J. P. Morgan Papers, Box 178/3, Young to Kellogg, January 2, 1929.

⁵⁸ Pierpoint Morgan Library, J. P. Morgan Papers, Box 34/5, Stimson to Young and Morgan, April 8, 1929; J. P. Morgan Papers, Box 34/5, Young to Hoover, Stimson and Mellon, April 10, 1929; and Jon Jacobson, *Locarno Diplomacy: Germany and the West, 1925-1929* (Princeton: Princeton University Press, 1972).

⁵⁹ Pierpoint Morgan Library, J. P. Morgan Papers, Box 178/3, Morgan to Young, October 25, 1929.

including its ascendance to a position as the leading player in the international bullion market.⁶⁰

Jackson Reynolds, who was Vice President of the First National Bank of New York, the largest commercial bank in the world in 1929, called a meeting of the heads of the delegations at Baden-Baden to ask each participant to state whether they agreed with the idea of making the BIS a useful business enterprise, and whether they were willing to act upon it. Sir Charles Addis, a British banker, was the first to agree with Reynolds, but added that he differed “somewhat on points of emphasis,” noting that the BIS probably would never have been proposed for establishment “if the reparations settlement had not provided the specific occasion for it.” In “complete and vigorous agreement” with Reynolds was Dr. Hjalmar Schacht, the German representative. M. C. Moret of the Bank of France expressed “equal agreement though more quietly.” Mr. Beneduce, the Italian delegate, was also in agreement, “exploring many related questions.” Japanese banker M. Tanaka was in “complete and brief agreement.” The Belgian representative Frank expressed agreement in “less clear language.”⁶¹

Despite attempting to depoliticize German reparations by securitizing them, governments still tried to influence the outcome of negotiations by indirect pressure on central bank governors. The FRBNY saw the BIS in its “dual role,” first as a reparations bank, and then as an international clearing bank.⁶² For it, the primary functions of the BIS were “politico-financial” in nature. Moreover, the FRBNY predicted that British influence

⁶⁰ Ibid. Also see, Pierpoint Morgan Library, J. P. Morgan Papers, Box 178/4, Lamont from Leffingwell, May 16, 1929; Pierpoint Morgan Library, J. P. Morgan Papers, Box 178, “Summary of Conversation of 25 October, 1929.”

⁶¹ For an record of the meetings of the Organization Committee, see Pierpoint Morgan Library, J. P. Morgan Papers, Box 178/3, “Typed Notes,” [No Author or Date].

⁶² FRBNY Archive, BIS File, 797.3, “Observations Suggested by The Bank for International Settlements [hereafter “Observations”],” by Foreign Information Division, July 12, 1929, p. 1.

would be prominent on the Board of Directors.⁶³ FRBNY officials fully expected England and Germany “to line up together,” backed by Holland, the Scandinavian countries and Italy, with France and Belgium the principle powers on the other side. Japan,⁶⁴ they expected, would “follow England’s lead,” the other countries “stringing along” with either “the Little Entente [sic] with France” or the British. As for their own influence over the Bank, these officials believed that

[t]he United States will be represented by what may still be called ‘observers’ whose position will be, as it has always been since 1919, at once a prominent and ticklish one. The reasons for both of these adjectives are clear: prominent, because of American wealth, power and objective adherence to realities; ticklish, because of the continual variance between American expert action in international affairs and American public opinion.⁶⁵

The American central and private bankers involved in the debt negotiations identified isolationist elements in Washington as “manifestations of provincialism in Congress,” lamenting the “ostrich-like State Department,” whose officials, they felt, tended to “bury their heads in the sand.”⁶⁶ For the United States’ part, the degree of private authority was considerable.

Britain In the case of Britain private-sector actors exerted authority in the context of a considerable divergence of interests between the Bank of England, on the one hand, and the British Treasury and Foreign Ministry, on the other, concerning the Young Plan and the BIS.

⁶³ Ibid., p. 1.

⁶⁴ The Japanese government and central bank performed a marginal role in the German debt negotiations. A consortium of private Japanese banks represented Japan in the debt talks and in the initial stock offering of the BIS.

⁶⁵ FRBNY Archive, BIS File, 797.3, “Observations,” p. 2.

⁶⁶ FRBNY Archive, BIS File, 797.2, “The Bank for International Settlements and the Central Banks,” June 27, 1929, p. 10.

For starters, unlike the Bank of England, the British government was adamantly opposed to the reopening of German debt negotiations. It, too, was dissatisfied with festering problems in connection with war reparations and inter-Allied debts. Rather than reopen talks, which were seen as inviting new considerations and political conflicts, British Treasury officials favored the cancellation of debts all around, or a major reduction in them, and an end to deliveries in-kind. They also wanted bankers to make proposals for short-term credits.⁶⁷ As for the bankers' idea of creating an international bank, the Treasury aimed to limit its scope and power to that of an agent of treasuries, specializing in the collection and distribution of Germany's payments.

As Simmons spells out, the British government was torn in two different directions during the Paris negotiations and the summer of 1929, one fiscal, and the other monetary.⁶⁸ Domestic political pressure against a disproportionate reduction in British reparation demands led the Treasury and politicians to emphasize fiscal considerations. The British government primarily wanted to secure enough income from reparations to meet its own debt obligations to the United States. The British Treasury shared the Bank of England's concern about the diminished international standing of the pound, as the pound, along with the German mark, suffered from downward speculation during the months of debt negotiations.⁶⁹ Monetarily, uncertainty over German reparations added to deflationary pressure on the pound.

The Bank of England went much further than the Treasury in supporting the idea of founding an institution with a broad public mission and identity. It desired the BIS to be a

⁶⁷ Bank of England Archive, BIS File, 61/451, Memo, "German Reparations," November 14, 1931.

⁶⁸ Simmons, pp. 386-90.

⁶⁹ During the Paris negotiations the United States received \$210 million in gold and France gained \$182 million at the expense of Britain and Germany. Federal Reserve System, *Banking and Monetary Statistics* (Washington, D.C.: Federal Reserve, 1943), cited in Simmons, p. 385.

nonprofit bank for central banks, espousing a system-management role for the BIS, though presenting it in abstract language of “central bank cooperation.” It placed a major premium on central bankers meeting informally and without publicity, stressing the importance of developing international monetary solidarity among central banks, a goal the Bank of England had sought throughout the 1920s. It also sought increased collaboration as a way of reconstituting the prewar gold standard, stabilizing the pound, restoring its international standing, and regaining ground that the City of London had lost to New York as the world’s premier financial center. Without central banks and leading international banks in financial centers like New York, Paris, Amsterdam and Berlin agreeing to defend the gold value of the pound by holding foreign exchange, particularly in pounds, dwindling reserves of gold made it nearly impossible for the Bank of England to achieve this objective. Thus, while privately supporting the creation of the BIS on the grounds that it could help restore the international standing of the pound and buttress a declining British Empire, the Bank of England made the case publicly that “the institution would...crystallize and support cooperative practices.” In any case, the Bank of England placated critics of the BIS in Parliament and in the City of London by insisting that “safeguards should be established to ensure that the social position of the institution in respect of taxation and otherwise...not establish undue competition with private finance.”⁷⁰

Private British bankers publicly supported the Bank of England’s goal of institutionalizing central bank cooperation on an international scale with some reservations. London-based banks feared the creation a super-bank with access to a sizable amount of central bank gold and currency that would compete with them in the London market. Bankers from London (and other European countries) questioned the American bankers’

⁷⁰ Bank of England Archive, BIS File, 61/451, “Fourth Draft of the Bank Plan,” March 5, 1929.

profit motives with regard to the BIS,⁷¹ and they saw the American attempt to make the BIS a profit-making institution as another way of American banks trying to capture a greater share of Europe's banking business. Already concerned about Wall Street's growth as a financial center, they also worried that if the new bank were allowed to accept private deposits, the Swiss market would be strengthened as an alternative to the City of London. This concern was reflected in the BIS's Statutes, which granted it the lending privilege of a private or central bank but denied it the borrowing privilege of a private institution.⁷²

Meanwhile, opposition from the House of Commons, the Treasury and Foreign Ministry helped dash the Bank of England's high hopes for the BIS. Before the convening of the Organization Committee in Baden-Baden, it was widely known in European financial circles that the British government aimed to limit the BIS to a reparations agency.⁷³ Recognizing that there was no chance of securing a cancellation of debts all around, and that it would have to support the establishment of the BIS in order for Germany's reparations debts to be securitized, the British Treasury deferred to the Bank of England and British bankers the task of defining the main functions of the BIS.⁷⁴ During the spring and summer of 1929 British electoral politics hardened the British government's reparation policy. In May of that year, the minority Labor government was elected to office. Incoming Labor officials who had criticized Bank of England policy in the general election campaign extended their antagonism towards British banking authorities into the sphere of the ongoing debt negotiations. Labor officials greeted the idea of commercializing German reparations and

⁷¹ Memo of an interview between Snowden and Francqui, written by Leith-Ross, November 14, 1929, T160 386 F11282/03/01, Treasury Documents, Public Records Office, London, in Simmons, fn. 64, p. 381.

⁷² FRBNY Archive, BIS File, 797.3, "Observations," pp. 7-8.

⁷³ FRBNY Archive, BIS File, 797.3, Jeremiah Smith Jr. to Lamont, Sept. 9, 1929.

⁷⁴ Leading British private-sector representatives included: Sir Charles Addis (banker), Lord Revelstoke (Barings and Brothers), Walter Layton (Editor, *The Economist*).

founding an international central bank of sorts with skepticism. As in the United States, British Labor officials associated this proposal with an informal and gathering alliance between Germany's private creditors and central banks. Inside the Bank of England it was common knowledge that their counterparts at the Treasury were questioning the central bankers' justification of the BIS on the abstract notion of improving central bank cooperation. In addition, the new Labor appointees to the Treasury were seeking to bring the BIS under greater government control by scaling back its more extensive functions.⁷⁵ Above all, the British Treasury opposed the BIS because "it establishes uncontrolled financial autocracy of Central Bankers ... and with authority to fix their powers."⁷⁶

The American international bankers believed that a strong attempt was going to be made at Baden-Baden to make the bank more accountable to political authorities, which, in turn, would have authority to consider periodic revision of the powers of the bank. Accordingly, Montagu Norman advised Layton, a British banking representative, to fight to give the League of Nations some measure of supervision over the BIS.⁷⁷ The American bankers adamantly opposed any link between the two institutions and made their support for any commercialization scheme contingent on this.⁷⁸ Thus, denied their request to link the BIS to the League and to alleviate the motive to earn profits in the bank's design, the Bank of England nevertheless saw in the BIS its hope for institutionalized central bank collaboration.

⁷⁵ Bank of England Archive, BIS File, 667/2, "The B.I.S.: Criticisms by R. G. Hawtrey," July 27, 192; and Bank of England Archive, BIS File, 667/2, R. G. Hawtrey, "International Clearing House."

⁷⁶ See footnote 73.

⁷⁷ FRBNY Archive, BIS File, 797.3, Gilbert to Young and Lamont, Sept. 10, 1929.

⁷⁸ Ibid.

France After World War I, French officials wanted to make Germany to pay dearly for the destruction France, particularly its northern region, had suffered during the war, pursuing a policy of weakening it by military, political and financial means. Military occupation of the German Rhineland and the Ruhr, disarmament and war reparations became centerpieces of this policy of containment. From the French government's perspective, the goal was to eliminate the German military threat, while securing reparation income to help cover its own war debts, especially to the United States government and American banks. On repeated occasions during the 1920s the French government rejected proposals to cancel or significantly reduce the sum of Germany's war reparations, a proposal which many leading bankers had been supporting since the early 1920s. Instead, it advocated their commercialization through bond issuance.

France's intransigence towards reparations had historical antecedents. Following the Franco-Prussian War of 1870-71, Germany saddled France with a large reparations debt. Although the imposition of reparations obligations was a well-established norm before World War I, French officials modeled their postwar reparations policy on Germany's policy following the Franco-Prussian War. Their intransigence on reparations also reflected relations between the Bank of France and French bureaucracies. In statist France in the late 1920s, central bank independence was, in a word, low. Although privately owned like other central banks, the Bank of France differed in that its governor was appointed by the Ministry of Finance. Three of the twelve members of its governing council, the Council of Regents, were also government appointees. By contrast, the central banks of other leading industrialized countries had a much greater level of discretion over appointments and monetary policy. Many German Reichsbank employees were civil servants, but Germany's

postwar constitution insulated the Reichsbank from political pressures.⁷⁹ Thus, the Bank of France was generally more susceptible to government control than its counterparts involved in Germany's debt negotiations.

France's insistence on reparations was also influenced by its financial condition. Unlike the British pound and the Belgian mark, the French franc was in a strong position, mainly due to strong gold reserves, a policy championed by Finance Minister Raymond Poincaré. This situation made France less inclined to search high and low for a political solution to Germany's debt problem.

Finally, France's reconstruction needs contributed to its intransigence towards reparations. The government's slogan "the Bôche will pay" reflected its need for a large amount of capital to rehabilitate its ten northeastern *départements*. These areas had served as the main western theater of the war and had suffered much destruction. While Britain's debt to the United States was largely offset by France's debt to it, France's total war debt was substantially greater. The American government's refusal to grant reconstruction loans to France in the late 1920s (or to forgive its debt) did much to harden the French position.⁸⁰

Still, France's growing trade interdependence with Germany helped ease its reparations policy in 1929. By early 1930, the German and French had become major trading partners. This, coupled with the United States government's categorical refusal to cancel or significantly reduce war debts, encouraged the French government to favor commercializing Germany's debts as an alternative to the Dawes scheme. French political leaders, central bankers and private-sector representatives understood full well that a collapse of the Young

⁷⁹ Barry Eichengreen, *Globalizing Capital: A History of the International Monetary System* (Princeton: Princeton University Press, 1996), pp. 29-30.

⁸⁰ Eichengreen, *Golden Fetters*, p. 128. Also see Ellen Schrecker, *The Hired Money: The French Debt to the United States 1917-1929* (New York: Arno Press, 1978); and Barry Eichengreen, "The Revolving Debt Crises: An Historical Perspective," in Sebastian Edwards and Felipe Larrain, eds., *Debt, Adjustment and Recovery: Latin America's Prospects for Growth and Recovery* (Oxford: Blackwell, 1989), pp. 68-96.

Plan would further complicate the international payments system.⁸¹ As a consequence, various segments of French society and government saw Young Plan as serving France's basic political, economic and financial interests.

Belgium, France's closest ally, mimicked the policy of France, as it had done time and again during the 1920s. These countries shared a common concern about Germany's commitment to satisfying its financial obligations. As Simmons notes, France and Belgium "concocted unorthodox means" to subject Germany to "the discipline of the capital market."⁸² French and Belgian policy-makers favored securitizing German government debt to deter Germany's repudiation of financial obligations, as such a move would limit its access to foreign capital. French and Belgian policy-makers even predicated early Rhineland evacuation on advance payment from Germany.

Although France and Belgium ultimately reversed its policy and withdrew from Germany ahead of the Versailles Treaty schedule, they did so reluctantly and sought additional concessions, for Rhineland occupation had been their principal lever to force Germany to pay reparations.⁸³ Accordingly, France demanded the first BIS president be an American with a private financial stake in avoiding the Young Plan's collapse.⁸⁴ The French government also wanted the BIS to have a French general manager, thus ensuring that persons of American and French nationality would hold the top two management positions.

⁸¹ FRBNY Archive, BIS File, 797.3, Moreau to Young, November 29, 1929.

⁸² Simmons, fn. 84, p. 392.

⁸³ Frank Costigliola, *Awkward Dominion*, p. 207; and Michael J. Hogan, *Informal Entente: The Private Structure of Anglo-American Economic Diplomacy, 1918-1928* (Columbia: University of Missouri Press, 1977), pp. 59, 66-67.

⁸⁴ See footnote 81.

The location of the BIS in Basle, “a neutral city of German language,” also motivated this request.⁸⁵

Most opposition to the BIS in France came from socialists who wanted make the BIS answerable to the League of Nations, which was seen by them as way of limiting the influence of private international financiers in its operations. In addition, as Germany was granted transfer protection by freezing debt payments, French socialists demanded similar protection.⁸⁶ All in all, the French government concluded that it was in the best interest of France to sign the Young Plan and support the establishment of the BIS.

Germany During the 1920s one of the principal obstacles to German monetary stabilization and economic recovery was “the reparations tangle,” Germany’s enormous burden of reparations.⁸⁷ As a result, from the outset of negotiations in Paris in February 1929, German central bankers, led by Hjalmar Schacht, tailored their proposals about reparations and a new international bank to the needs of the German state and economy.⁸⁸ Concerned about a slow- down in international lending, these bankers supported the idea of using German reparations payments as reserves to expand the volume of international credit. Such expansion, Schacht argued, could be used to finance international trade and investment, in turn increasing Germany’s tax receipts and capacity to pay its debts. However, the German proposal was railroaded by the other members of the Young Committee, who

⁸⁵ Ibid.

⁸⁶ The Young Plan included transfer protection for Germany by dividing its annuities into two categories, a transferable and non-transferable portion.

⁸⁷ Eichengreen, *Golden Fetters*, p. 127.

⁸⁸ The main architects of Germany’s reparation policy were Rudolf Hilferding, Hermann Müller, Hjalmar Schacht, and Karl Streseman.

feared its inflationary effects. The French were particularly opposed to it, favoring immediate payment for Germany's debts through a bond offering to private investors.

Germany's stance towards the debt negotiations was also influenced by geopolitical factors. During negotiations the German government pushed for the dismantling of barriers dividing Germany from Prussia and its former colonies to improve the German economy and reduce fiscal pressure on the German government. Yet this proposal was also felled, as the German government had been seeking colonial mandates since the early 1920s. Dejected, Schacht threaten to walk away from the negotiations unless the Young Committee first acted to return the Polish Corridor, access by mandate to the former German colonies and the reduction of European tariff barriers to stimulate a sluggish German export sector.⁸⁹

The idea of creating a new international bank was roundly criticized by Germans of different professional and political backgrounds.⁹⁰ When towards the end of months of negotiations Schacht distanced himself from the Young Plan and virtually withdrew his support for the BIS, his opposition was not exceptional but instead reflected a large and well-formulated share of German economic opinion that had been openly opposing the BIS for months. The path Schacht followed in reaching his opposition to the BIS differed from the paths by which German economists and businessmen arrived at essentially the same

⁸⁹ Jon Jacobson, *Locarno Diplomacy*, p. 257. American and European presses depict Morgan as spokesman for American banking interests. His authority at the conference was unparalleled and bundled up in the overall power of American international banking interests. About the possibility of German withdrawal toward the end of the conference, the *New York Herald Tribune* quoted Morgan as privately saying to Schacht: "Very well. Go ahead and break. But permit me to tell you that all the onerous consequences will be on your head and on the heads of the German people. If you wish to destroy your [German] mark you are entitled to do so, but do not expect American banks to lift a finger to help you restore it again." See Leland Stowe, "Power of Morgan to Sway Germany Is New Debt Hope," *New York Herald Tribune*, May 25, 1929.

⁹⁰ In fact, there was widespread criticism of the proposed BIS in business circles and in the popular presses of the world's capitals in the months leading up to its opening for business. Criticism centered on the claim that in the BIS powerful international banking interests were creating a super-bank that would be able to contravene national and international laws. On September 3, 1929, Bank of England Governor Montagu Norman writes of "widespread criticism of the Bank for International Settlements here." See FRBNY Archive, BIS File, 797.2, Norman to Harrison, September 3, 1929

point. He based his objections on “high moral grounds,” charging that the Young Plan had been subjected to changes of intention during the summer and autumn of 1929. In contrast, opposition from German economic and business circles took on a less abstract form, taking as its point of departure not moral values, but certain disadvantages the BIS would inflict on Germany. The major arguments against the BIS were: (1) that it could neither create credit nor materially stimulate existing credit; (2) that it could deliver no aid to the solution of Germany’s reparations problem; (3) that it would do more harm than good in the area of delivers-in-kind; (4) that it would perform the duties of a private deposit bank rather than a central bank; (5) that its scope in terms of an investment trust was too small; (6) that it had little purpose as a center for gold clearing; (7) that it would interfere with the business of already-existing private banking institutions; and (8) that as a consequence of the extreme caution conferred on it by its international character, the BIS would not be able to add materially to existing ad hoc central banking arrangements.⁹¹

Thus, German opposition to the BIS covered all of the functions assigned to it in the Young Plan. While Germans resented the “humiliation of foreign control” that characterized the Reparations Commission in Berlin, they insisted that the BIS was not needed, dismissing it on the grounds that its functions were being “executed in a highly satisfactory manner by existing organizations.”⁹² Germans understood that while the greatest power at the BIS’s disposal was its short-term lending capabilities, this capacity was of little use to them, as

⁹¹ For a survey of critical German economic opinion of the BIS, see FRBNY Archive, BIS File, 797.2, “Memorandum by Dr. Hjalmar Schacht,” [No Date]; Gustav Stolper, “Die Internationale Bank,” *Der Deutsche Volkswirt*, November 22, 1929; Wilhelm Lautenbach, “Die transferpolitischen Funktionen der Internationalen Bank,” *Magazin der Wirtschaft*, October 10, 1929; See FRBNY Archive, BIS File, 797.2, “Germany and the Bank for International Settlements,” by the Foreign Information Division, February 19, 1930.

⁹² Schacht, “Memo,” footnote 91.

Germans were not experiencing difficulties in securing short-term credits.⁹³ Unable to create credit by issuing notes, the BIS would have a minor effect on expanding the volume of existing central bank credit. For Germans, then, the BIS was more akin to a private deposit bank whose influence depended manifestly on balances maintained with it by central banks. Thus, German policy regarding the BIS was driven not by an abstract notion of central bank cooperation but by political factors.

Despite strong criticism of the BIS as a viable solution to its debt problem, the German government and central bank were at the mercy of its creditors and had little choice but to acquiesce in the Young Plan *in toto*, featuring the BIS as its cornerstone.⁹⁴ Their acceptance of the Young Plan was seen in Germany as the most controversial decision in post-World War I German policy up to 1930.⁹⁵ When presented with the final compromise, the Müller government saw no viable alternative—the German government expected that a rejection of the plan would lead to financial chaos for the Reich, attended by serious economic, social and political ramifications. Before the appearance of the Young Plan at the end of 1929, Germany had already experienced major fluctuations in its foreign currency reserves, especially during the Paris Conference from April to May 1929. The drainage of currencies from Germany further destabilized the German mark. But most important, the downward pressure on the mark resulted from strong pressure from the French franc, the French central bank's steadfast guardianship of French economic and political interests, and the French threat to withdraw 200 million dollars from Germany, almost equal to all of

⁹³ Ibid.

⁹⁴ The Hague Agreements prescribed a legal and passive role for the Reichsbank in the management of the BIS. In practice, however, there is little evidence of this fact. A prominent member of the BIS Board indicated that "it was desired to forget as quickly as possible that the Bank is a reparations Bank." See *Frankfurter Zeitung*, "The BIS: First Experiences," July 27, 1930, pp. 551-553.

⁹⁵ Jacobson, *Locarno Diplomacy*, p. 262. This finding is based on a study of German cabinet protocols.

France's short-term holdings in Germany.⁹⁶ Policy-makers in Berlin in 1929 were no doubt displeased with the prospect of having to pay even a substantially reduced sum of reparation debt. Yet, as these policymakers believed they were at the mercy of their creditors, the German government was forced to accept the Young Plan, including the BIS.⁹⁷ Parker Gilbert, who had resigned as Agent General of the Reparations Commission and joined Morgan and Company, made it clear to the German government that their failure to adopt the Young Plan in its entirety would have serious consequences for the German economy.⁹⁸

Private Authority in the Creation of the BIS

At the time of the founding of the BIS, the line demarcating the public and private sphere, particularly in the area of banking and finance, was not as clearly defined as in subsequent periods. Private financiers regularly responded to market failures by performing such public functions as lender of last resort. Such private-sector initiatives did not undermine the authority of central bankers or treasuries, but broadly complemented their regulatory objectives.

Furthermore, the tradition of private-sector actors creating regulatory structures was a well-established norm in the international system. The creation of the BIS during a period of intense interstate conflict was not an aberration but reflected a pattern of private actors taking up authoritative roles in international affairs. The authority of private creditors in German debts talks was also enhanced by the particular nature of the German reparations

⁹⁶ Paul Einzig, *Behind the Scenes of International Finance* (London, 1932), p 176.

⁹⁷ As Germans viewed the League of Nations as being politically manipulated by France, the idea of founding a new institution also presented new opportunities to have their interests better represented.

⁹⁸ Jon Jacobson, *Locarno Diplomacy*, p. 265. S. Parker Gilbert, an American lawyer, resigned from his position Agent General of the Reparation Commission and joined J. P. Morgan and Company as a partner. He was earning £10,000 British pounds per year as Agent General, but was offered an annual salary of £200,000 pounds by Morgan and Company.

and inter-Allied debt problem. While the budgetary situation of many European countries in the 1920s was poor, conditions were seldom so desperate as to induce any government to sacrifice its political sovereignty for financial assistance. Yet, under the burden of reparations debt, Germany was left in an exceedingly vulnerable position in relation to its main creditors, who could save or wreck its finances by granting or withholding financial support. This situation conferred onto them the legitimacy and power to devise a new debt settlement and institution that was recognized as legitimate to both governments and financial centers.

The authority of private bankers in Germany's debt negotiations was nowhere more evident than in the case of J. P. Morgan, whose appointment to the Young Committee was widely-viewed as a positive development in connection with the funding of Germany's financial obligations. Like his American, European and Japanese counterparts, Morgan desired a durable settlement to the debt question. However, of the private international banks participating in the Young Committee, J. P. Morgan and Company had a preponderant stake in the achievement of a durable solution.⁹⁹ When the Young Committee met in Paris in 1929, approximately \$700 million was still owed to J. P. Morgan and Company by four European governments. This figure was divided among Britain, France, Italy and Belgium, all of whom floated large credits through the House of Morgan. Britain was the largest beneficiary of Morgan loans, receiving \$1.3 billion between October 1915 and October 1919. By January 1929, most was repaid. But at the time of the commencement of the Expert Committee, it still owed \$158 million. France had borrowed \$700 million from October 1915 to November 1924, but by January, 1929, it owed \$149 million. Italy, on the other hand, had borrowed a total of \$142 million since 1915, and still owed the House of

⁹⁹ When the delegations of the six interested countries – Belgium, Britain, France, Germany, Italy and Japan – arrived in Paris in 1929 in small groups of three or four, the Americans delegates made the headlines of the world presses by turning up with an entourage of some thirty lawyers and bankers.

Morgan nearly that entire total (\$139 million) by early 1929. Belgium owed the Morgan firm the most of any European country at the time of the Expert Committee's deliberations. It had borrowed \$285 million since January 1920 and still owed \$230 million in 1929.¹⁰⁰ On March 19, 1929, after two weeks of consulting his European counterparts and sharing their excitement over the prospect of forming a new international bank, Morgan cabled Washington:

The great importance of the bank from the American point of view consists...in three things: it secures the color of commercialization [sic] to the German debt....It takes the handling of debts out of political hands and transfers them to the ordinary machinery of finance....it organizes the credit forces of the world for the collection of the debts from Germany in substitution of political and military forces, and therefore makes them much more certain of being paid.¹⁰¹

After the appearance of the Young Plan in June 1929, a number of last-minute demands threatened to derail it. For example, the Belgian government demanded that Germany reimburse it for the worthless marks left behind in Belgium during its occupation. Also, Germany requested that the Dawes Plan lien on the German railways be terminated. While the bankers agreed to remove the lien on specific German industries, they refused to remove the Dawes lien on the railways. Finally, Germany demanded the early withdrawal of Allied troops from the Rhineland ahead of the Versailles Treaty deadline of 1935.

After committing the Young Committee as a whole to the BIS, many European and American bankers were infuriated by these developments. But it was the American banking contingent which threatened to withdraw their support for the Young Plan.¹⁰² Further complicating matters, the support of the broader American financial community depended in large measure on the participating American bankers', especially Morgan's, attitude

¹⁰⁰ Christian Science Monitor, January 14, 1929.

¹⁰¹ Pierpoint Morgan Library, J. P. Morgan Papers, Box 34/5, Morgan to Stimson, Mellon and ?, March 19, 1929.

¹⁰² Pierpoint Morgan Library, J. P. Morgan Papers, Box 34/5, "Typed Notes," [No Author or Date].

towards the outcome of the negotiations. American markets watched Morgan's moves intently and clung to his every word. Given that the vast majority of capital for the sale of German government bonds would have to come from American investors,¹⁰³ the American bankers' authority over the outcome of the deliberations was undeniably strong. And the plan to create a new international bank was itself central to a broader debt settlement. Morgan outlined the American position on the BIS in a cable to Jackson Reynolds, the American banker who headed the final Organizing Committee Meeting in Baden-Baden:

It is to us i.e. you and J. P. Morgan & Co. that the European Central Banks will look to establish the American participation in the Bank for International Settlements. That being the case it seems to me it would be advantageous for us to agree on what must in substance be the powers and duties of the Bank to enable us to interest the American financial community. The requirement would be in my mind about as follows: (1) the Bank must be a real bank with power to handle its funds either capital or deposits in any manner that the Directors may consider in the interest of the institution; (2) it should be a bank for Central Banks and its accounts should be only with those Banks; (3) when it desires to act in any market through other agents than a Central Bank then it should be only with the approval of the Central Bank of the country involved; (4) its statutes should specifically provide powers to receive the German annuities and to deal with them as directed by the Governments interested; (6) it must not be under Government control except through the heads of the Central Banks; (7) the statutes of the Bank should be so drawn as to leave ample powers to formulate rules and regulations for the convenient conduct of the Bank.¹⁰⁴

With the United States government firmly opposed to official representation in the BIS, the American bankers made their support for the financing of German reparation contingent upon the granting of certain concessions in designing the bank. Of the participating European and North American bankers, American bankers played a particularly significant role in the debt negotiations for at least two reasons. First, as mentioned above, Germany's reparations became an international problem by virtue of their connection to inter-Allied debts and European government debt held by private, particularly American,

¹⁰³ London joined New York as the second most important center for the sale of these bonds.

¹⁰⁴ Pierpoint Morgan Library, J. P. Morgan Papers, Box 34/5, Morgan to Reynolds, October 29, 1929.

banks. In the post-World War I international financial system the United States financial market held a hegemonic position. Awash with surplus capital, American banks became the leading suppliers of loans, credits and capital investment to Germany during the 1920s. Germany imported massive amounts of foreign capital to finance domestic investment, consumption and reconstruction. However, a great deal of American capital investment in Germany in the 1920s was speculative in nature and did little to improve Germany's real economy and recovery. Eventually, international lending to Germany slowed towards the late 1920s, as rising interest rates and the Wall Street boom in stocks beginning in 1928 diverted investors from foreign bonds to domestic stock. This development was compounded by American, British, and French creditors' fears that Germany would default on its loans and obligations to pay war reparations.¹⁰⁵

The authority of American bankers in German debt negotiations was also a function of the geographic nature of the problem of German reparations. Postwar political disputes over the gold standard, Allied war debts and reparations fueled mistrust and confrontation among the European powers, impairing their ability to select a neutral European body to preside over debt negotiations. The League of Nations was quickly ruled out by Germany because it saw it as being politically manipulated by France. Most members of the Young Committee also ruled out the possibility of the League exerting authority because they saw it as a politicized institution. This sentiment was typified by the American bankers' ardent opposition to any link between the two institutions. This, they charged, would be fatal to the fledgling world banking institution and would force them to withdraw their support for its establishment:

¹⁰⁵ The crash of the New York stock market in October 1929 compounded this problem. See, Derek H. Aldcroft, *From Versailles to Wall Street, 1919-1929* (London: Allen Lane, 1977), especially pp. 260-268.

Responsibility to the League of Nations would probably be the worst thing that could happen to the Bank. The League of Nations itself is a political institution in which the foreign offices of the principal countries are accustomed to participate as well as the various treasuries, and the question of political control would thus arise in its most difficult form. Moreover, association with the League of Nations would give color to the conception of the Bank as a super bank, and it might very well prevent American participation in any form.¹⁰⁶

Thus, denied the opportunity to enlist the support of the League of Nations, European governments sought the support of the United States, both on the level of the state and the private sector. European bankers participating in the Organizing Committee in Baden-Baden even went so far as to insist that the first president of the BIS be an American banker, citing that this measure would “secure a more friendly [sic] attitude on the part of the United States toward reparations and perhaps toward the softening of our debt contracts with the allied governments.”¹⁰⁷ Reluctant to assume this responsibility, the United States government complied with the normative appeals of leading American businessmen for them to represent the United States in solving Germany’s debt problem and creating the BIS.

Given these conditions—the blurred line between the public and the private sphere in the area of banking and finance, the well-established norm of private-sector participation in international financial governance, and the particular nature of the German and inter-Allied debt problem—it is little wonder that private actors were so instrumental in creating the BIS from 1929 to 1930. Private international bankers not only proposed the BIS, they shaped its ultimate form.

¹⁰⁶ Pierpoint Morgan Library, J. P. Morgan Papers, Box 34/5, Gilbert to Young and Lamont, September 10, 1929.

¹⁰⁷ FRBNY Archive, BIS File, 797.3, “Past Consideration of the Question [of BIS Membership], 1929-30,” Foreign Information Division.

Conclusion

Thus, the form of international financial organization that resulted in the BIS reflected the authority and interests of its architects: central banks, private international bankers and, to a lesser extent, governments. Placed in a longer historical perspective, the creation of the BIS during a period punctuated by international political conflict was not aberrant. Nor was the participation of private-sector actors in its establishment. Prior to the founding of the BIS, private-sector actors regularly performed extensive roles in managing international crises. Their authority in such instances was shared with, comparable to, even significantly weaker than states. Yet while private authority was most pronounced in countries in which there was a high degree of central bank independence, in general private-sector actors were formidable, authoritative forces in international financial affairs.

Still, although private authority in founding the BIS did not undermine government regulatory objectives, there is evidence that interested governments exerted political influence over central and commercial banking experts; that governments granted weak support for the BIS; and that this weak commitment limited its effectiveness in the 1930s. Nonetheless, central and commercial banking experts extracted more compromises from governments than the other way around, with the BIS's organizational design and *modus operandi* more closely resembled a profit-making company than a reparations agency. But the founders also created a form of international financial organization that emphasized direct consultation and collaboration between central banks and representatives of the private sector. The idea behind this organizational feature was that, while central bank governors constituted the heart of the Board, there ought also to be room for input from the leading private bankers. In this sense, the BIS represented a particular mode of governance: a

partnership between representatives of markets and central banks sitting side by side, attempting to effect desired outcomes in financial markets.

That the BIS represented a different form of organization from the League of Nations can be found in its source of funding. Unlike the League of Nations and the generation of intergovernmental organizations that appeared after the Second World War, the BIS's capital subscribers were central banks, private investors and banking institutions, not national governments. By ensuring that the BIS's primary source of funding was to come from central bank reserves, and not quotas that required yearly approval by elected politicians, the BIS's founders twice removed the BIS from national politics: the first layer of insulation was a function of central bank independence, the second a result of the BIS's international, as opposed to national, character.

In the BIS a small group of European and North American central and private international bankers realized their goal of institutionalizing central bank collaboration on an international scale. With the gathering storm of the Great Depression and the cancellation of reparations payments only a little more than one year after the BIS's opening in May 1930, the bankers' dreams of producing a lasting settlement to German reparations, stabilizing international capital markets and fostering central bank cooperation proved short-lived. Even so, the founding of the BIS represented the extension internationally of the regulatory role of the state in the world economy.

Chapter 3

The Economic Consequences of Political Autonomy: The BIS during the 1930s

The previous chapter demonstrated just how authoritative private bankers were in governing international finance in the late 1920s. Not only did these actors perform leading roles in proposing and designing the first major international financial institution of the twentieth century in the BIS but also governments endorsed this activity as legitimate. The bankers' involvement in managing international finance was idiosyncratic neither in the international financial crises of the latter half of the 1920s nor in the issue of German reparations, but rather reflected a long-standing pattern of collaboration between states and firms in coping with the challenges of an expanding world economy. The distribution of authority and power between states and markets in the 1920s accorded a major role for the latter, as states openly endorsed the active participation of market actors in public policymaking.

State-market relations are, however, forever changing. The Great Depression marked an important turning point not only in the nature of relations among states and market actors in the advanced industrialized countries, but also in the history of the BIS. During the 1920s central bankers and leading international bankers actively collaborated in shaping state- and market-led initiatives aimed at stabilizing international finance, culminating in the creation of the BIS in 1930. The Great Depression, however, fundamentally reoriented relations between governments, central banks, and prominent commercial bankers, particularly in regard to foreign economic policymaking. In the advanced industrialized countries, governments responded to deteriorating economic, political and social conditions by reasserting their full authority and power over national economic policymaking, thus

limiting the authority and influence of central and private bankers. Consequently, central bankers surrendered a significant degree of autonomy to their government counterparts. Changes in relations among governments and market actors, and in relations between governments and central banks, in turn, handcuffed the BIS, which had partly been created to instrumentalize the model of central bank action on an international scale.

The diminution in the credibility, authority and power of central and private bankers in international financial policymaking coincided with the diminution in credibility of the classical liberal doctrine of economic thought. This doctrine of thought, which was dominant before the onset of the Great Depression, clearly manifested itself in the creation of the BIS. Throughout the 1920s bankers had dominated international financial policymaking by promoting the orthodox belief that politics and economics could and should be separated; that is, that government officials, especially representatives of treasuries, should leave the management of international finance to central bankers and prominent commercial bankers. In founding the BIS central and commercial bankers put this principle into practice by linking the institution to central banks, as opposed to treasuries, through representation on its Board of Directors and through the bank's access to central bank funds and not government quotas. As the previous chapter showed, these bankers resisted attempts by treasury officials to limit the BIS to a reparations agency that would have been answerable to treasuries and dedicated primarily to the collection and distribution of interstate war debts. Instead, the bankers institutionalized close collaboration among central bankers, on the one hand, and between central bankers and prominent international bankers on the other.

Ironically, the bankers' move to insulate the BIS from governments, the very principle that was to ensure its effectiveness as a financial institution, produced the opposite

result. Reluctant to cede political sovereignty over foreign monetary policy, governments granted the new institution only minimal support.¹ To produce desired monetary results through binding policies, international financial institutions like the BIS require the strong political backing of governments, not least the most powerful ones in the international system. International economic activity and international politics indeed are inseparable.² As Pauly reminds us, “well-functioning markets that span discrete political jurisdictions must themselves rest on a foundation of political collaboration.”³ However, in attempting to insulate the BIS from politics, the founding bankers unintentionally handicapped the institution, leaving it with little power to enforce the policy decisions that were reached in Basle throughout the 1930s. In addition, the volume of funds the BIS could marshal to stabilize currencies and promote economic recovery was by all measures insufficient. Without the political support of the major powers for decisions that were being made in Basle, the BIS had little chance of restoring market confidence in the way that only states could do at the time. Money, as it were, was political, and the kind of “sound money” that bankers aspired toward counter intuitively depended upon strong political collaboration and commitment by governments.

Overview of the Bank for International Settlements

¹ Beth A. Simmons, “Why Innovate?: The Establishment of the Bank for International Settlements,” *World Politics*, 45 (April 1993), 361-405; and Kevin Ozgercin, “When Bankers Were Diplomats and Diplomats Were Bankers: Private Authority and the Establishment of the Bank for International Settlements,” (revise and resubmission, *RIPE*).

² Richard Hemmig Meyer, *Bankers' Diplomacy: Monetary Stabilization in the Twenties* (New York: Columbia University Press, 1970), p. x.

³ Louis W. Pauly, “The League of Nations and the Foreshadowing of the International Monetary Fund,” *Essays in International Finance*, No. 201, Department of Economics, Princeton University, December 1996, p. 3.

Before analyzing the effects that the Great Depression had on the development of the Bank for International Settlements during the 1930s, it is important to take a step back and review basic aspects of the organization. The bank's connection to reparations as well as its original management and capital structure are reviewed here.

Reparations and the Administration of the BIS The original administration of the BIS was a reflection of the general nature of international financial policymaking of the late 1920s and the national groupings that negotiated the German reparations settlement. For example, since it was bankers – central as well as commercial – who performed the most dominant roles in reaching the reparations settlement and designing the BIS between 1929 and 1930, these two sets of actors constituted the subsequent administration of the bank. The upper management of the bank consisted of a board of directors and a group of senior managers. Membership on the board of directors and management was drawn mostly from central banks but also from private industry. Whereas Article 27 of the BIS Statutes vested the board of directors with the authority of administration, the Young Plan stated that “two nationals” of each country “shall be qualified to act in the full capacity of the directors of the bank.” Article 28 specifies that the BIS Board of Directors was to be composed of three groups: governors (or their nominees) of the central banks of Belgium, France, Germany, Great Britain, Italy, Japan and the United States; seven persons representative of finance, industry or commerce (one to be appointed by each of the governors); and not more than nine persons to be chosen by the board upon nomination of other countries. This latter group has historically been limited to the governors of Sweden, the Netherlands and Switzerland.

Thus, in its original composition, the BIS Board of Directors constituted a form of

international financial organization that emphasized direct consultation and collaboration among central banks and representatives of the private sector. The idea behind this organizational feature was that while central bank governors constituted the heart of the board, there ought also to be room for input from the private sector, typically in the form of a leading banker from each country. In this sense, the BIS represented a particular mode of governance: leading central bankers and prominent international financiers sitting side by side and managing international finance.

Furthermore, the senior managers of the BIS constituted an important part of the bank's administration. While central bankers were the principals of the bank's board of directors, "they did not wish to get involved in the day-to-day management of the bank."⁴ Also, since senior managers were responsible for managing the bank's daily operations, and thus possessed intimate knowledge of its financial operations, these managers subsequently played a crucial role in the monthly meetings of central bank governors. After all, senior managers set the agenda for, participated in, and influenced the decisions made at these meetings. The selection of Gates McGarrah and Leon Fraser, New York bankers associated with the reparations settlement of 1930, as President and Vice President of the BIS signified the Europeans' desire for two top management positions to be filled by Americans who were thought to transcend the European conflict over reparations. Since France was owed the greatest proportion of German reparations (55%), the next top position in the bank's management, General Manager, was informally accorded to the French. The German reparations problem involved predominantly transactions between France and Germany. Consequently, the position just below the General Manager, the Assistant General Manager, was to be a German, who doubled as head of the Banking Department, as this department

⁴ Basel University Library, Department of Manuscripts, NL 324, A I 110, Jacobsson Diaries, November 4, 1956.

was responsible for the handling German funds and payments. Besides these four top management positions, there was a position for a Briton, an Italian, a Belgian and a Dutchman. These managers, in addition to their staff members, were predominantly selected on the basis of national representation. Staff members were mostly drawn from the staffs of member central banks, giving the founding central banks a natural linkage to the BIS apart from the monthly board meetings. It also provided central bank representatives with valuable experience in European and international central banking.

Besides the members of the board of directors and senior managers, the economic advisor of the BIS constituted an influential position in the bank's operations from the very beginning. This position was first occupied by Per Jacobsson, who joined the BIS in 1931 in the throes of the Great Depression. An orthodox Swedish economist who had worked for the Financial, Economic and Transit Department of the League of Nations from 1921 to 1931, Jacobsson would become a towering figure in the BIS and in international finance for decades to come. Internationally renowned for his writings, particularly the BIS's annual reports, Jacobsson was thought to transcend conflicts among governments and the problem of war reparations in particular. After serving as economic advisor to the BIS from 1931 to 1956, Jacobsson's authority in international financial affairs would be recognized by his selection to be the third Managing Director and Chairman of the Board of Governors of the International Monetary Fund. It was a position that Jacobsson would hold from the time he left the BIS in 1956 to his death in 1963.

Despite the BIS's obvious connection with German reparations, members of the board of directors and senior managers sought to minimize the reparations character of the bank. Shortly after opening for business in Basle in May of 1930, a prominent member of the board of directors indicated that it was desired "to forget as quickly as possible that the

Bank is a reparations Bank.”⁵ Although BIS officials wanted to downplay the reparations character of the bank, achieving this objective was easier in theory than in practice. Not only was the BIS stigmatized by its connection to German war reparations; its association with them presented inherent contradictions for the bank. For example, part of the BIS’s original starting capital, which earned the greatest profits for the bank in its early years, originated from non-interest bearing compulsory deposits by central banks. While BIS officials knew that their bank’s influence in the international financial system would in part depend upon the amount of currency and gold that the bank could marshal, and that profits derived from reparations were important to building up the bank’s capital base, they also knew that the reparations connection would make it next to impossible for the BIS to avoid conflict arising from reparations. The Great Depression quickly ensured that reparations would leave an indelible mark on the BIS for decades to come. It also impeded the development of some of the broader functions that the bank’s founders had envisaged for it. Indeed, while Article 3 of the BIS’s Statutes stated the promotion of cooperation between central banks as a primary object of the bank, a careful reading of the Statutes show that the bank’s founders clearly had other commercial and banking transactions in mind. Accordingly, in the midst of a world-wide depression in 1931, the BIS sought to act as a catalyst in encouraging private banks and the public to employ their own funds “in the advancement of promoting the international flow of capital.”⁶ As this chapter will show, the ability of the BIS to develop some of these broader functions, which were aimed at managing international finance, would be limited by the consequences of the Great Depression.

The BIS’s Original Capital Base Founded on the model of a traditional profit-making

⁵ Frankfurter Zeitung, “The BIS: First Experiences,” July 27, 1930, pp. 551-553.

⁶ BIS Archives, MCG6/42, McGarrah to Armand Dreyfus [Vice Chairman of Swiss Banking Corporation], March 12, 1931.

company, one of the first tasks of the BIS's founding bankers and senior managers was to raise capital for the bank's operation. This objective was pursued through an initial share offering. Sixteen thousand shares each were subscribed by the Bank of Belgium, the Bank of England, the Bank of France, the Bank of Italy, the German Reichsbank, the Industrial Bank of Japan (leading a group of Japanese banks), and a group of American banks including J. P. Morgan & Company, the First National Bank of New York, and the First National Bank of Chicago. The bank started with deposits of 2.2 billion Swiss francs and total assets and liabilities of 3 billion Swiss francs.⁷ In addition, in connection with the Hague Agreements of 1930, the bank received non-interest-bearing deposits of some 155 million Swiss francs, which were deposited at long-term by the treasuries of the creditor governments to the reparations settlement; 77.5 million Swiss francs that were deposited by the German government for the same purpose; and a deposit by the French government in the amount of 69 million Swiss francs in the BIS's Guaranty Fund. Thus, at the time of its creation the BIS possessed an additional 404 million Swiss francs that yielded no interest to depositors – central banks and treasuries, which placed funds in the BIS through central banks. While the BIS's original capital base was substantial in itself, the amount was modest in proportion to the volume of funds that was required to prevent the magnitude of financial crises that occurred in the early 1930s. Unable to raise capital from private sources through the issuance of bonds, the BIS was dependent upon the support of central banks, which in turn, depended upon the political backing of governments. As this chapter will show, neither the requisite volume of capital nor the political support of governments to use the BIS to solve the most pressing international financial problems would be forthcoming.

Lastly, the origin of the funds deposited with the BIS can be explained by the

⁷ Bank for International Settlements, *1st Annual Report* (Basle: BIS, 1931), p. 1.

essence of its three basic functions: (1) to facilitate the payment of annuities in connection with the reparations settlements of 1930; (2) to advance cooperation among a select group of founding central banks and prominent international banks by establishing facilities to support such action; and (3) to promote the development of additional international financial facilities. Examples of such facilities are: systems for simplifying transfers from one currency to another, for settling international payments between governments and international organizations like the World Postal Union, and for clearing international payments in gold without the actual physical transfer of the metal. While the BIS's development of such financial facilities, especially its sophisticated system for gold transactions, became central parts of the international financial system from the late 1930s onwards, their use by states during the 1930s was limited by the bank's connection with reparations and the hard-fought and bitter campaign between treasury officials and bankers, central as well as commercial, over what constituted a proper approach to solving international financial problems.

Great Depression and the End of Bankers' Diplomacy

Throughout the 1920s prominent international financiers actively collaborated with central bankers in governing international finance. Relations between these bankers were cooperative and collaborative, not merely antagonistic and competitive. They shared with one another a common interest in facilitating industrial growth and increased trade among nations after World War I. Basing their proposals on classical liberal ideas, leading bankers argued that these twin goals were best built on the foundation of international financial markets that were unfettered by government controls. Throughout the 1920s, the bankers and their classical ideology dominated international economic policymaking.

The world-wide banking panics and economic downturns of the early 1930s fundamentally reoriented relations between governments and central banks and between states and market actors more generally. Internationalist-oriented private and central bankers who had successfully promoted the model of central bank action, became discredited in decision-making circles, mostly because political authorities and mass publics associated their policies and operations with the onset of the widespread unemployment and social turmoil that attended the Great Depression. Moreover, As Helleiner indicates, the year 1931 was significant because it

marked the beginning of an important break with liberal tradition in financial affairs.... Their views largely discredited by the crisis, the private and central bankers who had dominated financial politics in the 1920s were increasingly replaced at the levers of financial power in the industrial world by a new coalition of social groups that included industrialist, labor leaders, and Keynesian-minded state officials. Whereas the bankers had advocated a laissez-faire approach to domestic financial issues and the automatic following of “rules of the game” in the international financial sphere, these new groups favored a more interventionist approach that would make domestic and international finance serve broader political and economic goals.⁸

As we will see below, the international financial crisis of 1931 was important not only because it led to the discrediting of bankers but also because it exposed the limitations of the newly-created BIS in stabilizing international financial markets.

The BIS was thus born into a world of financial and economic crisis. Plummeting prices and credit squeezes associated with collapsing stock and capital markets made it harder for borrowers to repay their bank loans. As the value of collateral depreciated banks were reluctant to restructure existing loans or extend new lines of credit. Smaller firms that failed to secure additional credit had little choice but to downsize or cease operations completely. Seemingly everywhere, new investment ceased. As lenders of last resort, central

⁸ Eric Helleiner, *States and the Reemergence of Global Finance: From Bretton Woods to the 1990s* (Ithaca: Cornell University Press, 1994), pp. 27-28.

banks were keenly aware of this situation. Stabilizing their own currencies, offsetting a credit squeeze and preventing capital flight and a further decline in asset prices, however, was not as straightforward as increasing the supply of money in the economy. The faster central banks intervened to inject liquidity into the banking system, the faster such capital fled to more secure markets, and the faster it was hoarded or reallocated into speculative assets.

The shock of the world-wide banking panics and economic depression of the early 1930s also had certain political effects. Not only were central and private bankers discredited on both sides of the Atlantic; their authority and influence in international financial affairs diminished. More and more, political authorities reasserted their authority and power over the full gamut of national economic policies. This development, in turn, indirectly effected on the authority, influence and legitimacy of the BIS as an instrument of central bank cooperation. For the BIS was the embodiment of the orthodox model of monetary regulation, which featured central bank cooperation as a way of managing an international financial system based on featuring gold convertibility, the establishment of independent central banks, the disciplining of fiscal policy, and conditional financial assistance for countries in crisis.⁹

Although the BIS added important new services to central banks and international finance more broadly, it quickly proved incapable of being a catalyst for restoring confidence in international capital markets and inducing any meaningful level of interstate monetary cooperation. In *The End of Globalization* Harold James sees the failure of the BIS to produce international monetary cooperation and its transformation into “an institution for economic

⁹ Harold James, *The End of Globalization*, p. 33.

analysis” as rooted in a general breakdown in the pre-Great Depression theory of central bank action. James notes:

This collapse of the BIS into a center for merely routine operations was part of a broader breakdown of the theory of central bank action. As the Depression deepened, and as criticism mounted on all sides, central bankers more and more believed that their only mission lay in announcing loudly that they could do nothing, that monetary policy could not influence the development of the real economy. This was a complete break with the central bank activism of the mid-1920s. It was also of course theoretical nonsense, which arose out of the (forgivable) feeling that politicians’ rather than central bankers’ blunders had made the financial mess. If this is what was meant by a ‘common body of monetary doctrine,’ it was one that was led away from giving central banks great room for maneuver in international financial matters.¹⁰

This development was rooted in material changes in state-market relations. The Great Depression had deleterious effects on international trade and the possibility for interstate cooperation to reconstitute trade relations. For instance, Great Britain, which for a long time had followed a policy of liberal trade in goods and services, turned decisively towards trade protectionism after World War I but especially after 1932. Protective tariffs, quotas and other kinds of trade protections became the norm in international relations in the 1930s, especially as such great powers as the United States shifted its commercial policy in a decidedly protectionist direction. The Hawley-Smoot tariff of 1930, which raised US tariff levels to the highest in US history and resulted in retaliatory tariff acts from foreign countries, epitomized this trend.

Meanwhile, institutionalized multilateralism in economic and financial affairs was in its infancy. Internationalist-minded central and private bankers continued to support the BIS as a center for international monetary cooperation as governments came under increasing pressure from business groups for protectionist policies and from the public for welfare

¹⁰ Ibid., pp. 95-96

policies. The wave of economic nationalism overpowered the loose sense of internationalism among bankers. The transnational network of central bankers and their private financial counterparts that had sustained the prewar gold standard and postwar gold-exchange standard were severely weakened by this shift in relations between states and markets. Central banks became subordinated agencies of governments, sacrificing a great degree of independence in monetary affairs, and thus sacrificing independence in their dealings with market actors. The introduction in the mid-1930s and support for Keynes' ideas about state intervention in the economy narrowed still further the room for central bankers to maneuver internationally. The development of the BIS, an organization that was the embodiment of central bank activism, would be stunted as a result.

Early Tests, Crisis Spreads

This section analyzes the financial crises of 1931, particularly focusing on the activities of the Bank for International Settlements in attempting to respond to them. It argues that 1931 was the most decisive year for the BIS in the 1930s. Its inability to perform a meaningful role in reversing the financial crises in Austria, Germany and Hungary sealed the bank's fate as an insignificant international financial institution for the remainder of the decade.

The world financial crisis from 1929 to 1931 grew into a violent crisis in the summer of 1931. In May of that year Austria's largest deposit bank, Creditanstalt, was bankrupt. Its deposits were so enormous that it was impossible to freeze them until bankruptcy proceedings were completed. The Austrian economy would have lain in ruins. Even though the Austrian government attempted to reestablish confidence in the banking system by guaranteeing deposits, the move was too little, too late. Fears of currency devaluation spread.

Capital streamed out of Austria in search of more stable markets. Faced with enormous speculative capital flight and the cessation of long-term lending by US banks, the Austrian government instituted capital controls.

The need for concerted international financial action could not have been more apparent, but the snail-like pace and grossly inadequate sums of money offered to Austria, coupled with French politics, proved fatal. Austria was in dire need of foreign exchange and sought a loan of 150 million schillings (\$21 million). Austria's request was directed at the League of Nations Financial Committee, which referred it to the BIS. Under the leadership of its president Gates McGarrah, the BIS organized a loan of 100 million schilling (\$14 million) from the world's ten largest central banks. The process took from May 14 to 31. When McGarrah approached the Federal Reserve Bank of New York on May 14, he had already received the support of the Reichsbank, the National Bank of Belgium and the Bank of England. While some have associated the remaining delay with the amount of time needed to arrange for a standstill among Creditanstalt's creditors and to secure the Austrian government's guarantee of its borrowing, there is little question that the delay resulted from French politics.¹¹ French Premier Pierre Laval, a fervent nationalist, greatly influenced French foreign economic policy in 1931. Almost single-handedly, Laval blocked the proposed international support package for Austria, insisting that if France were to contribute, France had to get something out of it. These were bad times, and Laval demanded diplomatic concessions, the most important of which was the renunciation of a prospective customs union between Austria and Germany. The French government sought to weaken Germany even seemingly at the expense of its own economy. Indeed, there is strong documentary evidence to suggest that France exacerbated the 1931 run on the

¹¹ See, for instance, Stephen V.O. Clarke, *Central Bank Cooperation, 1924-1931* (New York: Federal Reserve Bank of New York, 1967), p. 189.

Austrian schilling in order to force Austria to abandon the Austro-German customs union project of that year.¹² The measly and delayed sum of 100 million schillings did little to temper Austria's crisis.

By June 5 the credit was expended and the Austrian National Bank asked for another. The 12th monthly meeting of the BIS, held on June 8, presented an additional opportunity for collective financial action. Central banks and international lenders were joined in Basle by Professor G.W.J. Bruins, who had been appointed Foreign Technical Adviser by the Austrian National Bank. The BIS Board recognized the seriousness of the Austrian financial crisis and by June 14 they had organized (and participated in) a new credit of 100 million schillings to the Austrian National Bank.¹³ The BIS stipulated that £3 million sterling in gold, which the Austrian National Bank had on deposit at the Bank of England, had to be deposited by the former on account of the BIS. The BIS was to hold the gold until the repayment of the credit had taken place.¹⁴ The loan of 100 million schillings, which was subject to the condition that the Austrian government should obtain a two-to-three-year loan abroad for 150 million schillings, fell apart because the French government interposed the condition that the Austrian government should abandon its customs union with Germany.¹⁵ The Austrian government rejected France's demand and the loan collapsed. Infuriated with the French, Bank of England Governor Montagu Norman unilaterally extended a one-week, 50-million-schilling (\$7 million) credit to the Austrian National Bank,

¹² Iago Gil Aguado, "The Credit Ansalt Crisis of 1931 and the Failure of the Austro-German Customs Union Project," *The Historical Journal*, 44 (2001), pp. 199-221.

¹³ BIS Archives, Board of Directors, Agendas and Minutes, "Minutes of the 12th Meeting of the Board of Directors, June 8, 1931.

¹⁴ Ibid.

¹⁵ Charles P. Kindleberger, *The World in Depression, 1929-1939* (Berkeley: University of California Press, 1986), p. 147.

and the BIS followed suit, but with reservations that did not inspire confidence.¹⁶ The Bank of England credit was renewed each week through July until in August, with increased pressure on the pound and the League of Nations arranging a 250 million schilling loan from seven governments, the Bank of England asked for repayment. Throughout the negotiations, BIS officials placed great importance on “keeping clear of the League of Nations.”¹⁷ BIS officials generally viewed the League of Nations as a politicized body, insofar as governments were represented in the League by their treasuries.

The BIS, which could have run the loan program, was not about to make a single move without the approval of all of Europe's major economic powers. The failure of the BIS to move in advance of and against the wishes of one of its major shareholders, France, is not unusual but is rather to be expected. It lacked the support of the governments of the major powers; it also lacked the volume of funds necessary to perform the role of lender of last resort. Austria was one of Europe's four largest debtors, Germany, Britain and Hungary being the other three, but it was a relatively small country whose financial panic could have been stopped.¹⁸ A large-scale international loan to Austria's central bank would have gone a long way toward strengthening its internal banking system. But the BIS was incapable of orchestrating a swift, concerted financial assistance package. Given that the volume of funds at the disposal of the BIS was limited, and that it was denied the right to increase its funds by discounting bills or by accepting deposits from private investors, the BIS could do little more than organize insufficiently-sized, short-term credits and host discussions about the crisis. Neither activity did much to buttress Austria's reserves and allow it to survive the

¹⁶ Barry Eichengreen, *Golden Fetters: The Gold Standard and the Great Depression, 1919-1939* (New York: Oxford University Press, 1995), p. 268.

¹⁷ FRBNY Archive, BIS File, 797.3, “Topics for Informal Discussion with Fraser to George Harrison, Burgess and Crane,” June 1931.

¹⁸ Barry Eichengreen, *Golden Fetters*, p. 254.

panic without either devaluing or suspending the convertibility of its currency. Too much time had passed to put an end to Austria's crisis or to prevent its spread to neighboring countries.

Meanwhile, Germany's financial and economic crisis began in May 1931. The success of the Nazis in the September 1930 elections in Germany precipitated the withdrawal of the majority of French investments from that country and a loss of £50 million in gold and foreign exchange. The Creditanstalt crisis led to withdrawals of short-term credit from Germany in the amount of £150 million. The crisis intensified in June, as the Reichsbank lost RM 164 million in gold in the first six days of the month. By June 13 the Reichsbank had lost another RM 400 million, prompting it to raise its discount rate from 5 to 7 percent, which slowed down the movement somewhat.¹⁹ European powers and the United States were at loggerheads over the linkage between war reparation and inter-Allied debts, especially those owed to the US, the Germans and the British seeking an "all-around cancellation" with the French and the Americans refusing to agree to an all-around cancellation of war debts.²⁰ The Hoover administration did, however, announce a one-year moratorium on all intergovernmental debts on June 20.²¹ As France initially refused direct acceptance, and since additional time was lost as a result of Secretary of State Andrew Mellon's talks in Paris, the favorable response in international financial markets was muted. Markets were not convinced that governments were committed to ending the crisis.

The time for BIS action was then. On June 25 it arranged a credit of \$100 million, with \$25 million each from the BIS, the Bank of England, the Bank of France and the

¹⁹ This account is based on Kindleberger, pp. 148-153.

²⁰ Bank of England Archive, BIS File, G1/452, Leith-Ross to Norman, December 30, 1931; Bank of England, BIS File, G1/452, "Draft Proposals for Reparations Conference."

²¹ German payments suspended indefinitely by the Lausanne Agreement of 1932.

Federal Reserve Bank of New York. However, the credit was far too short-term, maturing on July 16. The credit was also too late to help the Reichsbank statement of June 23, which would have shown a ratio below 40 percent.²² The run on German banks intensified, which led to their being forcibly closed from July 13 to early August. Weak confidence in the German mark raised fears of 1923-style inflation. There was a huge volume of notes in circulation at this time.

Governments interested in Germany's postwar financial obligations met in London, not Basle, in July 1931 to devise a response. At the London Conference government representatives recognized the connection between the financial stability of Germany and the stability of the broader international economy and agreed to take steps to restore confidence in the German market. They recommended that the central bank credit of \$100 million granted under the auspices of the BIS be extended for a period of three months. Between the BIS's monthly meetings of its Board of Directors in June and July 1931, BIS President Gates McGarrah indicated that "a number of important international events had taken place since the last meeting of the Board, of the nature likely to affect the development of the Bank for International Settlements."²³ The \$100 million credit that had been extended to the Reichsbanks fell due on July 16th. Nevertheless, this situation was "overshadowed by an event of more immediate import, namely, the great crisis of confidence which had developed in and as regards Germany."²⁴ The crisis had deepened so much that BIS officials questioned whether technical financial measures alone could stabilize the situation, recognizing that well-functioning markets depend on political collaboration by governments:

²² Stephen V.O. Clarke, *Central Bank Cooperation, 1924-31*, p. 193.

²³ BIS Archives, Board of Directors, Agendas and Minutes, "13th meeting of the Board of Directors, July 13, 1931."

²⁴ Ibid.

“Concerted action by the governments might provide a solution and clear the atmosphere so that financial forces might work normally, but it was evident that neither the Bank for International Settlements nor the Central Banks could deal with or solve questions of a political order.”²⁵

The London Conference of July 1931, also known as the Seven Power Conference, called for the continuation of short-term credits to Germany. The Standstill Agreements, which grew out of this conference, and were brokered by governments, central banks and interested commercial banks, effectively froze foreign claims on Germany. The German economy’s importance to the broader international economy was clear: “the foreign banking creditors of Germany should take concerted measures with a view to maintaining the volume of credits they have already extended to Germany...in order to ensure the maintenance of the financial stability of Germany, which is essential in the interests of the whole world.”²⁶ Consequently, the BIS was asked to form a committee with “full power to deal with such cases of differences in interpretation that may arise from the Agreement.”²⁷ Governments represented at the London Conference also recommended that the BIS set up a committee of nominees by the governors of the central banks to ascertain the total value of Germany’s credits, assess its additional credit needs, and study the possibilities of converting a portion of the short-term credits into long-term credits.

All of this was for naught, as only two months later in the September 1931, Germany unilaterally cancelled its debt payments on its obligations under the Dawes loan of 1924 and the Young loan of 1930. As much as BIS officials had tried to minimize the reparations

²⁵ Ibid.

²⁶ BIS Archives, H.S. 38, “The German Credit Agreement of 1936,” p. 1.

²⁷ BIS Archives, MCG2, Albert H. Wiggin to Walter T. Layton, August 18, 1931.

character of the bank from the outset,²⁸ Germany's decision denied the BIS an important source of income. In addition, it complicated the international payments system for the remainder of the 1930s.²⁹ Through much of the 1930s Germany's war debts were financed mainly by American but also European banks and were organized by a series of successive international Standstill Agreements. US President Hoover and French Premier Pierre Laval agreed that Germany should invite the BIS to convoke the Special Advisory Committee stipulated under the Hague Agreement, so Laval approached the German ambassador in Paris on November 3 for this purpose.³⁰ However unsatisfactory they were as responses to the financial woes of the early 1930s, the Standstill Agreements, originally for six months but thereafter renewed on an almost automatic basis, and the Hoover Moratorium on all intergovernmental debts, were the most effective measures undertaken.

Besides responding to the Austrian and German crises, the BIS instituted other measures to cope with crises elsewhere in Europe and the Balkans in 1931. For example, the BIS assisted the Hungarian National Bank on two occasions, by granting a credit of \$5 million on June 6 until September 18, and by organizing a credit by a syndicate of central banks to the Hungarian central bank in the amount of \$10 million, to which the BIS itself contributed \$750,000. The credit was opened on June 18 and ran until September 18. In the Hungarian case, even though the BIS first intervened independently, and was later joined by the syndicate it organized, the sum was inadequate and the duration of credits was far too

²⁸ This sentiment was expressed time and again in archival collections. See, for example, Basel University Library, Department of Manuscripts, NL 324, A I 51, Per Jacobsson Diaries, December 14, 1944.

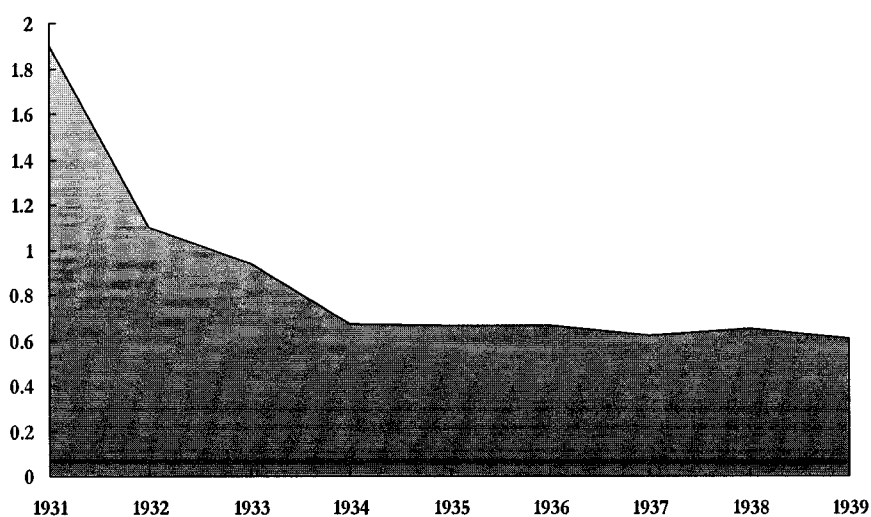
²⁹ In a letter dated November 19, 1931, Germany's Finance Minister, H. Dietrich, informed the BIS that "Germany's exchange and economic life might be seriously endangered by the transfer in part or in full of the postponable proportion of annuities." See Bank of England Archive, BIS File, G1/452, Dietrich to McGarrah, November 19, 1931.

³⁰ Bank of England Archive, B.I.S. File, 61/451, "German Reparations," November, 14, 1931. The committee was composed of representatives of each of the seven signatories of the Young Plan of 1929.

short-term to restore confidence in the marketplace. Elsewhere, the BIS attempted to stimulate long-term lending by subscribing capital in two international mortgage banks, the International Mortgage Bank in Basle and the Compagnie Central de Prets Fonciers at Amsterdam; and provided temporary emergency credits to the central banks of Yugoslavia and Danzig.

Although the BIS held ten percent (or SF5 billion) of total short-term indebtedness in 1931, this figure was a fraction of what was needed to stabilize markets and promote economic recovery.³¹ The crises that followed the creation of the BIS made these distinctions patently clear. The point is that this aspect of the BIS's institutional design constituted a clear limitation on the institution's ability to meet a basic goal of a central banking institution. Graph 3.1 shows the general decline in BIS's funds in the 1930s, while Table 3.2 shows a concomitant drop off in the bank's income and profits.

Graph 3.1: Financial Position of the BIS, 1931-39
(in billions of Swiss gold francs)*



Source: BIS Annual Reports, 1931-1939

* Not including gold earmarked by central banks on account of the BIS

³¹ BIS, *2nd Annual Report*.

Table 3.2: BIS Income and Profits in 1930-1939*

Year	Net Income	Income from capital	Net Profit	Profit after Dividends Paid
1930-31**	15.1	12.9	11.2	5.1
1932	19.4	17.1	15.1	6.4
1933	18.2	17.8	14.0	7.3
1934	16.6	16.3	13.0	7.5
1935	16.1	15.8	13.0	7.5
1936	12.1	11.8	9.2	7.5
1937	11.5	11.2	9.0	7.5
1938	11.2	10.9	9.0	7.5
1939	10.6	10.4	8.6	7.5

* Figures expressed in millions of gold francs. SGF is the equivalent of 0.290 322 58... grams of fine gold (Article 4 of the statutes). Assets and liabilities in US dollars are converted on the basis of US\$1 = 0.736 662 grams of fine gold; all other items in currencies at central or market rates against the dollar.

** The BIS's financial year begins on April 1 and ends on March 31.

By insisting that the BIS remain as liquid as possible, the founding bankers of the BIS ruled out the possibility of the BIS's providing long-term financing to countries in distress. This institutional feature made it impossible for the BIS to make a major difference in the international financial system. The lack of long-term financing, or an institution to convert short-term credits into middle- or long-term ones, made international financial stability a highly elusive goal. There was considerable opposition from states and market actors to the idea of the BIS accepting deposits from private banks as a solution to this problem. Private finance feared that the BIS would out-compete them for lending business, and central bankers feared that the BIS, by transferring massive sums of capital in and out of national money markets, would interfere with their domestic monetary objectives.

However, given that the BIS's financial limitations were exposed by the crises in Austria, Germany and elsewhere in Europe, BIS officials, in particular its American president and vice president, Gates McGarrah and Leon Fraser, felt they had a strong case. According to them, as the BIS could not create money by discounting bills, the only feasible way of increasing the volume of capital available to the bank would be to accept deposits from private sources:

In view of the fact, however, that the B.I.S. can only replace the funds entrusted to it through the intermediary of Central Banks, the question arises whether it would not be of advantage for the organization of markets to accept deposits offered by private banks in certain cases.³²

Member central banks and their governments balked. And despite the fact that the BIS organized committees to study the problem of middle-term and long-term credits, the fact that it was deliberately designed as a short-term arbitrage manager prevented it from creating a long-term international financing facility. There is little doubt that as the level of private

³² BIS Archives, H.S. 26, Annex IV/F, "Note on the Questions of Principle Submitted to the Board."

financing declined, long-term financing to governments experiencing a currency crisis was sorely needed. While the question of creating such an international facility would be given serious consideration in the so-called Kindersley Plan, which was presented to the BIS Board of Directors, the proposal received little international support. One of the greatest lessons of the Great Depression and the Second World War would be that the world needs an international institution whose mandate is to provide long-term loans at low interest rates. Hence the World Bank. However, the cost of such a lag time in political collaboration, which contributed to the rise of Hitler, would be felt for generations to come.

The Kindersley Plan

At the March 1931 meeting of central bank governors and market representatives, members of the BIS Board of Directors and the senior management questioned whether the BIS would attempt “to perform some of the larger functions embodied in the New Plan of 1930 with respect to stimulating international movements of capital and supplementing existing financial facilities,” or restrict itself to serving as a club for central bankers and a clearing house for interstate debts. The plan, which had been submitted to the BIS Board of Directors by the Bank of England one month earlier, called for the BIS to assume full responsibility for the establishment and subsequent management of a new international corporation whose primary mandate would be to supply long-term financing to countries in crisis.³³ The *raison d'être* of the new corporation resembled the mandate of the World Bank after the Second World War. An underlying objective of the plan, undoubtedly from the perspective of the British, was to reallocate foreign exchange surpluses from the French and American markets, where they had accumulated, to countries experiencing capital shortages.

³³ FRBNY Archive, Crane File, Bernstein [Morgan and Co., Paris] to J.P. Morgan, Lamont and S.P. Gilbert, March 12, 1931. The BIS was to appoint the president and the majority of the board of directors.

The plan called for the BIS to take on a much greater role in the international financial system. If the plan were implemented, the BIS was to go from being a provider of limited amounts of short-term financing to being an institution capable of raising a much greater volume of capital for long-term investment. The BIS would be authorized to sell to the public in various markets its own collateral bonds to obtain funds with which to provide badly needed long-term credits. The creation by the BIS of a credit institute under its auspices would, in effect, mark the establishment of open international securities markets for long-term investment. Long-term capital emanating from these markets would be directed primarily towards European countries, which were having trouble borrowing at reasonable rates on their own credit.

However sorely needed long-term financing was at the time, the plan was stillborn because of the contestation between bankers and governments, especially in the United States, over the international role of the BIS. The plan was well received by the German government, the Reichsbank and the German business sector. In desperate need of capital influx, all three saw the BIS as serving Germany's interests. Conversely, the plan aroused serious opposition in France, mainly because Germany would benefit from it. As the plan was, at least in the short term, likely to redirect capital from the United States and France to European countries, Latin American countries not represented in the BIS also opposed the plan.³⁴ Moreover, most Wall Street bankers viewed the plan with open skepticism, for the creation of a market for long-term credits outside Wall Street at relatively low interest rates presented European governments and businesses with an alternative to the American financial market, which had emerged after World War I as the principal source of lending to Europe. The Federal Reserve Bank of New York also opposed the plan, calling it

³⁴ FRBNY File, BIS File, J.E. Crane to Harrison, March 12, 1931.

inflationary.³⁵ But, as in most cases of international financial negotiation, sectoral interests were not cited as a motivating factor. Instead, American bankers argued that such a plan would immobilize BIS capital assets, thus reducing its high level of liquidity and capacity to use its funds for short-term currency stabilization programs.

The American bankers, led by J.P. Morgan, Morgan's confidant S. Parket Gilbert, FRBNY Governor Harrison, and Bank of New York President Jackson Reynolds, denounced the plan as impractical. Harrison summarized the sentiments of the New York market:

It has always been felt that these larger functions [of the BIS] were rather visionary and inflationary in character and should be left severely alone for the present. It would seem more desirable to have the B.I.S. at this stage in its career develop more slowly and conservatively and confine its activities towards serving as a super-central bank [sic] to promote central bank cooperation and be a clearing agency for international debts. Private and commercial bankers in New York would probably prefer to continue, as they have in the past, in handling foreign issues, rather than deal with this new international bank. In short, the New York market would probably not take kindly to the plan.³⁶

After the plan was shot down by the Federal Reserve Bank of New York and US bankers, Bank of France Governor Moret and Montagu Norman wanted then to take up the proposal outside the BIS. BIS President McGarrah felt that besides Norman and Schacht of Germany and Belgium's central bank governor Emile Francqui, not many other governors were prepared to reconstitute the BIS as a provider of long-term financing. Lacking any kind of support from their governments, BIS central banks decided to refer back to the Brussels

³⁵ See BIS Archives, MCG6/48, Harrison to McGarrah, April 24, 1931. Despite US government opposition to any formal link between the Federal Reserve System and the BIS, the President, the Federal Reserve Board, Stimpson and others all approved Harrison's request to travel to Basle in 1931. New York Fed also provided the BIS with two codebooks and a telegraph key to communicate with New York on personal and confidential matters. See BIS Archives, MCG6/48, McGarrah to Alan Sproul, June 20, 1930.

³⁶ The President of First National Bank of New York, Jackson Reynolds, and Federal Reserve Bank of New York Governor George Harrison were in close consultation with Montagu Norman in the spring of 1931 about this plan. See footnote 34.

Committee the task of finding ways and means of financing international trade. After a period of negotiation, the Brussels Committee recommended that the BIS grant a five-year export credit in the amount of 250 million Swiss francs. On May 18, 1931, the BIS voted to reject this request, deciding instead to examine possible ways for intermediate credits. The inability of the BIS to induce central bank cooperation in support of the Kindersley Plan epitomized the limitations of the BIS as an effective international financial institution in its early years. The BIS founders were clearly more willing to cooperate in governing the world economy than were their government counterparts. However, the Great Depression restructured relations between states and markets in a way that discredited central bankers and the weak form of institutionalized multilateralism they championed. As Pauly notes:

The catastrophe [of the Great Depression] brought to light the need for a collaborative political mechanism to underpin ostensibly private capital markets. It also underlined a basic paradox. The actions of states could easily destabilize those markets. But without a sense of confidence that only states could provide, the markets could not function at all ...[and]...the dream lived on that politics could somehow be removed from the markets.³⁷

Still, the BIS's institutional characteristics did not make political collaboration among the great powers any easier. By deliberately excluding government officials from the BIS's decision-making structure, the central bankers and prominent international financiers responsible for creating the BIS gained the support of governments for its creation at the expense of seeing the most important decisions concerning the international finance being made outside Basle. Frustrated by the inadequacy of its funds, by its loss of income from the suspension of reparations payments by Germany, by its inability to raise capital from private sources, and by its lack of political support from governments, the BIS took the bold step of refusing to make new advances and thus effectively "suspended the policy of being a

³⁷ Louis Pauly, "The League of Nations and the Foreshadowing of the International Monetary Fund," p. 17.

substantive new credit-giver to sundry central banks.”³⁸ Reflecting on the role of the newly formed Organization of European Economic Cooperation after World War II, BIS Chief Economist Per Jacobsson felt strongly that “the advantage of the OEEC is that it has the political body which can take the necessary decisions.”³⁹ As much as central and private bankers desired to avoid “political entanglements,” formal political autonomy brought with it serious economic consequences.

Conclusion

As undesirable as politics was from the standpoint of financial policymaking, weak political support for the BIS in government circles handicapped the institution in international financial affairs. The decision of the founding bankers to link the institution to central banks and not governments through their treasuries had immediate and, as later chapters will demonstrate, longer-term implications and consequences. Central bankers and private financiers alike believed that reparations, a constant source of international political conflict throughout the 1920s, needed to be depoliticized as much as possible.

However, the decision to create the BIS not as an intergovernmental institution but as a bank for central banks left the BIS between a rock and a hard place. Ironically, the move to insulate the BIS from politics, the very principle that was supposed to enhance its effectiveness as a financial institution, produced the opposite result. Reluctant to cede political sovereignty over foreign monetary policy, governments granted the new institution only minimal support. Analysis of the BIS’s early history has shown that in order to produce desired monetary results through binding policies, international financial institutions like the

³⁸ BIS, *2nd Annual Report*, p. 9.

³⁹ Basel University library, NL 324, A I 82, Per Jacobsson Diaries, December 1950.

BIS require the strong political backing of governments, not least the most powerful ones in the international system. On a technical level, this meant that the volume of funds placed at the BIS's disposal was much smaller than the volume of funds needed to stave off financial crises in Austria, Germany and elsewhere throughout Europe.

Regardless of the circumscribed manner in which the BIS operated during the 1930s, the bank sought to develop a niche for itself in the international financial system. For example, the BIS created the Monetary and Economic Department to develop the bank's analytical capabilities. This department was responsible for establishing a system for gathering and disseminating statistical information, which quickly became highly valued by central bankers, government officials, academics and private businessmen alike. The development of the BIS's analytical prowess was evidenced not least by the fact that its annual report, which was almost single-handedly authored by Per Jacobsson, became internationally renowned.

By the mid-1930s, the BIS had also taken practical steps to make its monthly meetings "a more effective vehicle for mutual acquaintanceship and understanding among central bank officials."⁴⁰ Through all the trials and tribulations of the 1930s, the bank's monthly meetings, annual general meetings of all shareholders, and site consultations with key policy makers in the leading industrialized countries, helped the BIS maintain a sense of purpose, solidarity and identity among bankers, central as well as commercial. In particular, little could the central bankers imagine in the 1930s just how much they would come to value, especially after World War II, the friendships and bonds they developed through their private monthly meetings in Basel. The first governor might arrive as early as Thursday and

⁴⁰ Gunter D. Baer, "Sixty-Five Years of Central Bank Cooperation at the Bank for International Settlements," in Carl-L. Holtfrerich, Jaime Reis and Gianni Toniolo, eds., *The Emergence of Modern Central Banking from 1918 to the Present*. (Aldershot, 1999), p. 345.

the last governor may leave on the following Wednesday. On the Sunday evening before each monthly meeting, an unofficial or informal meeting was held. The only formal session was typically a brief meeting on Monday morning followed by lunch. There was plenty of time to discuss problems or concerns to the bankers, and no one was tied down to his desk. As BIS Chief Economist Per Jacobsson's diaries disclose, almost everybody went for walks, quite safely and in total anonymity. The hospitality extended to the bankers and other visitors at the homes of BIS officials was an essential ingredient of the work. Central bank collaboration was still a new art; many of the central banks had only existed since the 1920s and they were not nationalized entities. The number of men was small; there was a nucleus of perhaps some twenty who had at least met, though few knew each other well. Others met as strangers for the first time in Basel. The environment could relax even the most anxious young economist.

Furthermore, the BIS succeeded in developing intricate systems for simplifying transfers from one currency to another, for settling international payments between governments and international organizations, and for clearing international payments in gold without the actual physical transfer of the metal. This latter system for clearing international payments had certain short as well as long term implications. In the short term, with imminence of conflict in the late 1930s, this system proved especially useful to European central banks seeking to relocate a substantial portion of their gold holdings, both by physical delivery and non-physical transfer, to a safer destination such as New York. Over the longer term, this system would become an indispensable part of the post-World War II international financial system that was based on the dollar's link to gold. Indeed, as Chapter 5 will show, despite efforts to abolish the BIS at Bretton Woods, its financial machinery, its

personnel and the services they could render to central banks would provide an important set of resources for the reconstruction of the post-war monetary order. In the meantime, the development and use of the BIS's broader system-management functions during the 1930s was limited by the bitter campaign between treasury officials and bankers, central as well as commercial, over what constituted a proper approach to solving international financial problems. With conflict among the great powers brewing and war just around the corner, the fact that the BIS was incapable of inducing central bank cooperation was overshadowed by its growing financial dependency on Germany. Again, its connection to German reparations presented an inherent contradiction for the bank. By 1939, approximately 72 percent of BIS investments were located in, and a similar percentage of its gross profits were derived from, Germany. Consequently, the Second World War would, even more than the economic and political turmoil growing out of the Great Depression, test the BIS.

Chapter 4

The Anatomy of Neutrality: The BIS during the Second World War

This chapter examines the activities of the Bank for International Settlements (BIS) during the Second World War and assesses whether its management followed the strict policy of neutrality which had been declared by the BIS Board of Directors once the war had begun in September 1939. It argues that while there is ample evidence of BIS management activities and transactions that could be judged as reproachable, there is also overwhelming evidence showing that on the whole, the bank did not privilege its traditional clients in either the Axis, Allied or neutral camps. Overly simplistic characterizations of the BIS's wartime activities fail to realize that by maintaining normal business relations with its traditional customers – member central banks and a select group of leading financial firms – the BIS was by and large being neutral. BIS managers did not employ a concept of neutrality that was ideal, insofar as they completely disassociated themselves from any and all activities and transactions that any one party to the conflict might regard as reproachable. Instead, with few exceptions, these officials gave no preference to representatives of any one camp or country. In terms of financial transactions, the BIS conducted its “normal business operations, albeit on a reduced scale,” with most of its established clients.¹ More important, throughout the war, and often at great risk to their own safety, BIS managers continued to provide their customers with highly specialized information on economic and financial conditions throughout Europe and to advise these same state and market actors on how to overcome specific, complicated and oftentimes politically delicate problems.

¹ BIS Historian and Head of Research and Archives also reaches this conclusion. See Piet Clement, “The Bank for International Settlements during the Second World War,” in *Nazi Gold: The London Conference* (London: The Stationary Office, 1997), p. 45.

Accounts of the role of the BIS during the Second World War tend toward two extremes. The first strand of argumentation paints the BIS in a very dark light. It holds that the BIS was controlled by Nazis who used the bank to aid Germany's war efforts. For example, the Swiss investigative journalist Gian Trepp characterizes the BIS as the international arm of the Reichsbank.² In *Trading with the Enemy* Charles Higham argues that the BIS as the "bank for all reasons" and "an instrument of Hitler" and that its managers were connected to a Nazi-American "fraternity" of bankers whose interests transcended war and peace.³ Indeed, most accounts of the BIS in this vein are based on the accounts of the London Times journalist Paul Einzig, who sensationalized claims against the BIS during the war, only to support the BIS afterwards. As we will see below, while the BIS continued to accept interest payments in gold from the Reichsbank on its prewar investments in Germany, in the overall context of the war, the scale of the BIS's wartime financial activity with Axis and neutral countries – above all Germany, Switzerland and Sweden – should not be exaggerated. In fact, as the case of gold looted by Nazis from the National Bank of Czechoslovakia will show, the BIS even gained the consent of the governors of the Bank of England and the Bank of France before it executed the transaction that was responsible for so many to label the bank pro-Nazi.

² Gian Trepp, *Bankgeschäfte mit dem Feind: die Bank für Internationalen Zahlungsausgleich im Zweiten Weltkrieg: von Hitlers Europabank zum Instrument des Marshallplans* [Banking with the Enemy: The Bank for International Settlements during the Second World War: From Hitler's European Bank to Instrument of the Marshall Plan]. Zürich: Rotpunktverl., 1997.

³ Charles Higham, *Trading with the Enemy: The Nazi American Money Plot* (New York: Barnes and Noble, 1983), p. 1, 7. Higham's very dark account of the BIS during wartime is riddled with factual errors and mischaracterizations. For example, Higham claims (p.4) that in March 1938 gold looted by the Germans from Austria was "packed into vault controlled by the Bank for International Settlements," while, in fact, the BIS had (and still has) no vault of its own to control. And, while the BIS was endowed with certain rights by international law that protected its assets held by central banks, by no means did (or to this day does) the BIS have any jurisdiction over what occurs in central bank vaults. To utilize assets, whether gold or foreign exchange, held on its account by central banks, the BIS first had to gain the approval of central bank leadership.

The other strand of argumentation casts the bank in a much brighter light. It holds that for the duration of hostilities the BIS operated on a very reduced scale and that the bank maintained normal business relations to safeguard the financial interests of its creditors and shareholders and to survive the war.⁴ Statistically, the volume of BIS operations in gold and foreign exchange indeed was substantially less than prewar levels. Yet while BIS financial activity declined sharply, it is misleading to suggest, as BIS Historian and Head of Archives Piet Clement does, that the bank was virtually dormant and inactive throughout the war. In fact, documentary evidence overwhelmingly shows that BIS managers remained busy throughout the war as they provided their clients with highly specialized information on (and advice on how to cope with) economic and financial conditions throughout Europe. Previously undiscovered archives of the BIS's wartime Economic Advisor Per Jacobsson show that even while the bank was relocated to the remote French Alp town of Châteaud'Oex from June to December 1940, BIS management were busy conducting central banking activities. During the war BIS managers traveled regularly throughout Europe and intermittently to the United States. Per Jacobsson undoubtedly proved to be the most valued BIS official, both by BIS President McKittrick, who contended that Jacobsson was "more valuable outside the bank than in it," and by the BIS's clients who visited Basle frequently.⁵

⁴ See, for instance, Clement, especially pp. 44-45. For other official BIS accounts, see Roger Auboin, *The Bank for International Settlements, 1930-1955* (Princeton: Essays in International Finance (22) 1955); and BIS Archives, 1/3(4), "Report on BIS Operations from 1.11.1939 to 30.11.1946."

⁵ Indeed, the importance of the BIS as a repository of information and intelligence during the war hardly can be overstated. People of all kinds visited with BIS management during the war. Year after year during the war, BIS officials, and above all President McKittrick, attributed the BIS's success "largely because of Jacobsson traveling." See NL 324, Per Jacobsson, A I 48, May 2, 1944. As Economic Advisor to the Bank for International Settlements from 1932 to 1956, Per Jacobsson held a unique position in international finance. Few individuals in the Western world had quite the quality or level of access to central banking, commercial and government circles. Before joining the B.I.S. in late 1931 Jacobsson served on the Financial Committee of the League of Nations. After leaving the B.I.S. in 1956, Jacobsson became the third Chairman of the Board and Managing Director of the International Monetary Fund, where he remained until his death in 1963. During the war Jacobsson's brother-in-law, Lt. General Nye, was Vice Chief at the Imperial General Staff in London. Jacobsson asked Paul Hechler to inform Emile Puhl of this fact. Jacobsson notes: "Puhl had not known and

The main argument of this chapter is that while the BIS undertook activities that could legitimately be judged as reproachable from either a belligerent's or a neutral state's point of view, by and large the bank was neutral insofar as its management took great care not to discriminate against any one side of the war. These senior managers maintained normal business relationships with most of the bank's traditional clients for at least two reasons. First, the principal members of the BIS Board of Directors and senior management wanted the bank to safeguard the BIS's financial interests and to ensure a place for the bank in the postwar monetary order. Second, the Hague Treaty of 1930 endowed the BIS and its assets with explicit immunities and privileges during wartime. As a result, BIS management operated within an immense grey area between finding a *modus vivendi* which would allow the bank to protect the interests of its creditors and shareholders, while conforming to the policy of neutrality that the board had decreed. These competing interests, especially in the first few years of the conflict when the outcome of the war hung in the balance, led the BIS to undertake certain activities and execute some transactions that were not beyond reproach to any one party. However, documentary evidence overwhelmingly shows that the BIS, on the whole, duly served the Allied, Axis and neutral camps.

The history of the BIS during the Second World War cannot be covered in great length in one single chapter or article. It is the hope of the author to undertake a more thorough treatment of the BIS's wartime activities in a book-length manuscript after the completion of this dissertation. For present purposes, however, it is necessary to be selective in choosing certain wartime activities of the BIS to illustrate the main argument outlined above. On this basis, the remainder of this chapter is organized as follows. The first section briefly describes the BIS's policy of neutrality and explains the bank's actual practice in

hoped it would not be discovered by others in Berlin: one had enough difficulties with McKittrick without adding to them." See *Handschriftenabteilung*, NL 324, Per Jacobsson Diaries, A I 45, Nov. 26, 1942.

dealing with different sides of the conflict. The second section documents the BIS's wartime financial activities, focusing in particular on the gold transactions undertaken with the German Reichsbank. The third section examines the BIS's efforts to safeguard the financial interests of its creditors and shareholders by acting as a mediator among the Allied, Axis and neutral camps, focusing particularly on the BIS's efforts to unblock foreign-owned assets located in the United States.

The BIS's Policy and Practice

When war broke out in September 1939 the question of how to conduct the business of the BIS and the question of interest payments owed to it by the German Reichsbank were carefully examined by the board of directors. The governors of the Bank of France and the Bank of England obtained the position of their respective governments, which at the time were, with Poland, the only governments at war with Germany.⁶ Besides, Poland was not represented on the BIS board of directors, which included central bank representatives from Belgium, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland and the United Kingdom. On September 22 the Chairman of the Board of Directors, Sir Otto Niemeyer, instructed BIS President Johan Willem Beyen to inform the members of the board that the meeting scheduled for October 9 would not take place. Responding by correspondence, the principal members of the board of directors voted unanimously to suspend their monthly meetings for the duration of the war (Resolution 927). On December 18, 1939, the BIS declared its rules of conduct in a statement that was transmitted to all 24

⁶ BIS Archives, McKittrick Collection, 7/33, "Memorandum of the Management of the B.I.S. on the Gold Identified As Forming Part of the Gold from the National Bank of Belgium," June 21, 1946, p. 3.

member central banks.⁷ Throughout the duration of hostilities, BIS management in residence in Basle were to refrain from any business transactions involving the gold or currencies of two countries at war with each other, and also from any transaction that might be considered reproachable from either a belligerent's or a neutral state's perspective.⁸

American banker Thomas McKittrick was appointed to preside over the BIS during the war once BIS President Johan Willem Beyen's term ended on December 31, 1939.⁹ Throughout the war BIS Board members were called upon to endorse major management decisions by correspondence, because of the difficulty of holding a board meeting during wartime. Nevertheless, by 1939 there was a well established rule in the BIS of the Board of Directors not getting involved in the day-to-day operations of the bank.¹⁰ Moreover, given the importance attached to secrecy in central banking operations, the BIS would not inform a particular central bank about its transactions unless it occurred through that particular central bank or in that bank's market. Besides, at the same time the BIS board of directors

⁷ BIS Archives, 1/19c, "Banking Policy of the BIS during the Second World War." Of all the directors of the BIS during the war, Swiss National Bank President Ernst Weber maintained the most regular face-to-face contact with BIS management.

⁸ Ibid.

⁹ After 1935, when American banker Leon Fraser resigned as president, American shareholders began a massive sell off of BIS shares. The sell off was so significant that the BIS imposed a bloc on the selling of American-held shares. The BIS believed that it would be "highly regrettable if the American market would no longer have a substantial interest in the Bank." See BIS, HA, 7.18(2), MCG12/95, [? of the BIS] to Fraser, April 19, 1937. However, the Americans worried that Germany was preparing for war and that this would hurt the BIS. Jacobsson, referring to the process of finding a replacement for Fraser, remarked in January 1937 that [blank space] was supporting Johan Willem Beyen as President "knowing there could be no Frenchman." See Basle University Library, Department of Manuscripts, NL 324, A I 30, Per Jacobsson Diaries, [Date?] 1937/8. Beyen, a Dutchman, was selected to head the BIS. In 1939, once it was clear that Beyen would leave the BIS to join the senior management of Unilver, Otto Niemeyer of the Bank of England began "to look around for a successor and, fearing that war would come, he got McKittrick appointed in 1939 – nine months in advance of his taking up the position in Basle. If the appointment had not been made then, it would clearly have been impossible in the autumn, once the war had started, to get an American chosen as President of the B.I.S. [Jacobsson felt that] it was foresight on the part of Sir Otto Niemeyer to secure for the BIS a most suitable president for the BIS." See Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 43, Apr. 6, 1942.

¹⁰ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 110, November 4, 1956.

formalized its rules of conduct, it availed BIS managers of the responsibility of making a special declaration for each transaction that they wished to execute.¹¹

Since the beginning of the war in Europe, BIS managers were motivated by the belief that

if any one of the three Governments at war should decide that they wanted to do away with the B.I.S. as an effective factor in international finance, they could probably do so – by withdrawing directors, announcing a permanently hostile policy, or similar measures. It must be the prime purpose of all of us to avoid this eventuality.¹²

That the BIS's board of directors decided at the outset of the war to allow the BIS to continue its business relations was not a coincidence. Ever since the Concert of Europe in 1815, the great powers broadly agreed that it was in their collective national interests to have one country in Europe – Switzerland – remain free and neutral in wartime. Swiss neutrality was a European conception based on a certain balance of power between France, Germany (Austria), and Italy.¹³ It comes as no surprise that Switzerland's economy benefited handsomely from this arrangement. Yet while the BIS came into existence by virtue of an international treaty – the Hague Treaty of 1930 – and was governed by international law, it was a limited share company that was domiciled in Switzerland and thus endowed with

¹¹ BIS Archives, McKittrick Collection, 2.2/11/5, "Report of the Management of the Bank for International Settlements to the Board of Directors on the Period Since the Last Board Meeting," October 1, 1945, p. 6. See also, "Note on the Attitude of the B.I.S. with Regard to Financial Transactions Concerning Belligerent Countries," Annex XIII to Ibid.

¹² BIS Archives, McKittrick Collection, 7/33, McKittrick to Rooth [President of the Swedish National Bank], Apr. 6, 1940.

¹³ The British and American attitude toward the question of neutrality during the war differed considerably. The British recognized Swiss neutrality as an outgrowth of the Congress of Vienna, whereas the Americans felt that all non-declared Axis countries should collaborate against Germany. The British, on the other hand, felt that for some countries, and Switzerland in particular, it was in the general interest of Europe that they remained a neutral party to the conflict.

certain privileges according to Swiss law.¹⁴ Thus, BIS managers believed that while member states wanted them to avoid transactions that could be deemed reproachable by any belligerent or neutral state, these same member states wanted the BIS to continue serving their national interests. These governments knew full well that by virtue of its international character and highly talented staff, no institution in Europe could provide them with nearly the same level of information on economic and financial conditions on the continent as the BIS. Its vast network of loyal supporters was unparalleled in Europe, a fact which most of the major powers benefited from during the Second World War.

When war broke out on September 1, 1939, the BIS management took a number of immediate decisions to safeguard the interests of the bank. For example, BIS management made a duplicate of the bank's accounts and sent it to a safe location. As per the French government's request of August 29, the BIS reimbursed it 305 million French francs which it had deposited in the BIS. High-ranking members of the bank questioned if the BIS should "maintain its investments on the various markets, or should it take steps to reduce them systematically, thus preparing the way either for a liquidation or at least a radical transformation of its own position?" Having been posed this question by correspondence, the principal members of the board decided that "there was no occasion to take any exceptional measures in the direction of a systematic liquidation of the Bank's assets. They left the Management to protect its interest as best they could, in a manner constant, of course, with the policy of strict neutrality."¹⁵

¹⁴ Article 10 of the Hague agreement of January 20, 1930, which is reproduced in the BIS Charter, states that: "The Bank (for International Settlements), its property and assets, and also the deposits of other funds entrusted to it, on the territory of, or dependent on the administration of the Parties shall be immune from measures such as censorship, requisition, seizure or confiscation, in time of peace or war, reprisals, prohibition or restriction of export of gold or currency and other similar interferences, restrictions or prohibitions."

¹⁵ BIS Archives, McKittrick Collection, 2.2/11/5, "Report of the Management of the Bank for International Settlements to the Board of Directors on the Period Since the Last Board Meeting," Oct. 1, 1945,

It was on this basis that BIS member states instructed the bank to continue its normal business relations with care. Practice, however, is not as simple as theory. BIS management could not separate politics and economics as much as they wished. The interdependence of the economies of member BIS states, coupled with pressure to safeguard the financial interests of the bank's shareholders, led to complicated activities and transactions. Moreover, for the first several years of the war, the outcome of the war and its impact on the BIS's postwar standing in the monetary order, was unknowable.

Furthermore, BIS managers were keenly aware of lessons from history: after wars are fought, peace conferences are held. They knew that after the war there would be a peace conference at which the BIS's postwar role would be decided. As a result, as early as mid-1940, BIS Economic Advisor Per Jacobsson noted: "I tried to make as good a report as possible so that the B.I.S. should have a good visiting card to a Peace Conference."¹⁶ But what this small group of men could not know during the first several years of the war was what the balance of power would look like at the peace conference. Still, even before the US entered the war, BIS management employed a concept of neutrality that did not privilege any one side of the conflict. Neutrality for the BIS meant that it would operate throughout the war as it continue to be "loyal and useful to its friends."¹⁷ Accordingly, BIS officials regularly advised neutral countries, especially Switzerland and Sweden, throughout the war.¹⁸ For

p. 2, 4, 5.

¹⁶ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 32, Sept. 5, 1941.

¹⁷ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 73, March 27, 1948.

¹⁸ For examples of the BIS advising Swedish National Bank and major Swedish bankers and industrialists on conditions in Switzerland and Germany and policy currents in these and other governments, see any one of the dozens of letters Jacobsson wrote to Ivar Rooth, governor of the Swedish central bank, during the war. See, among others, Jacobsson to Rooth, Apr. 22, 1940; Jacobsson to Rooth, June 28, 1940; Jacobsson to Rooth, July 12, 1940; Jacobsson to Rooth, July 12, 1940. See also Jacobsson to G. Cederschiöld

example, in February 1940 Jacobsson met with officials at the Reichsbank in Berlin. Later, he informed Rooth about the policy aims of the “leading people in the Reichsbank....When I asked for advice on the question of whether or not Sweden should introduce exchange controls...everyone I spoke to [at the Reichsbank] at that time unanimously warned me against any system of exchange control...it is the intention of the German authorities to allow the countries which have been conquered to maintain their currencies but that fixed rates of exchange should be applied to the continent of Europe.”¹⁹

BIS officials also regularly advised German central and private bankers and industrialists on various matters. For example, in November 1942 Jacobsson accepted an invitation by Reichsbank Vice President Emile Puhl “to make a report to the Directorium of the Reichsbank.” Even Paul Hechler of the BIS was surprised that Puhl had asked Jacobsson to make a presentation to the Refereuten (Directors) of the Reichsbank, “since that was often all more closely connected with the centre of Germany’s war effort.”²⁰ On several occasions from 1941 onwards, Jacobsson gave formal and informal briefings on advance copies of the postwar international monetary plans of John Maynard Keynes and Harry Dexter White. On May 1, 1943 Jacobsson met in Zurich with Emile Puhl, Hechler (BIS), Hermann Abs (Chairman of Deutsche Bank), and Carl Goetz (Chairman of Dresdner Bank) and made a report.²¹ On June 1, 1943 Jacobsson began a discussion at the *Directorium* of the

[Swedish Match Company], January 28, 1943. These letters can be found in NL 324, Jacobsson Collection, Personal Letters. As of July 2003, when this researcher completed archival work on the Jacobsson Collection at the Basle University Library, Per Jacobsson’s correspondences were filed and organized in boxes according to the first letter of the last name of the person with whom Jacobsson corresponded. The correspondences had not, however, been catalogued. Therefore, there is no one formal citation for these letters.

¹⁹ Basle University Library, Department of Manuscripts, Jacobsson Collection, Box “R,” Jacobsson to Rooth, July 12, 1940.

²⁰ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 45, November 26, 1942.

²¹ For a detailed (11 pp.) report on Jacobsson’s briefing on the Keynes and White Plans, see Basle

Reichsbank by reporting on the Keynes and White Plans for one hour. Ten persons were in attendance: Jacobsson, Emile Puhl, Otto Christian Fischer (Chair), Hermann Abs and Rossler from the Dresdner Bank, Marx (CommerzBank), Kissler (Renten-Bank-Kredit-Anstalt), Ernst, and Frank Fahler (Director, I.G. Farben).²² In Addition, Paul Hecher periodically hosted representatives of the German government and private industry at BIS headquarters and at his home. For example, on February 12, 1944, Frau von Diskau, Jacobsson, Dr. Frank Fahle (Director of the I.G. Farben), Mr. Rong (I.G. Farben), Albert Nussbaumaer (General Director, Swiss Banking Corporation) held a discussion at Hechler's house.²³

Similarly, BIS officials regularly advised American political officials stationed in Switzerland and used the American legations diplomatic pouch to brief contacts in the United States. Jacobsson was providing American officials with intricate accounts of developments in respect to Swiss National Bank policy and Reichsbank exchange and tariff policies, market developments, etc. For example, Jacobsson periodically traveled to the American Legation in Bern to brief OSS station chief, Allen W. Dulles, of the American legation in Bern.²⁴ After returning from his trip to New York, London and Paris in the

University Library, Department of Manuscripts, NL 324, Jacobsson Collection, G26, International Institutions, 1943-61, "Notes on Conversations with Vize-Reichsbankpräsident Puhl Regarding the Keynes and White Plans," [No Date].

²² For a detailed (14 pp.) report see, Basle University Library, Department of Manuscripts, NL 324, Jacobsson Collection, G26, International Institutions, 1943-61, "Per Jacobsson in Berlin 1943 on Keynes and White Plans," June 15, 1943.

²³ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 48, February 12, 1944.

²⁴ Basle University Library, Department of Manuscripts, NL 324, Jacobsson Diaries, A I 45, December 3, 1943. Also see, Basle University Library, Department of Manuscripts, Box C, Per Jacobsson to Merle Cochran [US Treasury], November 23, 1939; Box B, Per Jacobsson to Parker W. Buhrman [American Consulate Basle], July 8, 1940; Box K, Jacobsson to Kindleberger [Federal Reserve Board Washington], August 8, 1940; Kindleberger to Jacobsson, September 12, 1940; Kindleberger to Jacobsson, Oct. 11, 1940; Jacobsson to Kindleberger, October 31, 1940.

autumn of 1944, Jacobsson meet with Allen W. Dulles to debrief him on political and economic developments in those centers.²⁵

These examples are given both to show that BIS managers duly served the Axis, Allied and neutral countries during the Second World War, and that contrary to official BIS reports, the bank was by no means “inactive” or “virtually dormant” during the war. Indeed, even while the bank was temporarily relocated to the remote French Alp town of Château-d’Oex for the latter half of 1940, Per Jacobsson noted: “We are steadily going on with our work here and find ourselves rather more in contact with different central banks than last winter.”²⁶ Surviving the war thus necessitated the maintenance of normal business relations.

BIS Financial Activity, 1939-1946

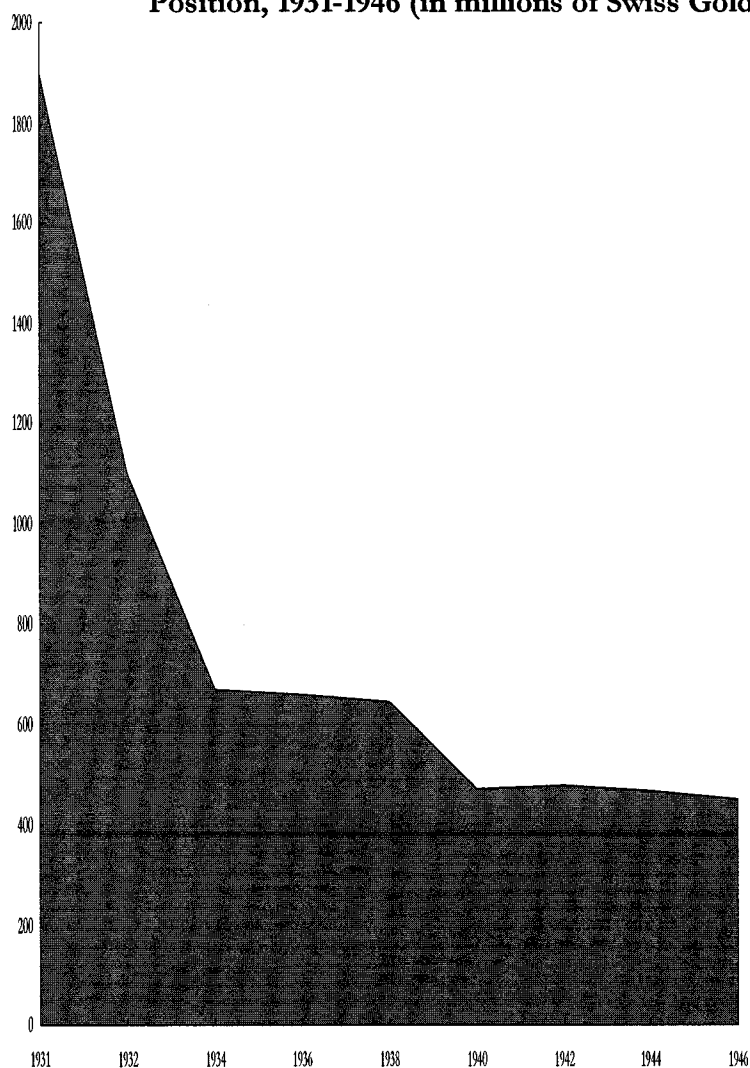
With the outbreak of war in September 1939 the BIS’s level of financial activity declined sharply. For example, the average monthly volume of business declined sharply in September, and again in June 1940, after the Germans had overrun the Low Countries and France. By the summer of 1941 business volume had fallen to less than one-tenth the monthly average recorded from 1936-1939, and by 1943 it stood at less than 5 percent.²⁷ Graph 4.1 shows that the BIS’s financial position (assets and liabilities) remained largely unchanged throughout the war. Graph 4.2 also shows that as the level of financial activity of the BIS declined, so too did its profits.

²⁵ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson, A I 50, December 29, 1944.

²⁶ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Collection, Box K, Jacobsson to Kindleberger, October 31, 1940. See also Box K, Jacobsson to L. Werner Knoke [Vice President of the FRBNY], February 4, 1941. Since BIS officials wanted to avoid being put out of business for an indefinite period of time in the event that the Swiss government enacted its plan for compulsory evacuation of certain areas, including Basle, the bank spend 173,000 Swiss francs to relocate to Château-d’Oex in late June 1940. The BIS was back in business on Basle by October 7, 1940.

²⁷ This account is based on BIS statistics. See Clement, p. 45.

Graph 4.1: Bank for International Settlements Financial Position, 1931-1946 (in millions of Swiss Gold Francs)*

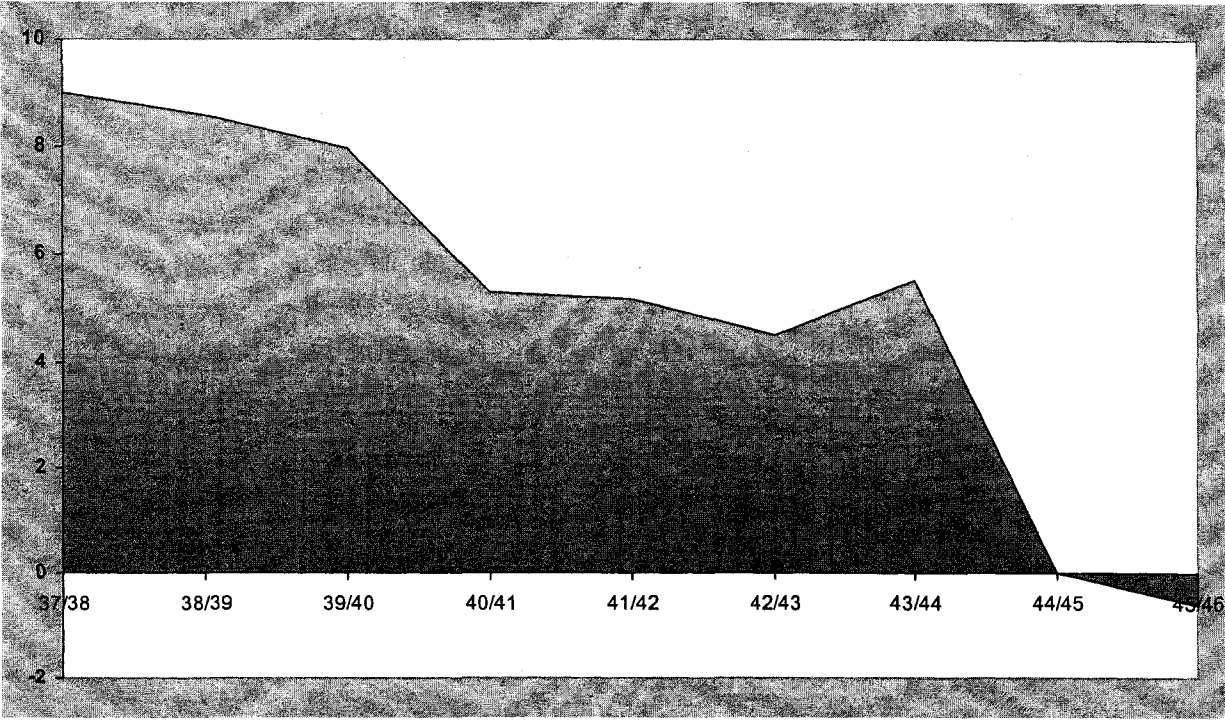


* Source: BIS Annual Reports, 1931-1946

** Figures do not include gold earmarked by central banks on account of the BIS.

*** Until September 27, 1936, when the Swiss francs gold parity was suspended, 1 Swiss gold franc or 1 "Statutory franc" (used by the BIS since 1930 for accounting purposes) = 1 Swiss franc at its fixed gold value of 0.29032258 grams of fine gold. The exchange rate of the Swiss gold franc during the Second World War was approximately: 1 Swiss franc = US\$ 0.32755 = Swiss franc 1.41.

Graph 4.2: Bank for International Settlements: Net Profits, 1937-1946 (in millions of Swiss francs)



Source: BIS Annual Reports, 1937-1946

Indeed, interest payments by the Reichsbank to the BIS on the latter's prewar investments on the German market became the most important source of income left to the bank.²⁸ Maintenance of these payments constituted the primary financial interest of the BIS's clients and shareholders, as they were connected to the prewar reparations settlement that had been frozen in the mid-1930s.²⁹ At the onset of hostilities, nearly 81% of BIS investments were located in Germany and roughly the same percentage of its income was derived from those investments. After a decision by the BIS to maintain a non-interest bearing deposit of 25 million Reichmarks with the German Reichsbank in October 1944, the percentage of BIS interest bearing assets that were based on investment in Germany declined slightly from 79.3 percent to 77.9 percent. Meanwhile, prior to this decision 83.3 percent of the BIS's gross profits was derived from those investments. After it the percentage declined only slightly to 82.6 percent. Until March 1940 the Reichsbank settled the interest due on these investment through monthly payments of 1 million Swiss francs (US\$230,000) to the BIS. However, between March and June 1940, in October 1943, and for all payments between January 1943 and March 1945, the Reichsbank made interest payments in gold to the BIS. Between September 1, 1939 and May 8, 1945, the Reichsbank made interest payments to the BIS in gold that amounted to 6,266.82753 kilograms.

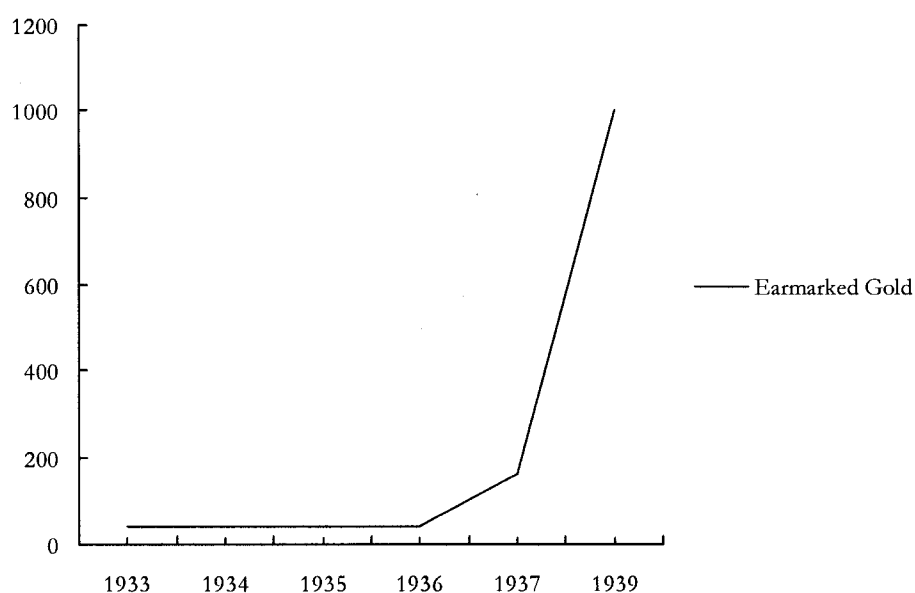
The evolution of the BIS's gold shipments is also quite illustrative of an overall drop in BIS wartime financial activity. These operations can be traced back to the late 1930s, when the BIS developed an elaborate system for gold clearing among central banks and international institutions for settling debts of various kinds. For example, this system

²⁸ The placement of funds by the BIS on the German market was required under the Young Plan of 1930. On August 31, 1939, BIS investments on the German market totaled 294.3 million Swiss gold francs. No new funds had been invested in Germany by the BIS since July 1931. See BIS Archives, 7.17, 6/8, "Bank for International Settlements: Assets and Liabilities Connected with the Application of the Hague Agreements of 1930," March 1, 1947.

²⁹ When the war began in 1939 seventy-two percent of BIS shares were owned by Germans.

facilitated international postal payments and payments between the telephone and telegraph administrations of various countries. Further, with the imminent danger of war in Europe, the BIS's gold clearing system enabled European central banks and commercial banks to transfer large portions of their gold supplies to the United States. Graph 4.3 demonstrates the sharp increase in these transfers.

**Graph 4.3: Average Value of Gold Earmarked at the FRBNY
(in millions of dollars)**



Source: BIS Archives, 2/2, Harrison [Governor FRBNY] to McKittrick [BIS President], April 11, 1940.

For instance, gold held for earmark in New York for four years between 1933 and 1936 averaged \$43 million. It rose to \$160 million in 1937 and was in excess of \$1 billion at the end of 1939.

The movements of gold both as regards the BIS's own reserves and as regards gold earmarked with it by member central banks, were also comparatively large. From June 1938 to August 1939, the BIS was responsible for shipping for the account of its member central banks or for its own account, well over 100 tons of gold to the United States for safekeeping. Between July 1, 1939, and August 31, 1939 alone, the BIS enabled central banks to obtain a total of 7,000 kilograms of gold in New York, while it shipped nearly 9,000 kilograms to New York for its own account.³⁰ From September 1939 to June 1940, the BIS shipped an additional 29 tons of gold to New York under increasingly difficult circumstances.³¹ However, Germany's occupation of most of Western Europe in the Spring of 1940 and the escalation of war at sea brought the transatlantic movement of gold to an end. According to the BIS, for the duration of the war these shipments were "few and far between."³²

Analysis of the BIS's involvement in the Czech gold affair and the broader functioning of international financial relations during the Second World War suggests that the BIS's management performed a larger and more active role than their contemporaries would lead us to believe.³³ Yet it also shows that while the BIS was involved in major

³⁰ BIS Archives, McKittrick Collection, 2.2/11/5, "Report of the Management of the Bank for International Settlements to the Board of Directors on the Period Since the Last Board Meeting," October 1, 1945. Also, between June 30, 1939 and August 31, 1939 the BIS's long-term holdings in dollars increased considerably, rising to \$16.5 from \$4.5 million. This is significant considering that by design the BIS was to remain as liquid as possible, thus forgoing investments maturing in more than six months.

³¹ Clement, p. 45.

³² They amounted to 18 shipments in five years, in the amount of 21 tons of gold.

³³ Though it suspended monthly meetings in October 1939, in June 1940 the BIS held, as it had for the previous nine years, its annual general meeting of shareholders. It was decided at this meeting that the BIS should continue to pay dividends on its shares. The US dollar was chosen as the medium of payment of dividends because at the time the dollar was the most readily available and freely negotiable of all the principal currencies. However, the US Treasury's imposition of controls on the dollar in 1941 impeded the payment of BIS dividends in the US. Seventy-two percent of BIS shares were controlled by Axis states and market actors. BIS paid a standard cumulative dividend of 6% in Swiss gold francs to its shareholders for the first three years

international financial transactions, these transactions were not as straightforward as its staunchest critics claim.

The Czech Gold Affair When news broke in England and the United States in the Spring of 1939 that the BIS had complied with an order of the National Bank of Czechoslovakia to hand over Czech gold reserves held on account of the BIS at Bank of England to the Germans, there was a flurry of charges that the BIS was a Nazi-controlled bank. Yet while analysis of the events surrounding the transfer of Czech gold is illustrative of poor judgment by BIS managers, the BIS's involvement in the affair is not as straightforward as its staunchest critics at the time claimed. Previously undisclosed documents reveal that the transaction was cleared by the governors of the Bank of England and the Bank of France, two major shareholders and members of the bank's Board of Directors.³⁴

Throughout the 1930s, the Czechoslovakian government had been secreting gold abroad to offset the growing threat from Nazi Germany, particularly to London and Geneva. Part of its gold reserve had been deposited at the Bank of England on account of the BIS. After October 1938 units of the German *Wehrmacht* entered Czechoslovakia and brought with them Dr. Friedrich Müller, who was a high-ranking Reichsbank official. On March 15, 1939, Müller and his colleagues headed straight for the National Bank Czechoslovakia in Prague.³⁵ There, he demanded at gunpoint that the directors sign letters instructing the BIS and the Bank of England to transfer 23 tons (\$30 million) of gold from

of the war, until 1942.

³⁴ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 114, Nov. 21, 1956.

³⁵ For a more detailed description of these events see Eduard Kubu, "Czechoslovak Gold Reserves and Their Surrender to Nazi Germany," in British Foreign Office, *Nazi Gold: The London Conference* (London, The Stationary Office, 1998), pp. 245-248.

the Czech BIS account at the Bank of England to another BIS account with the same bank. The other demand was for the transfer of 26,793 kilograms of gold, which had been deposited by the National Bank of Czechoslovakia directly in the Bank of England. Citing a decision by the Chancellor of the Exchequer freezing all Czechoslovakian assets in Britain immediately after the German occupation, the Bank of England declined the latter request but approved the request involving the Czech gold held on account of the BIS. Within days the gold was sold or transferred to other banks, including the Swiss National Bank, while its real value eventually reached the Reichsbank in the form of foreign exchange.

When the transaction was belatedly discovered by the British press and debated in the House of Commons in May and June 1939, there was a general sense of outrage. Winston Churchill was particularly vocal, arguing that the transaction padded the German war coffers by millions. The decision to transfer the gold was made neither by the British government nor by appeasers. Rather, the directors of the Bank of England considered the transfer to be a technical operation.³⁶ Aware of the actual origin of the gold, they nevertheless did not want political considerations to interfere with their banking operations. After all, the BIS had been deliberately designed by central bankers and leading international financiers as a non-political body to avoid national interference. The immunity of its assets from controls during wartime was enshrined in Article 10 of the Hague Treaty.³⁷ Eventually, even the Czechoslovakian government in exile had grudgingly to accept the argument of the British government.

³⁶ The Bank of England testified to the House of Commons that it “could not have stopped the transfer” because it was bound to its statutory obligations of the BIS which were authorized under the Hague Treaty of 1930. See New York Times, “World Bank Nears the End of Its Service,” October 14, 1945, p. 1, 7.

³⁷ See footnote 14.

Similar to the representatives of the Bank of England and the Bank of France, BIS managers approached the transaction from an overly legal and technical perspective. The following quote captures their sentiment: “All Swiss banks carried out orders they received from Prague. The B.I.S...could not make the law – it had to follow the law as applied. Now [in 1942] it [is] different.”³⁸ When asked years later about the Czech gold affair during a meeting at JP Morgan & Co. in New York with Thomas Lamont and Russell C. Leffingwell, BIS Economic Advisor Per Jacobsson replied: “the BIS had done what other banks had done; that even American banks had carried out orders from Czech banks; that every Swiss bank did the same; that the BIS could not declare a private war on the Reichsbank!”³⁹

Most important, previously undiscovered documentary evidence shows that, in effect, the governors of the Bank of England and the Bank of France, Montagu Norman and Jacques de Fouchier respectively, approved the BIS’s transfer of Czech gold.⁴⁰ When the order from the National Bank of Czechoslovakia to transfer the gold in question was received in Basle, the BIS asked Norman and de Fouchier to advise them on the order. After considering the question, the governors decided they could not, as members of the BIS Board of Directors, legally “advise the management not to give effect to the order received (although in their respective countries they were able to refuse the carrying out of similar

³⁸ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 37, Jan. 1, 1942.

³⁹ Meeting with American officials in Washington a little more than a month before Germany’s unconditional surrender, President McKittrick added: “it was our duty on our part to act whenever possible in the interest of the Bank’s creditors and shareholders.” See BIS Archives, 7.19(5), Looted Gold, “Memorandum of Conversation with Minister Harrison and Daniel J. Reagan,” March 29, 1945. On yet another occasion Jacobsson remarked: “The B.I.S. could not take upon itself not to recognize the orders from a country in which the U.S.A., Switzerland, Great Britain, [and] France retained their diplomatic representatives. One could not ask the B.I.S. to declare war on Czechoslovakia, when none of the powers did so.” See *Handschriftenabteilung*, NL 324, Per Jacobsson Diaries, A I 59, 1/23/46.

⁴⁰ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 114, Nov. 21, 1956.

orders – having the Government decrees to base themselves on).”⁴¹ Moreover, on June 7, 1940, McKittrick met with Swiss National Bank President Ernst Weber and explained the BIS’s responsibility regarding the Czech gold and its desire for the gold to be stored in the safest possible place. At the time a significant amount of the Swiss National Bank’s own gold was held in Bern and Luzern. Gold earmarked for other countries was being held in Bern. McKittrick asked Weber that if any part of the Swiss National Bank’s gold were stored in a place that he considered safer than these sites, the Czech gold could be transported to the same stronghold. Weber agreed and said that after the gold was packed, McKittrick should instruct the Swiss National Bank by letter to transport the gold to a safer location “without naming the owner of the gold.” McKittrick then asked Weber “not to tell [him] where the gold would go and he did not do so.”⁴²

In addition, documentary evidence shows that on many occasions during the war, the BIS refused to execute transactions due to the de facto occupation of various countries and to the fact that BIS officials did not obtain “satisfactory guarantees regarding the neutral origin of...gold.”⁴³ For example, on October 9, 1939, the BIS received an order from the Bank of Bohemia and the Bank of Moravia to transfer part of the gold earmarked for their account with the BIS.⁴⁴ Since the British and French governments had formally declared that they did not recognize the de facto situation that the German authorities had created in the

⁴¹ Ibid. No emphasis added.

⁴² BIS Archives, McKittrick Collection, 7/33, “Memorandum of Conversation with President Weber at Swiss National Bank, Bern, June 7, 1940.”

⁴³ Ibid., especially pp. 7-10. For example, it refused orders received from the Latvian and Lithuanian central banks, and followed up on by the State Bank of the Soviet Union, to transfer the formers’ gold deposits with the BIS to the later. BIS Archives, HEC 2/2. See cables dated July 12, 1940; July 13, 1940; July 16, 1940; July 23, 1940; July 24, 1940; August 1, 1940; August 24, 1940; November 7, 1940; November 9, 1940; and December 3, 1940.

⁴⁴ After Germany’s annexation of Austria in 1938, Germany claimed 4,000 additional shares of the BIS. Thereafter, the National Bank of Austria became a branch of the Reichsbank, and the Nazis formed two other central banking institutions, Bank of Bohemia and the Bank of Moravia.

Czechoslovakian territories, the BIS management refused to execute the order. In addition, in the first half of 1940, the BIS declined requests by a number of private Dutch banks to ship gold to New York and London, because it could not obtain guarantees of the neutral origin of the gold. In fact, Reichsbank Vice President Emile Puhl was displeased when BIS President McKittrick informed him that the BIS decided to block its central bank accounts in situations where “a change of national status occurs.”⁴⁵

Jacobsson’s diaries reveal what previous accounts of the Czech gold affair had not: that by effecting a transfer of gold that conceivably aided the German war effort, BIS officials acted on their own volition but also on the legal opinion of prominent members of the bank’s board of directors. Thus, analysis of the events surrounding the Czech gold affair, which became the reference point for wartime and postwar claims that the BIS was pro-Nazi, shows that the transaction between the Czechoslovakian National Bank and the BIS was not as straightforward as has been previously reported.

“Tainted Gold” Received by the BIS Over the course of the Second World War 21.5 tons of gold moved through the Reichsbank gold account with the BIS.⁴⁶ Of this amount, 13.5 tons constituted new gold delivered to the BIS by the Reichsbank during the war. The 21.5 tons of gold served several purposes: German interest payments to the BIS for prewar investments in Germany (7.8 tons); payments to other central banks in respect to international settlements, including postal and railway (6 tons); and for the sale of gold or

⁴⁵ BIS Archives, McKittrick Collection, 2/BP/8/6, Memorandum of Conversation with Puhl, May 28, 1940.

⁴⁶ Clement, p. 45.

exchange transactions the BIS executed for the Reichsbank (1.9 tons). The remainder was withdrawn by the Reichsbank early in the war (5.8 tons).⁴⁷

In the 1930s the BIS held gold for the Reichsbank in several locations: Amsterdam, Bern, Brussels, London, and Paris. All but 1,862 kilograms were emptied from these account by the Reichsbank and transferred to Berlin. During the war the Reichsbank deposited new gold with the BIS “at regular intervals.”⁴⁸ All gold was first sent by the Reichsbank to its own gold deposit account at the Swiss National Bank in Bern. The Reichsbank then instructed the Swiss National Bank to transfer the gold to its account with the BIS. From September 1, 1939 to May 8, 1945, the Reichsbank deposited a total of 12,016 kilograms of fine gold with the BIS loco Bern. In addition to the deposits in Bern, the BIS received one further deposit of gold from the Reichsbank: on April 12, 1945, the Reichsbank deposited 1,525 kilograms of fine gold at the Reichsbank’s regional bank in Constance, close to the Swiss-German border near Basle. Since 1945 the German Reichsbank and the BIS have maintained that this deposit of gold was “intended as an advance settlement of interest payments due by Germany to the BIS in the course of 1945.”⁴⁹ In sum, the amount of gold newly deposited by the Reichsbank with the BIS during the war totaled 13,542.21 kilograms.

On several occasions throughout the war the BIS management received assurances from the Reichsbank that it would not supply the BIS with “tainted gold.” In other words, according to the BIS’s management, the Reichsbank assured them that “only gold which had already belonged to the Reichsbank before the war would be remitted to the BIS.”⁵⁰ The

⁴⁷ Ibid., p. 45.

⁴⁸ Ibid., p. 45.

⁴⁹ Ibid., p. 49.

⁵⁰ BIS Archives, 7.19(5), Looted Gold, “Memorandum of the Management of the B.I.S. on the Gold Identified As Forming Part of the Gold from the National Bank of Belgium,” July 15, 1946.

personal diaries of Per Jacobsson corroborate this claim. This writer has found no evidence to prove otherwise.

Before the war ended the Allied governments announced that at the end of hostilities they would seek the full restitution of assets looted and transferred by the Axis powers, including looted gold, to their original owners.⁵¹ Consequently, in December 1945, the US, the UK, and France formed the Tripartite Commission for the Restitution of Monetary Gold.⁵² The commission was charged with collecting all recovered monetary gold into one pool so that the gold could be restituted to its rightful owners. This included not only gold recovered in Germany, but also the gold that had been shipped to neutral countries like Switzerland, Portugal, Spain, Sweden and Turkey.⁵³ Investigations revealed that on a minimum of two occasions, the Reichsbank shipped the BIS monetary gold it had looted from occupied countries: France and the Netherlands.

The Belgian gold looted from occupied France is one case in point. On May 10, 1940 Germany invaded Belgium. By May 27 the Belgium government had surrendered. The Belgian National Bank was seized, its gold and currency commandeered by the occupying power. Consequently, the BIS was informed by Belgium's minister in Bern that the National Bank's legal office had relocated to London. Rather than recognizing the relocated legal office, the German representative in the BIS, Paul Hechler, who was Assistant General Manager and Head of the Banking Department, issued an internal memorandum stating that

⁵¹ See joint UN declaration of January 5, 1943 and the declaration issued by the UK, US, and USSR Treasuries on February 22, 1944.

⁵² By all indications the Tripartite Gold Commission of the United States, the United Kingdom and the France was secretive. The BIS never granted the commission access to its archives. BIS archives opened to researchers fifty years later, in 1997.

⁵³ The Paris Reparations Agreement of January 14, 1946 included this stipulation.

“the BIS recognizes the existence of the National Bank of Belgium in Brussels and is in continuing business contact with this institution. The BIS will continue this relationship.”⁵⁴

In the meantime, it was widely known that the Nazi regime had been systematically looting gold from the occupied territories and using this gold to fund wartime transactions with neutral countries. Perhaps the most notorious examples involved the gold of the National Bank of Belgium, which had been entrusted to the Bank of France before the war. After the Germans occupied France, they shipped the Belgian gold to Berlin. Subsequently, the Germans had it resmelted by the Prussian Mint. The Tripartite Commission established that between August 1943 and March 22, 1944 the BIS received from the Reichsbank 1,606 kilograms of gold bars that had the official Reichsbank seal and bore the years 1934 to 1939. However, the bars, originally Belgian, had been resmelted at the Prussian Mint from January to June 1943.

Jacobsson's personal diaries suggest that the BIS did not expect that the Germans would provide it with tainted gold. For example, on August 12, 1943, only months after the Germans transferred the Belgian gold to Berlin, Bank of France Governor Bréart de Boissanger visited the BIS to inquire about German gold transactions. He informed the BIS that the Bank of France had delivered Belgian gold to Berlin “with the instruction that this gold would be handed over to the National Bank of Belgium.”⁵⁵ Evidently, de Boissanger did

⁵⁴ BIS Archives, 7.18(5), HEC 1/7, December 8, 1941. From 1930 to May 1935 Ernst Hulse was the top German representative in the BIS management. He was replaced from Berlin by Paul Hechler, who had been working in the foreign exchange division of the Reichsbank. In the BIS organization structure in the 1930s, it was an unofficial rule that the president should be an American, the general manager a Frenchman, and the next in command, the assistant general manager, a German. The German representative doubled as the Head of the Banking Department. The English, Dutch, Belgian, and Italian representatives rounded out the senior management of the bank, filling top positions. Owing to the BIS's predominantly European character, Japan, the seventh founding country, was not represented in the management in the 1930s or 1940s. This structure was a direct result of German war reparations, the administration of which was one of the main purposes for creating the BIS.

⁵⁵ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 48, August 12, 1943.

not know if the gold had been delivered or not. In any case, he informed the BIS that the Bank of France would accept full responsibility for the fate of the gold. Asked about his thoughts on German gold and about German gold transactions, Jacobsson writes:

I told B. [de Boîsanger] about my visit to Berlin and how I got the impression that Germans had some gold left. But besides I could not think that the Reichsbank would send the B.I.S. "tainted gold." After all, the object of paying interest to the B.I.S. was that the B.I.S. could serve as an instrument for negotiations after the war; and if there would arise serious disputes with regard to the B.I.S. assets the bank would not be able to fill the role envisaged.⁵⁶

Since in July 1946 the BIS no longer had possession of the Belgian gold, it decided to use the gold the Reichsbank had placed at its disposal at the branch in Constance to satisfy the Belgian claim for restitution.⁵⁷ Given that the BIS had no vaults on its premises in Basle, it also contended that it had "no means of verification as regards the exactitude and scope of the assurances given."⁵⁸ While I was unable to uncover evidence of BIS officials physically inspecting gold deposits made by the Reichsbank on its account with the Swiss National Bank in Bern or with the Reichsbank regional branch in Constance in April 1945, there is no doubt that BIS officials regularly traveled to Bern throughout the war and visited Constance on several occasions after the gold was placed there at its disposal.

Meanwhile, after the halt of hostilities, the Bank of Netherlands launched an investigation into the end destination of gold looted by the Germans during the war. Given that the Germans had used the Prussian Mint to resmelt the Dutch gold and fuse it with looted gold of different qualities and origins, it proved difficult to establish initially if the Dutch looted gold had been part of the gold the BIS had accepted from the Reichsbank.

⁵⁶ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 48, August 12, 1943.

⁵⁷ BIS Archives, 7.19(5), Looted Gold, "Auboin and Pilotti to Emmanuel Monick, August 9, 1946.

⁵⁸ Ibid.

Ultimately, Dutch officials were able to supply the BIS with evidence from their own records, and from the files of the Reichsbank and the Prussian Mint, proving that 2,093 kilograms of gold delivered to the BIS by the Reichsbank had been stolen by the Germans from the Bank of Netherlands.

After the investigation into the Belgian and Dutch gold had been completed and the BIS had restituted 3,740 kilograms of fine gold to the Tripartite Commission Gold Pool at the Bank of England, the British, American and French governments agreed to waive all claims against the BIS in respect to looted gold transferred to it by the Reichsbank.⁵⁹

By February 1, 1947, only 3,893 of the 13,542 kilograms that the BIS had received from the Reichsbank during the war were still in the possession of the BIS. This gold was held in two locations: the Swiss National Bank in Bern and the branch of the Reichsbank at Constance. The remainder had been subsequently used by the BIS in banking transactions with the National Bank of Romania (3,892 kg.), the National Bank of Yugoslavia (3,138 kg.), the Bank of Portugal (799 kg.), and the Swiss National Bank account in New York (699 kg.). To date this writer has found no evidence of BIS officials willingly and knowingly accepting “tainted gold” from the Reichsbank, that is, gold looted by the Nazis from individual citizens including Holocaust victims. Given the Germans’ practice of resmelting and fusing looted gold of different qualities and national origins, the world may never know if the BIS possessed “tainted gold.”

BIS As Intermediary and Advisor to Axis, Allied and Neutral Countries

Trade with Nazi Germany played an important part in the economies of all non-occupied European countries. Without imports of Swedish ore, Rumanian oil, Spanish

⁵⁹ Washington Agreement, May 13, 1948.

manganese, Turkish chrome and tungsten from Portugal, the German *Wehrmacht* most likely would have sputtered well before 1945. Neutral central banks and commercial banks, especially in Switzerland, accepted Nazi gold during the war in exchange for foreign currency to finance imports. While the role of the BIS in relations between Germany and neutral countries should not be overstated, BIS dealings in respect to the US Treasury's freezing of assets shows that the BIS served as an intermediary among the Allied, Axis and neutral countries during the war. BIS officials, in particular Thomas Mckittrick and Per Jacobsson, duly served all sides of the war.

The US Treasury's Freezing of Assets In the early years of the war the main concern of the United States (US) government was to prevent the Nazis from using the financial resources of the US to finance their military campaigns. The US Treasury sought to achieve this goal by regulating monetary transactions in foreign exchange or property dealings in the United States in which any foreign party held an interest. Consequently, President Roosevelt issued Executive Order 8389 on April 10, 1940, which froze Norwegian and Danish assets in the US. Eventually, every country in Europe except Great Britain as well as China and Japan were included in this Executive Order, Foreign Funds Control, established in 1940 with the Office of the Secretary of the Treasury and made a separate bureau within Treasury in September 1942, administered the freezing controls, thus permitting use of frozen assets only with a license granted by the Department.

The US Treasury's blocking of assets had two specific objectives. First, the measure aimed to weaken the Axis powers. Officials in Washington were concerned that the Axis powers had been using Swiss financial intermediaries in pursuit of their war aims. They also believed that nationals of Axis countries could be selling their interests in accounts blocked

in the United States to Swiss purchasers, either voluntarily or under duress, and that these funds could become available to the Axis. Consequently, in October 1941, the Treasury Department denied the Swiss National Bank's application to transfer \$34 million in gold from New York to Switzerland. Second, the Treasury aimed to strengthen the position of the US government in postwar negotiations. Well before the US entered the war, many Washington officials felt that by delaying the unblocking of assets after the war, the US could exert more influence over the peace negotiations.

Meanwhile, the Treasury's policy stripped the BIS of its special wartime immunities, thus making it necessary for it to apply, like all American and foreign banks, for a special treasury license to utilize its dollar assets in American banks, including the Federal Reserve Bank of New York. As a result, BIS officials sought, typically in vain, to pressure the US Treasury to ease restrictions on its US-based dollar assets. But they also negotiated with American officials on behalf of neutral countries like Switzerland and Sweden.⁶⁰ Between 1941 and 1943 BIS President Thomas McKittrick and BIS Economic Advisor Per Jacobsson traveled to New York and Washington on separate occasions to "help get rid of the special Treasury ruling as to nationality of the B.I.S. which we cannot accept and...facilitate business which would not in an American bank fall under Executive Order."⁶¹

Between December 1941 and February 1942 Jacobsson traveled to New York and Washington to meet with high-ranking US officials to discuss the blocked assets, allay fears that the BIS was pro-Nazi, and provide the Americans with intelligence on conditions in Europe. In particular, on December 18, Jacobsson visited with the President of the Federal

⁶⁰ Jacobsson noted: "Marcel van Zeeland back from Lisbon and Madrid. He has obviously been successful in establishing valuable contacts." Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson, A I 32, February 23, 1941.

⁶¹ BIS Archives, 2/2, Federal Reserve Bank of New York, McKittrick to FRBNY, Aug. 24, 1940.

Reserve Bank of New York, Alan Sproul, along with several vice presidents. There, Jacobsson informed Federal Reserve officials about “conditions of the BIS and Europe generally” and assured them that the BIS would adhere to a strict policy of neutrality.⁶² Jacobsson questioned Sproul about the blocking of assets, wondering whether the treasury officials “really thought that they could stop Germany’s transfer of capital” through such a measure.⁶³ Jacobsson told the Federal Reserve officials that while he agreed with the blocking of assets of occupied countries as a preventative measure, it was unwarranted to block assets of such neutral countries as Sweden and Switzerland. Indeed, he believed that the US government treated Swiss banks unfairly during the war:

I thought the Americans were largely unfair to the Swiss banks. These banks had to deal with their neighbors, Italians and Germans and French, and could of course not grant credits to Canadians and Brazilians. Bank secrecy was the law of the land in Switzerland.; if U.S.A. had objections it should turn to the Swiss Government and not go for the bankers. It is as when I hear the Standard Oil being blamed for having sold oil to the Japanese in 1939 or 1940 or 1941. It would be highly improper if the Standard Oil allowed politics to determine its business – if delivers to Japan had to cease it would be for the U.S. Government at the instigation of the State Department to issue an order to that effect. It is not for the Swiss banks against the express provisions of the Swiss law to reveal the amounts held for the account of their customers.⁶⁴

According to Jacobsson, the blockade made it more necessary for neutral countries like Switzerland and Sweden to collaborate with Germany and that the Treasury’s policy had

⁶² Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 37, December 1941.

⁶³ Jacobsson remarks about the American policy: “The American inclination was to say that if it is not clear that a transaction is harmless from the Anglo-American point of view, that transaction is not allowed. The same would apply to the B.I.S. If it was not clear beyond doubt that a proposed transaction cannot possibly aid the enemy then no license will be given. I pointed out that the B.I.S. had every reason not to propose any unneutral [sic] transaction,” arguing that, “[w]e had publicly announced a policy of strict neutrality; We would be fools to risk our standing through the undertaking of transactions on which the profits (commissions) at best would be trifling; We are in the Management Committee persons of different nationalities who keep a watch on each other, should anything unneutral [sic] occur.” See NL 324, Per Jacobsson, A I 37, December 1941.

⁶⁴ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson, A I 45, June 15, 1943.

“this most undesirable unintended consequence.”⁶⁵ Federal Reserve Bank of New York President Allen Sproul agreed with Jacobsson that he should “repeat these arguments in Washington.”⁶⁶

From New York Jacobsson traveled to Washington, where he met with high-ranking officials at the Federal Reserve Bank, the Treasury, and the State Department. On January 5, 1942 Jacobsson met with Harry Dexter White, the Treasury Department’s chief international economist. Later, Jacobsson recounted his discussion with White:

I told him about the felling in Switzerland and Sweden – that these countries worked for Germany but that they held out against the European order. About the B.I.S. I understood that the question of the Czech gold had made people in the Treasury and elsewhere suspicious of the B.I.S. I said that we now followed a policy of blocking the assets of countries invaded.⁶⁷

Nevertheless, White was not enamored by what Jacobsson had to say and declined his request to reverse the Treasury’s policy. From Washington Jacobsson returned to New York to meet with officials of the New York Federal Reserve, J.P. Morgan and Company, Chase Manhattan Bank, and the First National Bank of New York. Each of these institutions shared with the BIS a firm conviction that the Treasury’s policy caused more harm than

⁶⁵ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 37, December 1941.

⁶⁶ In *ibid.* Jacobsson noted: “With regard to Switzerland and Sweden, I underlined the beneficial influence of these countries from the Anglo-Saxon point of view. First of all I admitted, however, that there was a debit side: these countries undoubtedly worked for Germany – and probably were able to deliver more to Germany than if they were attacked, defeated and made to work. But there were three items on the credit side:

1. Sweden and Switzerland stood out against the New Order. They by their refusal made it impossible for Hitler to present the picture of a unified Europe under German leadership. The important point was that the only two countries which could have a free choice held themselves aloof. For German morale it would be an encouraging matter if these two countries joined as they so often had been invited to do.
2. The Swiss especially have for a year believed in Germany’s ultimate defeat....Swiss views have a greater effect than Anglo-Saxon propaganda.
3. Sweden and Switzerland are democracies – two outposts of the Anglo-Saxon conception of life.”

⁶⁷ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 38 January 6, 1942.

good and that it should be reversed.⁶⁸ By the end of his visit to the US Jacobsson recognized that because “the Federal Reserve had lost a lot of power to the Treasury and it had relatively little influence over the Treasury in respect of the issue of the freeing of blocked funds,” he had an uphill battle to face.⁶⁹

On April 1, several weeks after returning to Switzerland, Jacobsson traveled to the Swiss National Bank in Zurich to meet with President Weber, with whom he discussed Swiss foreign exchange difficulties in connection with US Treasury’s policy.⁷⁰ Jacobsson used the example of Spain – i.e., how the Swiss were transferring dollars to Spain to finance Spanish-German trade relations – to illustrate the Treasury’s policy of refusing every request that might directly or indirectly be of advantage to the Axis powers. Weber replied angrily that the US government

ought to press for that in Madrid but not prevent the National Bank to use its money....I pointed out that the Americans were perhaps more ruthless than the British (with which Weber agreed) and that they felt they were fighting for the freedom of Switzerland, while Switzerland produced armaments for Germany – on this point Weber repeated what he had said to me before that the manufacture of arms for Germany was a mistake.⁷¹

The Swiss National Bank and Swiss commercial banks had been transferring a considerable volume of dollars to Spain. The US Treasury wanted to force Spain to export more to the United States instead of to Germany, and it sought to accomplish this objective by making it difficult for the Spaniards to obtain dollars from Switzerland. According to

⁶⁸ See, for example, Jacobsson account of his meetings with Leon Fraser of the First National Bank of New York on December 19, 1941. Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 37, December 1941; and at J.P. Morgan & Co., Diary A I 37, January 3, 1942.

⁶⁹ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 38, February 28, 1942.

⁷⁰ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 43, April 6, 1942; and Per Jacobsson Diaries, A I 43, April 25, 1942.

⁷¹ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 43, April 6, 1942.

Jacobsson, few Swiss at the time understood the connection, instead seeing the measure as antithetical to American interests since the Swiss retaliated with similar restrictions on the Swiss franc. Jacobsson believed that Portugal and Sweden were more willing than Switzerland to make concessions to the US, giving escudos and Swedish crowns against blocked dollars, while the Swiss National Bank insisted upon free dollars. He notes that

The Swiss were in my opinion stupid; they did not understand the advantage of being generous now and then. I said [to Weber] that they could not afford to adopt such a line of behavior. They had to be careful and circumspect to get a living out of a country with so few raw materials.⁷²

Nevertheless, Weber eventually found a way out of this conundrum: “it happened to be the case that the Americans needed free Swiss francs: he could not be expected to give them free Swiss francs except against free dollars.”⁷³

In the meantime, throughout the war “important Germans” continued to visit the BIS to discuss and conduct central banking operations.⁷⁴ For example, on November 25, 1940, Emile Puhl, Vice President of the Reichsbank, arrived at the BIS for a two-day visit. The BIS hosted a lunch for him at the *Schutzenhaus* at which all top management were present. Jacobsson recounted the event:

I sat next to Puhl. Dr. Weiser [BIS Legal Advisor] and van Zeeland [Belgian representative] turned up after some hesitation. I explained to van Zeeland that it was his duty to be present as Puhl may discuss matters important to the Banking Department. Dinner that evening was held at Hechler’s house [German Assistant

⁷² Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 43, April 25, 1942.

⁷³ Ibid.

⁷⁴ Hechler had lunch in Basle with “a number of important Germans – interested in Rhine schiffart – were present, among others a friend of Hermann Goring.” Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 33, Nov. 22, 1940. On February 12, 1944, Hechler hosted a lunch at his house for Frau von Diskau, Dr. Frank Fahle, a top director of IG Farben, who was an opportunist Nazi especially concerned with foreign relations and camouflage operations; Herr Rong also of I.G. Farben; and Albert Nussbaumaer, who was a top director of the Swiss Bankers’ Association. Also see, Per Jacobsson Diaries, A I 48, February 12, 1944.

GM and Head of Banking Department]....Puhl said 'in monetary matters it is possible to get a certain amount of freedom. But in economic matters it is politically impossible to introduce freedom. Those in power want control'....I spoke to Puhl about the Swiss currency; and Puhl underlined the importance of the freedom of the Swiss exchange market. 'That the Swiss do not introduce exchange restrictions is important even from a political point of view, for it provides another reason for leaving Switzerland free'....[The next day] I sent a letter to President Weber of the Swiss National Bank reporting to him what Puhl had said; and adding that I supposed he had said the same in Zürich but it might be useful to get confirmation from the other source.⁷⁵

Much to Jacobsson's satisfaction, the following day Weber expressed his gratitude in a letter.⁷⁶

On another occasion, after Jacobsson returned from the United States, Emile Puhl again traveled from Berlin to Switzerland to attend to central banking matters, visiting the BIS on May 18, 1942. Paul Hechler joined Puhl and Jacobsson in a discussion in which Puhl questioned Jacobsson "a great deal about the U.S.A." They discussed "the US position toward Germany, what the Americans thought about Russia, and the BIS."⁷⁷ On the 28th of May, Puhl returned to Basle from Luzern, where he was "settling all kinds of clearing questions with the Swiss," calling the work "rather hard."⁷⁸ Puhl had come to Basle that afternoon especially to talk to Jacobsson."⁷⁹ Jacobsson noted that

[Puhl] was more than ever interested in America. He asked about the Freezing Committee in the Treasury. Why did not the Committee allow transfers from the B.I.S. to the Swiss National Bank? What could the American objections be[?] I told

⁷⁵ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 32, November 27, 1940.

⁷⁶ In *ibid.* Jacobsson added: "It gives me great pleasure to work confidently with the Swiss authorities. They believe now that I only want to be of help as far as I can."

⁷⁷ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 43, May 28, 1942.

⁷⁸ *Ibid.*

⁷⁹ *Ibid.* Jacobsson writes: "But was it worth while? Only the outcome of the war (ausgauf des Krieges) would decide that: everything now done were [sic] dependent upon the outcome of the war. (P.J. Puhl does not take the outcome of the war for granted any longer.)."

him I did not think that any American interest stood in the way of such a transfer, but personally I believed that the Freezing Committee wanted to create a position in which it would have some say at the end of the war. More a question of safeguarding the position of the Treasury at the peacemaking than the position of the U.S.A. The State Department did not like the striving for power and maneuvering for influence by the Treasury – but there it was. Puhl thought my explanation might be the right one.⁸⁰

Jacobsson also informed Puhl about policy currents in England.⁸¹

Months later, in early December 1942, BIS President McKittrick left Basle for New York and Washington to meet with high-ranking officials.⁸² Regarding McKittrick's trip, Jacobsson notes:

There was everywhere much interest in the B.I.S. McKittrick tried in particular to explain the neutral policy and to show that the pursuit of such a policy did not involve any damage to the interests of the United Nations. McKittrick thinks he succeeded in making this clear – except perhaps in the Treasury, though even there they must understand that the B.I.S. does not do harm to American interests.⁸³

In Washington McKittrick met with high-ranking officials of the Federal Reserve Bank, the State Department and the Department of Treasury. While visiting the Treasury McKittrick met with Treasury Secretary Henry Morgenthau and Treasury Undersecretary Daniel W. Bell. He addressed three subjects: "The payment of the dollar debt to the Swiss – because so far refused. The possibility of the Belgian Government paying the interest due on the bonds held by the B.I.S. Would license be given? The payment of the B.I.S. dividend to

⁸⁰ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 43, May 28, 1942.

⁸¹ Ibid. Jacobsson adds: "when I spoke about American post war plans I made it clear to Puhl that the Americans assumed that the United Nations would win the war."

⁸² Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 43, November 4, 1942.

⁸³ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 45, May 5, 1943.

bondholders in America from the B.I.S. holdings of dollars – license so far refused.”⁸⁴ After a long discussion with these and other Treasury officials, the United States Treasury agreed to allow the BIS to use its dollar funds deposited with the Federal Reserve Bank of New York to pay dividends to American shareholders. However, since Belgium was occupied at the time, and its government was in exile in England, the US Treasury opposed the BIS’s use of dollars to allow the Belgian government in exile to pay the interest it owed the BIS. Likewise, the BIS’s proposed payment of dollar debt to the Swiss National Bank was refused outright. The Treasury explained that its policy was to block as much capital as it possibly could and that it would be to the advantage of the United States to force the BIS to pay the Swiss National Bank in Swiss francs.⁸⁵

While the negotiations between BIS officials and US Treasury officials demonstrate that the BIS was attempting to safeguard the interests of its creditors and shareholders, it also shows how the bank served as a mediator between Allied and neutral countries. Thomas McKittrick and Per Jacobsson played key roles as mediators by attempting to persuade American officials that the policy of blocking foreign-owned assets in the US did not prevent Germany from gaining capital and that its reversal would do no harm to US interests. It was only after the governments of neutral Sweden, Spain, Portugal, and Switzerland gave the American government formal assurances that they would forbid transactions involving blocked countries or individuals did the US Treasury grant general licenses to those countries. Behind the scenes, the BIS served as an effective mediator

⁸⁴ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 45, May 10, 1943

⁸⁵ *Handschriftenabteilung*, NL 324, Per Jacobsson Diaries, A I 45, May 10, 1943. Documentary evidence shows that the US government made it difficult for McKittrick to return to Basle during the war. Top officials at the BIS questioned whether he really wanted to return. See Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 59, January. 23, 1946.

between the US Treasury and neutral countries affected by its policy of freezing foreign-owned assets in the United States.

Conclusion

Common wisdom of the role of the Bank for International Settlements during the Second World War holds that, at a minimum, the bank did not adhere, as strictly as it could (or should) have, to its official policy of neutrality. At a maximum, the BIS was controlled by Axis powers and made an instrument of their war plans. In this view the BIS was, in a word, pro-Nazi.

This chapter has focused on selected aspects of the wartime activities of the BIS. By drawing on previously unstudied archives of the BIS and the Jacobsson Collection, it has attempted to shed light on the internal thinking and actions of BIS officials that were responsible for guiding the bank through a period of time as complex and challenging as the Second World War. There absolutely is no doubt that BIS President Thomas McKittrick and, above all, Economic Advisor Per Jacobsson were the most important BIS figures during the war and thus to understanding the bank's wartime activities.

The answer to the question of whether the BIS was neutral throughout the war is not as straightforward as the BIS's most vehement critics have led people to believe. Analysis of the Czech gold affair, which has long and widely been held as exemplifying the BIS's decidedly pro-Nazi character, helps casts doubt on the claim that the BIS was an instrument of the Germans. And yet the picture is fuzzier still. For one can identify numerous wartime activities or financial transactions undertaken by the BIS that, in isolation, could have been judged as reproachable from any one belligerent or neutral state's point of view. But while this is true, documentary evidence presented in this chapter has also shown that, on the

whole, BIS officials did not discriminate against any one side of the war. On the contrary, and as a matter of fact, the top management of the BIS continued duly to serve their traditional central banking clients as they had before the outbreak of hostilities in Europe. While there were instances of the BIS ceasing relations with certain member central banks, as was the case with the central banks of occupied Baltic states, the BIS's essential character of serving its traditional clients in Europe and the United States (i.e., conducting financial operations and providing highly specialized information on international financial developments) did not change. However, contrary to official accounts, the BIS remained quite active and busy throughout the duration of hostilities.

Why did the BIS continue to maintain normal business relations with most of its traditional clients? The explanation offered in the proceeding pages has not differed greatly from the recent article by BIS Historian Piet Clement.⁸⁶ Broadly, BIS wartime activities can be explained by the bank's desire to safeguard the financial interests of its creditors and shareholders, to survive the war and to secure a position for itself in an unknowable postwar financial order. But unlike Keynes and White, who during the war were developing postwar monetary plans on the assumption that there would be an internationally coherent political order, the uncertainty of the outcome of the war, even from 1940 to late 1942, meant that the BIS could not afford to take the part of any belligerent or neutral country. If its management were expected by the Reichsbank to continue providing it with financial services, then it was conceivable that BIS would expect that the Federal Reserve Bank of New York, the international correspondent of the Federal Reserve System, to receive the same. And the Bank of England and so on. If the evidence had clearly shown that the BIS had maintained normal relations with Axis and neutral countries but not with the Allied

⁸⁶ Clement, "The Bank for International Settlements during the Second World War," pp. 43-60.

powers, then one could reasonably conclude that the bank took on a decided national or allied character. That is, that it was not neutral. However, as this chapter has shown, the BIS did not belong to the Axis, Allied or neutral camp. Instead, it sought to safeguard the financial interests of its creditors and shareholders and to ensure a place for itself in the postwar monetary order.

The analysis in the proceeding pages add perhaps one missing dimension to conventional accounts of the BIS's wartime activities: that the undeniable and unenviable truth is that the most powerful states in the international system historically have made the rules up as they have gone along. At a time in history when central banks possessed little independence from governments, the principal members of the BIS board of directors deliberately chose to keep the BIS going, so that it could continue to serve their national interests during wartime. All international institutions are composed of two elements: a corpse of international officials and a group of member states. While there is some room for maneuver for the former, the latter are undoubtedly responsible for the most important decisions taken by the institution (e.g., whether or not to continue during wartime). On this basis, it comes as no surprise that the BIS continued to maintain normal business relations with most of its traditional members. After all, states create international institutions to serve their interests in good times and bad. As will be shown in the BIS's coming struggle to survive the Bretton Woods negotiations, which called for its liquidation "at the earliest possible moment," political expediency often trumps morality in government decision-making in international financial affairs.

Chapter 5

Struggle for Survival

While the Bretton Woods Agreement that was signed by world leaders on July 22, 1944 led to the creation of new international economic and financial institutions, it also contained a resolution recommending the abolition of the Bank for International Settlements. Spearheaded by US Treasury officials, Resolution V of the agreement called for the liquidation of the BIS “at the earliest possible moment.”¹ American opposition to the BIS was motivated by the belief that the BIS would compete with the International Monetary Fund in Europe and that it had compromised its neutrality during the war. American treasury officials also opposed the BIS on the grounds that the institution served central banks at the exclusion of treasuries. Yet, by April 1948, not only had the US government officially withdrawn its support for the resolution it had orchestrated; it had also assigned the BIS important financial tasks in connection with the Marshall Plan, officially known as the European Recovery Program. This chapter examines the genesis of the American government’s reversal of its policy of attempting to eliminate the BIS as an effective factor in international finance in the early postwar years.

There are several reasons why the US government stopped pursuing the BIS’s abolition between 1944 and 1948. First, public assertions in the United States and Britain that the BIS was pro-Nazi during the Second World War proved to be exaggerated. By cooperating with the Tripartite Commission for the Restitution of Monetary Gold between 1945 and 1947 and by returning gold that had been looted by the Germans and delivered to it during the war, BIS officials were able to soften opposition to it immediately following the

¹ BIS Archives, 7.18(8), ROY 7/41, “The Post-War Position of the B.I.S.”

war. The second reason why the BIS survived efforts aimed at its abolition was the solidarity that existed among orthodox central and private bankers in the United States and Europe. The “bonds of monetary solidarity [that existed among these bankers] through the intermediary of the Bank for International Settlements” helped to build a strong and effective opposition to Keynesian-minded treasury officials, especially in the US, who wished to do away with the BIS because it represented a pre-Depression alliance among central bankers.² Prominent New York bankers who favored the recreation of an international monetary order not on new institutions linked to government treasuries but on the foundation of the BIS played an integral part in this process. Third, in the early postwar years, the US Treasury underwent a slow but certain transformation, as hard-line critics of the BIS, such as Treasury Secretary Henry Morgenthau and Harry Dexter White, vacated their positions and were replaced by officials who looked more favorably upon, or openly supported, the BIS. The ascension of BIS supporters to important positions in the United States Treasury and State Department and the Bretton Woods institutions paved the way for official collaboration between these latter institutions and the BIS.

The finally and perhaps most important reason why the United States government withdrew its support for the BIS's liquidation was that the BIS and its supporters in the US and Western Europe persuaded opponents in Washington that the BIS could (and would) duly serve its strategic interests in Western Europe in the postwar period, especially in regard to European economic reconstruction. As the American government associated European economic recovery with preventing the spread of communism in Western Europe, following the war the Treasury recognized that regardless of what it felt about the BIS in regard to Nazi Germany or the new international monetary fund, the BIS's belief in free market

² BIS Archives, H.S. 26, “Summary of Conclusions of the Special Committee with Respect to the Operations of the B.I.S.,” June 17, 1930, p. 5. See also Article 3 of the Statutes.

capitalism and its machinery for supporting capitalist development in Europe superseded all other considerations.

The remainder of this chapter is organized as follows. The second section outlines the battle over the role of the BIS in the postwar financial order between the United States Treasury, on the one side, and American central and private bankers, on the other. It argues that the United States Treasury's antagonism towards the BIS was rooted in a broader struggle between Keynesian-minded treasury officials and orthodox central and private bankers for control over economic policy that could be traced back to the Great Depression. The third section examines the negotiations at Bretton Woods over the proposal to liquidate the BIS in the context of these relations. The fourth section details the events leading up to the United States government's decision in April 1948 to stop pursuing the BIS's dissolution.

United States Treasury Versus Wall Street

From the late 1920s through the Second World War, there was a discernable pattern of struggle over financial decision-making in the leading Western industrialized countries. Such contestation centered on the changing nature of relations among treasury officials, on the one hand, and central bankers and prominent financiers, on the other. Nowhere was this pattern of antagonism greater than in the United States, which became the epicenter of the battle over the postwar fate of the BIS in the mid-1940s. In fact, it was in this country that the idea of abolishing the BIS both originated in the first instance and was defeated at the end. The antipathy of the US Treasury towards the BIS was in large part a manifestation of the New Deal antagonism between "Main Street," represented by the US Treasury, and Wall Street, represented by the banks, which formed a formidable alliance with the Federal Reserve Bank of New York, the international correspondent of the Federal Reserve System,

which was stridently in favor of preserving the BIS. A bastion of monetary orthodoxy, the BIS indeed was the institution of choice of these bankers who wished to reconstitute international finance after the war on the pre-Depression model of central bank activism.

In examining the circumstances surrounding the creation of the BIS from 1929 to 1930, Chapter 2 showed that monetary relations among the great powers were to a large extent shaped by leading central bankers and private international financiers who worked in close collaboration. As central banks in the leading industrialized countries evolved major banking houses regularly performed public functions, responding to financial crises by providing key credits and loans to central banks and governments as part of currency stabilization projects.³ Accordingly, private bank coalitions have historically been substituted by nationalized central banks and government deposit insurance schemes, thus signifying an important development in the evolution of national central banks during the twentieth century.⁴ That the modernization of central banks is a relatively recent historical development comes as no surprise. Murphy shows that in thirty-three international institutions that were created between 1865 and 1914, private-sector actors provided financial sponsorship, organizational resources and political leadership in establishing new institutions to cope with the unprecedented problems created by the expanding world markets for trade and finance. Moreover, international cooperation among aristocrats was aided by the European conference system, which “helped mute conflicts among the powers.”⁵ In brief, prior to the First World War there was a well-established norm of private

³ BIS Archives, MCG7/49, 7.18(2), Fraser to Reynolds, May 30, 1930.

⁴ Gary Gorton and Lixin Huang, “Banking Panics and the Origin of Central Banking,” Wharton Business School, the Wharton Financial Institutions Center Working Paper Series, 02-31 (August, 2001), pp. 1-42.

⁵ Craig N. Murphy, *International Organization and Industrial Change: Global Governance Since 1850* (New York: Oxford University Press, 1994), pp. 48-49.

actors regularly performing public functions, particularly in fostering and regulating financial and industrial development and promoting the international expansion of the regulatory role and capacity of states.

The First World War completely disrupted international financial and economic relations, both between governments and private institutions, inside as well as outside the sphere of countries directly involved in the war. Chapter 2 showed that despite the devastation of the First World War, the state system was strengthened in the years that immediately followed it. In the area of international finance treasury officials and central bankers came to the fore. In every major industrialized country a group of financial diplomats developed.⁶

At the same time, the enhanced importance of economic questions bolstered the belief that businessmen and central bankers, not politicians or bureaucrats, possessed the flexibility and technical expertise required to stabilize markets and facilitate economic recovery. Policymaking elites openly announced that fiscal degeneration and economic downturns could only be avoided, and world peace and prosperity could only be achieved, by forces entirely divorced from politics, through “the healing power of assistance of private finance and commerce.”⁷ The establishment of the BIS in 1930s epitomized this trend as prominent central bankers and international financiers designed the BIS to commercialize German reparations in the short term and promote central bank cooperation and provide additional facilities for international finance in the longer term.⁸

⁶ See Richard Hemmig Meyer, *Bankers' Diplomacy: Monetary Stabilization in the Twenties* (New York: Columbia University Press, 1970), esp. pp. 3, 13-14; and Paul Einzig, *Bankers, Statesmen and Economists* (New York: Books for Libraries Press, 1967) and *Behind the Scenes of International Finance* (London: Macmillan, 1932).

⁷ Herbert Hoover to Benjamin Strong, August 30, 1921, Herbert Hoover Papers, Herbert Hoover Presidential Library, Box 284, cited in Costigliola, p. 912.

⁸ See Chapter 1. Also see Simmons, “Why Innovate?”

Nevertheless, the Great Depression caused a fundamental change in relations among states and market actors in BIS-member countries. During the 1920s central bankers and market actors had actively shaped state- and market-led initiatives aimed at economic reconstruction and expansion. With the exception of a few countries like France, this development reflected a general pattern in state-market relations in industrializing countries. In the 1930s, by contrast, the authority of central and private bankers in international financial decision-making waned, as governments responded to deteriorating economic conditions by reasserting their authority over the full range of national economic policies. In the international sphere, this shift culminated in the Tripartite Agreement of 1936 in which the treasuries, not the central banks, of Britain, France and the United States brokered an agreement to stabilize the rates of the franc, pound sterling and the dollar. Franklin D. Roosevelt's landslide victory in 1936 ended any hope at the time that the United States government would enter into official and closer relations with the BIS. In many countries central banks surrendered a significant degree of autonomy to their governments. As Chapter 3 showed, this shift in relations between states and firms, which was bound up in the changing nature of relations among treasuries and central banks, in turn, weakened the BIS as an instrument of central bank cooperation.

Wartime planning for international monetary stabilization and economic recovery was largely controlled by treasuries, not central banks, which had become subordinated agencies of governments. This was the case for many European countries, including Britain, where John Maynard Keynes was developing a proposal for an International Clearing Union and an international trade currency, the *bancor*, intended to foster an equal balance of trade between all countries. But again, nowhere was the battle between treasury officials and private bankers over postwar monetary planning fiercer than in the United States, where the

Treasury sought to preserve its position of supremacy in financial decision-making by blocking foreign-owned assets in the United States and imposing tight licensing controls on foreign as well as domestic commercial interests and institutions. During these years, Henry Morgenthau and Harry Dexter White were the key architects of American domestic and foreign economic policies and the chief antagonists against the BIS.⁹ According to Rudolf Pfenninger of the Swiss National Bank remarked that “the mere existence of the BIS did not fit in with the [Treasury’s] plans for the new institutions, the IBRB and the IMF, which Harry White and [Edward] Bernstein envisaged.”¹⁰ Indeed, the US Treasury’s quest for international dominance in economic and monetary affairs necessitated the abolition of the BIS, which was the embodiment of the alliance among central and private bankers, particular between the Federal Reserve Bank of New York and prominent Wall Street firms. The Treasury’s opposition to regional economic and financial arrangements in the postwar period also hardened its position against the BIS during the war. While these factors account for American opposition to the BIS during the war, the US Treasury publicly based its opposition to the BIS on the grounds that it was Nazi controlled.

On Wall Street, the strong opposition of New York bankers to White’s proposals for the postwar monetary system and for creating a new monetary fund “reflected the still unresolved direction of New Deal financial politics.”¹¹ These bankers had supported the New Deal in large part to weaken the House of Morgan’s position of financial dominance on

⁹ In addition to Morgenthau and White, Edward Bernstein and John Pehle were influential characters in the Treasury during the war. Bernstein was special assistant to the Secretary Morgenthau on international monetary affairs. John Pehle was Director of the Foreign Funds Control division of the Treasury Department between 1940 and 1944.

¹⁰ Letter from Rudolf Pfenninger to Erin Jacobsson, June 2, 1976, cited in Erin Jacobsson, *A Life for Sound Money: Per Jacobsson* (Oxford: Oxford University Press, 1979), p. 186.

¹¹ Helleiner, *States and the Reemergence of Global Finance*, p. 43.

Wall Street.¹² After the implementation of progressive financial reforms between 1933 and 1935, the bankers' support for additional financial reforms was virtually non-existent. As Helleiner points out, though such bankers as James Forrestal and Dean Acheson remained affiliated with the Roosevelt administration, other prominent New York bankers increasingly distanced themselves from it, "denouncing its excessive public spending, inflationary policies, and penchant for financial regulation."¹³ White's proposals received particularly strong opposition from Winthrop Aldrich of Chase National Bank, who maintained close ties to the BIS and was an active supporter of the institution in the United States in the 1940s. Since Aldrich himself had been an "active supporter" of New Deal reforms in the early 1930s, his opinion on public policy were highly regarded both within the Roosevelt administration and in the general public.¹⁴

Meanwhile, senior managers of the BIS continued throughout the war to undertake steps to ensure that after the war the BIS would remain "an effective factor in international finance."¹⁵ This objective was pursued by different means. First and foremost, the bank sought to avoid activities and transactions that deviated from its expressed policy of neutrality. The previous chapter showed that, on balance, the BIS served the national interests of countries in the Allied, Axis and neutral camps during the war.

BIS officials also sought to secure a position for the BIS in the postwar financial order by undertaking internal analysis and evaluation of the institution's strengths and

¹² Thomas Furguson, "From Normalcy to New Deal: Industrial Structure, Party Competition, and American Public Policy in the Great Depression," *International Organization* 38, pp. 41-94.

¹³ Helleiner, *States and the Reemergence of Global Finance*, p. 43.

¹⁴ Arthur Johnson, *Winthrop W. Aldrich: Lawyer, Banker, Diplomat* (Boston: Harvard University Graduate School of Business Administration, 1968), pp. 194-96; and Helleiner, *States and the Reemergence of Global Finance*, p. 43.

¹⁵ BIS Archives, McKittrick Collection, 7/33, McKittrick to Rooth [President of the Swedish National Bank], Apr. 6, 1940.

weaknesses, which would allow them to propose constructive institutional reforms during postwar negotiations. Accordingly, the BIS struggled with the “idea of finding specific tasks for the B.I.S.”¹⁶ For example, BIS President Thomas McKittrick and Economic Advisor Per Jacobsson identified weaknesses that could be remedied after the end to hostilities.¹⁷ For starters, high-ranking BIS managers roundly supported the idea of eliminating the reparations character of the bank after the cessation of hostilities. While these officials believed that after the war the BIS “must be greatly reorganized to free it from the connection with reparations, etc.[.]” they also felt that “there was no particular reason to blame the B.I.S. or to destroy the institution before a sensible plan had been formed.”¹⁸ Since reparations had been the Achilles heel of the BIS since its creation in 1930, and they had inhibited the bank’s ability to undertake some of the broader system-management functions envisioned by its founders, BIS managers reasoned that “the Young Plan part [of the BIS] will have to go.”¹⁹

Furthermore, recognizing that the United States would play a dominant role in international relations after the war, high-ranking BIS managers placed great importance on the need to gain the support of the United States government for its operations on the European continent. Yet while “full American participation” in the BIS was the objective of these officials, they anticipated that the antagonistic relationship between the Treasury, the Federal Reserve Board in Washington and the Federal Reserve Bank of New York would

¹⁶ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 34, November 16, 1941.

¹⁷ Account based on BIS Archives, McKittrick Collection, 7/24, “Post-War Position of the B.I.S.,” October 1942.

¹⁸ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 51, December 14, 1944.

¹⁹ Basle University Library, Department of Manuscripts, NL 324, NL 324, Per Jacobsson Diaries, A I 61, March 11, 1946.

likely prevent such a development.

The problem of American participation in the BIS was related to the general question of what should be the make-up of BIS membership after the war. As the US Treasury clearly favored international economic and monetary arrangements over regional ones, the BIS internally questioned whether the British Dominions, China and Russia should not be granted representation on the board of directors, thus giving the bank a more certain international character. Also, given that seven out of the seventeen board members were from Axis countries, BIS President McKittrick recognized that “[t]hose responsible for United Nations policy must hesitate to entrust important tasks to an institution whose Board offers such slight protection against the formation of a hostile majority. The greater the responsibility, the greater the need to place it in sure hands.”²⁰ From an Allied perspective, the BIS’s balance sheet was “undesirable.” During the war, the overwhelming majority of assets, profits and shares were located in, derived from or held by Germany, Italy and Hungary. In fact, in 1944, about 72 percent of BIS investments were located in Germany. This situation, BIS officials surmised, would have to be altered following the war in order for the Allied countries, especially the United States, to entrust the BIS with additional funds and tasks for carrying out operations in support of their postwar policy objectives.

Finally, senior BIS managers recognized the need to eliminate the expression of national interests in the bank’s management. Since the BIS’s founding in 1930 there was a well-established rule that each member of the BIS management be of a certain nationality and appointed by the central bank of his own country. For example, while the general manager of the BIS was a Frenchman, the assistant general manager was a German who doubled as Head of the Banking Department. This organizational feature, which was a direct

²⁰ BIS Archives, McKittrick Collection, “Post-War Position of the B.I.S.,” p. 2.

outgrowth of the German reparations settlement, was not without its controversy, as the nationals of Germany, Italy, France, Belgium and Netherlands were granted top posts in the bank's management.²¹ Accordingly, McKittrick concluded that after the war, "the whole idea of national groups within the staff should be given up."²²

Still, while BIS officials were quietly positioning themselves between 1942 and July 1944 for the postwar negotiations, the public relations battle over the BIS intensified between the US Treasury and Wall Street. This situation reached its apex as a result of comments made in support of the BIS by Leon Fraser, who was vice president of the First National Bank of New York, and who had served as vice president and president of the BIS from 1930 to 1935. In November 1943, months before the Bretton Woods Conference, Fraser publicly declared that the BIS would be a suitable instrument for performing many of the functions that were being contemplated for a new international monetary fund.²³ The New York Banking Association and the American Banking Association also publicly criticized the Treasury's plan for such an institution, and instead passed a resolution in favor of the BIS's being assigned the core functions of postwar monetary institutions. These public rebukes of the Treasury's plans for abolishing the BIS sent shock waves through the Treasury and provoked a vehement response from Harry Dexter White, who proclaimed that the B.I.S. is German-controlled. Germany is being very nice, and hopes to get into power. There is an American president [of the bank] doing business with the Germans, while

²¹ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 17, March 21, 1933; and A I 20, December 22, 1933.

²² BIS Archives, McKittrick Collection, 7/25, "Organization," [no date], p. 1.

²³ BIS Archives, H.S. 100, Leon Fraser, "Reconstructing International Money," *The New York Herald Tribune*, November 21, 1943.

our boys are fighting Germans.²⁴

In Basle Fraser's comments and the American Bankers Association's resolution in favor of the BIS were seen as doing more harm than good. BIS managers felt that the publicity it received in New York "aroused all the suspicions of the Treasury people and was very much the reason for subsequent attacks."²⁵ BIS officials saw the resolution passed by the New York bankers in favor of the BIS in 1943 as turning "Washington (i.e., Morgenthau and White, New Deal and Roosevelt) being anti-New York automatically against the B.I.S."²⁶ After all, these officials thought that "it might have been much better for the B.I.S. if Fraser and our other friends in New York had said nothing."²⁷ Thus, it was against this backdrop that the Bretton Woods Conference would be held during the first three weeks of July 1944. The wartime confrontation between the Treasury and Wall Street over the place of the BIS in the postwar monetary system would manifest itself during these three eventful weeks during the summer of 1944.

The BIS and the Bretton Woods Conference

Historical experience has shown that postwar planning begins well before the end of any major war. In this regard, the Second World War was no different. Preparing to rebuild global capitalism as the Second World War was still raging, seven hundred thirty delegates from forty-four Allied countries gathered at the Mount Washington Hotel in Bretton

²⁴ BIS Archives, H.S. 317, Edward H. Collins, "A Lynching Party that Failed," *New York Times*, January 4, 1954, p 2.

²⁵ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 62, March 20, 1944. Leon Fraser, the first vice president and second president of the BIS, committed suicide in 1946.

²⁶ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Dairies, A I 50, November 5, 1944.

²⁷ Ibid.

Woods, New Hampshire, in June of 1944 for the United Nations Monetary and Financial Conference. While negotiations at Bretton Woods over the constitution of the postwar international economic order were dominated by treasuries, especially the United States Treasury, American and European central and private banking representatives at the conference presented an effective opposition to those who supported the abolition of the BIS at all costs. In fact, these bankers thwarted American Treasury representative White's attempt to impose a resolution that would have predicated membership in the new monetary fund on governments' making their central banks agree completely to sever ties to the BIS. As a result of effective opposition from the European and American central and private banking elites, the US Treasury withdrew its proposal, agreeing to a considerably weaker resolution calling for the investigation and liquidation of the BIS "at the earliest possible moment."

At the outset of the conference, treasury officials felt that the BIS would be made superfluous by the creation of new international economic and financial institutions. The BIS's main antagonist, the US Treasury, argued that the BIS would provide undesirable competition with the new institutions and thus impede their development. Led by Secretary Morgenthau, US Treasury officials also opposed the BIS on the grounds that it had compromised its neutrality during the war. In this connection, other officials at Bretton Woods reasoned that because of its location in "the half-German city of Basle," the BIS was "obviously under German domination."²⁸

Meanwhile, the question of the fate of the BIS was very much bound up in the more general debate over the design of the postwar international monetary order. Although the

²⁸ Willy Dreyfus, *Die Wirtschaftswende. Betrachtungen zur finanziellen Gesundung des Kontinents*. Zurich: Europa-Verlag, 1945, pp. 132-135, in Henry H. Schloss, *The Bank for International Settlements: A Experiment in Central Bank Cooperation* (Amsterdam: North-Holland Publishing Company, 1958), p. 119.

British delegate John Maynard Keynes expressed modest support for the United States Treasury's proposal to abolish the BIS, both he and Harry Dexter White, the main architects of the British and American monetary plans respectively, sought to safeguard and expand on the authority of governments to intervene in the economy through national economic planning. As Helleiner shows, treasury officials sought at Bretton Woods to create "a rather restrictive financial order in which capital controls were not only permitted but encouraged."²⁹ Since it was widely held that speculative capital flows had destabilized international trade during the interwar period, there was broad international support among Keynesian-minded government officials, industrialist and labor leaders at the time of Bretton Woods for restricting the international movement of capital.

Yet while the private and central bankers at Bretton Woods and beyond strongly opposed plans for state intervention through capital controls, the most strident opposition stemmed from the New York financial community. In stark contrast to treasury officials who proposed national planning as a method of reducing speculative capital flows, the New York bankers sought to minimize speculative capital flows by ending national planning. They based their opposition to national planning on the belief that such measures distorted natural economic processes, and even went so far as to support speculative flows because of their disciplining effect on governments.³⁰ Meanwhile, the BIS publicly denounced capital controls and deficit spending as a method of increasing consumer demand and economic growth. Along with the bankers, BIS managers advocated fiscal austerity and for interest rates to be consistent with the maintenance of external balance. As an international authority on and advocate of "sound money," the BIS discouraged exchange controls, deficit spending, and

²⁹ Helleiner, *States and the Reemergence of Global Finance*, p. 25.

³⁰ *Ibid.*, p. 40.

any other policies that caused inflation on the grounds that they compromised the integrity or the soundness of money.³¹

Still, opponents and proponents of the BIS at Bretton Woods were motivated by a common desire to avoid the mistakes of the interwar period in which cooperation in the area of economics and finance had broken down and intergovernmental relations had become marred by competitive currency devaluation and high tariffs on imported goods. Where the thinking and interests of the bankers and treasury officials differed fundamentally, however, was on the role of finance and thus the BIS in reconstituting the international economy after the war. Essentially, whereas the bankers supported the reconstruction of the international economy on the foundation of open financial markets and on central bank cooperation centered at the BIS, treasury officials desired to build an open international trading system by restricting international capital markets, including the elimination of the BIS. As Helleiner points out, “the only international financial institution in which [the New York bankers] had faith was the Bank for International Settlements because it was run not by Keynesian-minded government bureaucrats but by pragmatic central bankers.”³² More importantly, as an exclusive club for the Western Hemisphere’s most powerful central banks, the BIS could deliver what no other institution could: absolute secrecy and confidentiality in conducting central banking operations.

Broadly, while the Keynes and White plans represented an “agent-directed financial order,” the bankers advocated a “Hayekian spontaneous order” of the kind that the BIS had epitomized since its establishment in 1930.³³ In other words, rather than predicating the

³¹ For a detailed of Per Jacobsson’s views on sound monetary policy, see Erin Jacobsson, *A Life for Sound Money: Per Jacobsson*.

³² Helleiner, *States and the Reemergence of Global Finance*, p. 40.

³³ Miles Kahler, “Institutional Choice in International Monetary Affairs: Bretton Woods and Its

postwar financial relations on an intricate and legalized constitution, as the proposed institutions epitomized, the bankers argued for reconstructing international finance on the foundation of the BIS, which embodied a laissez-faire approach to financial market regulation. Contrary to the Bretton Woods institutions, the BIS represented (and advocated) a much more decentralized monetary system in which cooperation was predicated on independent central banks, instead of treasuries, and was supposed to be voluntary and spontaneous, not structured and rule-based. According to the orthodox model, which was prefigured by the nineteenth-century gold standard, the achievement of financial stability depended on principles of credibility and confidence among pragmatic central bankers who were expected to behave according to the “rules of the game.” The rules set out by the BIS were: “(i) The amounts of foreign exchange to be held by Central Banks should be kept within reasonable limits[;] (ii) Foreign exchange reserves should only or practically...be invested with the Bank for International Settlements or with or through the Central Bank of the currency concerned[;] (iii) Central Banks in general should abstain from withdrawing foreign assets in gold unless the foreign exchange position gives rise to gold movements in the direction envisaged[;] and (iv) Central Banks should in general abstain from converting foreign assets from one currency with the sole object of making a profit on the transaction or earning a higher rate of interest.”³⁴

Finally, BIS managers and European and American central and private bankers alike

Competitors,” in David Andrews, Randall Henning, and Louis Pauly, eds., *Governing the World's Money: A Festschrift in Honor of Benjamin J. Cohen* (Ithaca: Cornell University Press, 2002), pp. 38-59.

³⁴ BIS Archives, H.S. 28, “Rules of the Gold Standard,” March 12, 1933, pp. 2-3. See also Barry Eichengreen, *Golden Fetters: The Gold Standard and the Great Depression, 1919-1939* (New York: Oxford University Press, 1995), pp. 29-66; and Beth A. Simmons, *Who Adjusts?: Domestic Sources of Foreign Policy During the Interwar Years* (Princeton: Princeton University Press, 1994), p. 4, 25, 27.

opposed the American plan to situate the new international institutions in Washington.³⁵ That New York had a port and was a major commercial and financial center factored heavily in the thinking of these bankers. Placed in Washington, they argued, these institutions would never compete with London and New York as centers for influencing international economic and financial developments.

Therefore, it was in this context that on July 20 the Norwegian delegation submitted a resolution to the conference recommending the “liquidation of the Bank for International Settlements at Basle...at the earliest possible date, and that the Governments of the United Nations now at war with Germany, appoint a Commission of Investigation, in order to examine the management and transactions of the bank during the...war.”³⁶ As soon as the resolution appeared, the Dutch and British delegations vigorously opposed the proposal. After being instructed to modify the resolution, however, an even more drastic resolution appeared requiring that “no nation will be admitted to either the proposed international monetary fund or the Bank for International Reconstruction which has not previously broken with the Bank for International Settlements.”³⁷

As was the case, the BIS officials and their supporters at Bretton Woods believed that White had used the Norwegian delegation as a front to introduce the motion to liquidate the BIS. According to them, the Treasury was motivated by its “anger against the

³⁵ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 63, April 16, 1946; and NL 324, Per Jacobsson Diaries, A I 63, April 19, 1946

³⁶ U.S. Department of State, *Proceedings and Documents of the United Nations Monetary and Financial Conference, Bretton Woods, New Hampshire, July 1-22 1944* (Washington, DC: Government Printing Office, 1948), p. 330.

³⁷ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Collection, Box C, Edward H. Collins, “This Week in Finance: The Campaign Against the B.I.S.,” *New York Herald Tribune*, July 24, 1944, p. 1.

New York bankers!!,”³⁸ and that the resolution was part of an elaborate propaganda campaign by the United States Treasury to discredit the BIS and to build support for the new economic and financial institutions it was proposing.³⁹ While the Bretton Woods conference was proceeding, Per Jacobsson outlined the position of the BIS with regard to the proposed resolution:

What do we say about this here [at the BIS]: (1) We welcome an intervention into the business of the Bank. But the Board is responsible and the Board will have to tell what investigation shall be made! In fact, the B.I.Z. has had luck: we have done much better than anybody could ever imagine during the war. (2) We are generally of the opinion that the B.I.Z. having weathered one world war could be used for the reconstruction after this war. Be usefully fitted into the general scheme. (3) What is disturbing is that Harry White and his friends want to destroy the B.I.Z. because the American Bankers’ Association have been in favor of the B.I.Z. No desire to find a common ground for collaboration but a continuation of the spirit, which brought 6 years [of] stagnation with 9 million unemployed in the business of the U.S.A. Roosevelt and his crowd took a pleasure in showing their superiority to businessmen and bankers – and the people paid in unemployment.⁴⁰

Despite the dominance of treasuries at Bretton Woods, there were a considerable number of BIS supporters in attendance. For example, Johan Willem Beyen, financial advisor to the Dutch government and former BIS president, organized support for the BIS. Leon Fraser of the First National Bank of New York featured prominently among the American supporters of the BIS at Bretton Woods. In fact, the Federal Reserve Bank of New York officials and prominent New York bankers almost unanimously opposed to the resolution to abolish the BIS and made a strong stand against it at Bretton Woods. Moreover, Thomas Dewey’s chief foreign policy advisor, John Foster Dulles, then of the law

³⁸ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Dairies, A I 50, July 15-16, 1944.

³⁹ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Dairies, A I 37, December, 1941. Also see BIS Archives, H.S. 170, Ernest H. Weinwurm, “The Future of the Bank for International Settlements and the Marshall Plan,” *The Commercial and Financial Chronicle*, September 4, 1947, pp. 1-4.

⁴⁰ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Dairies, A I 50, July 15-16, 1944.

firm Sullivan and Cromwell, criticized the resolution and privately reminded his American colleagues of how the BIS had supplied New York and Washington with sensitive information on conditions in Europe throughout the war. Other segments of the American financial community came out in support of the BIS at Bretton Woods. Prominent among them was Chicago banker Edward Brown, who strongly opposed the resolution.⁴¹ Though many of these bankers believed that the BIS would have to be reorganized, and some felt that the bank should be relocated to London or New York, they overwhelmingly favored reconstituting international finance after the war on the foundation of the BIS instead of a new international fund.⁴²

Furthermore, as the BIS had maintained very strong ties to the Bank of England since its establishment in 1930, the British delegation led by Keynes worked frantically behind the scenes to get the resolution withdrawn. The opposition of British central and commercial bankers to the idea of liquidating the BIS was well known at the conference. In London opposition stemmed largely from old-line bankers associated with Montagu Norman who yearned for the gold standard and opposed government spending to achieve full employment. Between 1930 and 1944 the BIS had served as an important instrument for British interests on the European continent in general and in the sterling area in particular. After the Bank of England abandoned the gold exchange standard in the autumn of 1931, it became a strong advocate of a protectionist sterling area. The BIS supported its objectives, for instance, by helping to reform the Bank of Ireland in 1935. BIS Economic Advisor Per Jacobsson, who was a key figure in this process, also supported British interests abroad by traveling to other British dominions like Egypt to institute financial reforms in accordance

⁴¹ Van Dormael, *The Birth of a Monetary System*, p. 204.

⁴² BIS Archives, H.S. 100, Leon Fraser, "Reconstructing International Money," *The New York Herald Tribune*, November 21, 1943.

with London's plans for the sterling bloc. Although the Bank of England and London bankers supported the restrictive proposals of Keynes and White, they privately urged world financial leaders at Bretton Woods to help restore the international standing of the pound and the position of London as a financial center by formally extending the sterling bloc, which had dwindled to a legal entity during the war.⁴³

At the same time, the US Department of State and the Treasury were deeply divided over the question of whether the BIS should be abolished. For example, while Treasury's designs for the BIS were well-known, figures like Dean Acheson, who chaired the State Department's subcommittee on postwar monetary planning, argued that the proposal to abolish the BIS should not be discussed at the conference altogether. Winthrop Aldrich of Chase National Bank joined his private banking counterparts at the conference in viewing Morgenthau and White as being from a "different world" since they believed in active state intervention in financial policymaking.⁴⁴

But beyond their support for the BIS on the grounds that it practiced financial orthodoxy, BIS supporters at Bretton Woods argued that the BIS should be preserved because it was capable of making a constructive contribution to postwar stabilization and economic recovery. For example, they pointed to the BIS's gold clearing system, which allowed gold payments between different countries to be carried out without actual physical transfer of the metal. For them, this system formed an indispensable component of a modern international financial system. The BIS's economic and statistical reporting were also widely believed to be invaluable. Moreover, by the time of the Bretton Woods Conference, the BIS had accrued some fourteen years of experience in central banking collaboration, and

⁴³ Helleiner, *States and the Reemergence of Global Finance*, p. 45. Also see, Van Dormael, *The Birth of a Monetary System*, pp. 131-32.

⁴⁴ Helleiner, *States and the Reemergence of Global Finance*, p. 43.

its location in the heart of Europe provided a useful meeting place for central bankers seeking to develop common lines of monetary action. While the bankers argued for the continued existence of the BIS on these grounds, moderate critics of the BIS argued that this kind and quality of financial analysis, in addition to its key technical personnel, should be absorbed into the new monetary fund.

With the opponents of the BIS lining up in support of the proposal to abolish the BIS, BIS supporters were infuriated by the fact that White had “instigated” the Norwegian proposal in the first place.⁴⁵ The proposal was referred to a committee that was chaired by André Istel of Schlumberger and Company, so that a resolution could be prepared and submitted to the conference. Norway, France and Belgium supported the resolution and believed that they could line up a majority. However, insisting that the resolution was not strong enough, White drew up an alternative resolution stating that no nation would be allowed to join the proposed international monetary fund unless it had severed connections with the BIS altogether. After he handed over the new draft resolution to Istel, White took the bold step of leaking the wording of the resolution to the press before members of the committee had an opportunity to read or discuss it. Outraged by White’s actions, the British and Dutch delegations vigorously protested the new resolution. When he learned about the new resolution, Keynes informed Morgenthau in a letter that

We are entirely in accord with the general purpose.....What we cannot manage is a recommendation...to write some specific agreement into the International Monetary Fund. For technical reasons this...would inevitably prevent us from participating either in the Fund or in the Bank until after the expiry of an indefinite period.⁴⁶

⁴⁵ This account is based on a conversation between BIS President Thomas McKittrick and Johan Willem Beyen. See BIS Archives, McKittrick Collection, 9/1, Thomas McKittrick, “Memorandum of Conversation with Mr. Beyen as to the Bretton Woods Conference,” December 14, 1944.

⁴⁶ Van Dormael, *The Birth of a Monetary System*, p. 199.

Keynes believed that by introducing a new, stronger resolution linking membership in the new monetary fund with the abolition of the BIS, the Americans had double-crossed him. Thus, Keynes countered White's proposal by recommending wording that ensured that the BIS would, in effect, be liquidated after, not prior to, the establishment of the proposed monetary fund. With a contingent of private and central bankers supporting Keynes' proposal, the American delegation agreed to the inclusion of the new wording in the Final Act of the conference.

In his biography of Keynes, Robert Skidelsky correctly notes that US Treasury officials' last-minute plot to make membership in the BIS and International Monetary Fund incompatible was motivated by their desire to discredit the New York bankers who supported the BIS and opposed the creation of a new international monetary fund. Yet while Keynes' outburst at the Bretton Woods Conference over White's proposal was instrumental in defeating the resolution, Keynes' intervention alone did not "save" the BIS.⁴⁷ While some conservative commentators remarked at the time that liquidating the BIS "would be impossible...since such action requires a vote of three-fourths of the shares," the vast majority of the BIS stock was owned by government-controlled central banks whose votes could have been influenced.⁴⁸ Rather, if it were not for the solidarity toward the BIS showed by the European and American central and private bankers in attendance, US Treasury officials would have succeeded in passing their stronger resolution. Even though the US Treasury consolidated its influence over the postwar financial order by defeating opposition to its plan to situate the new economic institutions in Washington instead of New York, the BIS had fared much better than many had expected. Even the Czech delegation knew that

⁴⁷ Robert Skidelsky, *John Maynard Keynes: Fighting for Freedom, 1937-1946*, 3rd ed. (New York: Viking, 2001), p. 354.

⁴⁸ Edward H. Collins, "This Week in Finance: The Campaign Against the B.I.S.," *New York Herald Tribune*, July 24, 1944, p. 3.

despite the BIS's questionable handling of its gold in March 1939, the BIS could provide them with important services in the postwar period. Yet, with Resolution V looming, the BIS was neither saved at nor destined to be abolished because of Bretton Woods. On the contrary, its position in the postwar financial system hinged largely on the United States Treasury's resolve to implement the resolution and on the resourcefulness the BIS and its allies convert BIS opponents into proponents.⁴⁹

From Exile to Reintegration

Although European and American central and private bankers defeated the US Treasury's stronger resolution at Bretton Woods, the real struggle over the BIS began anew once the conference ended. The United States had officially committed itself to abolishing the BIS, and given that its designs for the postwar financial order were predicated not on the foundation of the BIS but on entirely new institutions linked to treasuries, it was widely expected that the US government would stop at no cost to abolish the BIS after the war. Why, then, did the US government slowly relax its stance against the BIS and eventually employ the BIS as a financial instrument of its strategic political interests in Western Europe?

There are three broad reasons why the American government not only abandoned its efforts to implement Resolution V of the Bretton Woods Agreement but also made the BIS an integral part of its foreign economic policy after the war. The first was that the BIS cooperated with the governments of France, the United Kingdom and the United States, returned looted gold it had received from Germany, and convinced these governments that

⁴⁹ Edward Luck highlights the relationship between the devotion by governments of substantial political resources to conference resolutions and the actual implementation of such resolutions. See Edward C. Luck, "Blue Ribbon Power: Independent Commissions and UN Reform, *International Studies Perspectives*, Vol. 1 (1) (April 2000), pp. 89–104.

it had not been pro-Nazi during the war. The second reason why the BIS survived attempts to abolish it in the early postwar years was because of the solidarity that European central bankers, representatives of the Federal Reserve Bank of New York and prominent New York bankers showed in support of the BIS. Finally, the BIS survived Bretton Woods because its allies, especially in New York and Washington, convinced their detractors in the United States government of two eventualities: that the BIS would cooperate with and complement, not compete with, the Bretton Woods institutions (especially the International Monetary Fund) in Europe and that the BIS would actively pursue American economic and financial interests in Europe, especially Western Europe. By linking the Bretton Woods institutions to treasuries and locating them in Washington, the United States government succeeded in institutionalizing its long-term influence in international finance through these agencies. But in the shorter term, the BIS benefited from the fact that it took several years for these institutions to become fully functional, and that hard-line critics of the BIS in Washington were gradually replaced by officials who looked more favorably upon the prospect of entrusting the BIS with financial tasks in connection with European economic reconstruction. In the context of growing political tensions between the Soviet Union and the United States, and the latter's fear of the eventual spread of communism throughout Europe, key decision-makers in Washington recognized that the BIS's commitment to free market capitalism made it a useful ally in its strategic goals of promoting capitalism and democracy in Europe.

Rebutting the Charge of Being Pro-Nazi Chapter 4 presented documentary and other evidence showing that, on balance, the BIS was not pro-Nazi during the Second World War. In fact, while the BIS maintained normal business relations with most of its traditional

customers throughout the war, it did so in order to safeguard the financial interests of its creditors and shareholders and to secure a position for itself in an unknowable postwar financial order. In short, the BIS did not privilege its traditional clients in the Axis, Allied or neutral camps.

Nevertheless, in the several years that followed Bretton Woods, the BIS was forced to confront the charge that it had violated its policy of neutrality by willingly and knowingly accepting looted gold from the German Reichsbank. In December 1945, the governments of France, the United States and the United Kingdom formed the Tripartite Commission for the Restitution of Monetary Gold Investigations, which was charged with collecting all recovered monetary gold into one pool so that the gold could be returned to its rightful owners. Investigations proved that the Reichsbank had supplied the BIS with gold it had looted from at least two countries (France and the Netherlands).

After the end of hostilities, the Bank of Netherlands launched an investigation into the final destination of gold looted by the Germans during the war. Given that the Germans had used the Prussian Mint to resmelt the Dutch gold and fuse it with looted gold of different qualities and origins, it proved difficult to establish initially if the Dutch looted gold had been part of the gold the BIS had accepted from the Reichsbank. Ultimately, Dutch officials were able to supply the BIS with evidence from their own records, and from the files of the Reichsbank and the Prussian Mint, proving that 2,093 kilograms of gold delivered to the BIS by the Reichsbank had been stolen by the Germans from the Bank of Netherlands. As regards the fate of Belgium's gold, the Tripartite Commission established that between August 1943 and March 22, 1944, the BIS received from the Reichsbank 1,606 kilograms of gold bars that had the official Reichsbank seal and bore the years 1934 to 1939. The bars, originally Belgian, had been resmelted at the Prussian Mint from January to June

1943. Since the BIS was no longer in possession of the Belgian gold in July 1946, it decided to use the gold the Reichsbank had placed at its disposal at the branch in Constance to satisfy the Belgian claim for restitution.⁵⁰ Given that the Germans had assured the BIS that it was not sending them “tainted gold,” the BIS deflected charges that it had knowingly laundered looted gold by arguing that it had no vaults on its premises in Basle and, thus, “no means of verification as regards the exactitude and scope of the assurances given.”⁵¹

The BIS continued to defend itself through informal and formal channels during and immediately following the end of hostilities. It was given an official opportunity to present its case to the US Treasury when BIS Chairman Maurice Frère and General Manager Roger Auboin visited Washington and New York in the spring of 1947. After examining the documents submitted by the BIS representatives, the Federal Reserve Bank of New York concluded that the BIS’s “defense” as well as its “arguments for ignoring the Bretton Woods resolution” should be “accepted in full.”⁵² Ultimately, the BIS delivered 3,740 kilograms of fine gold to the Tripartite Commission Gold Pool at the Bank of England to satisfy the Belgian and Dutch claims. In response, the British, American and French governments agreed to waive all claims against the BIS in respect to looted gold transferred to it by the Reichsbank, officially settling this aspect of postwar opposition to the BIS.⁵³

Bankers Rally Behind Their Bank After Bretton Woods Between 1930, when the BIS

⁵⁰ BIS Archives, 7.19(5), Looted Gold, “Auboin and Pilotti to Emmanuel Monick, August 9, 1946.

⁵¹ Ibid.

⁵² BIS Archives, H.S. 170, Herbert M. Bratter, “Clarification of International Settlements Bank,” *The Commercial and Financial Chronicle*, July 10, 1947, quoted in Ernest H. Weinwurm, “The Future of the Bank for International Settlements and the Marshall Plan,” *The Commercial and Financial Chronicle*, September 4, 1947, pp. 2-3.

⁵³ Washington Agreement, May 13, 1948.

was created, and May 1945, when the war in Europe ended, the BIS was predominantly concerned with conditions in Europe. While the Allied nations were busy designing new institutions to manage international trade and finance on a global scale, as early as 1941 BIS managers were busy identifying specific ways in which the BIS could serve distinctly European interests after the war.⁵⁴

Thus, during and immediately following the war, the BIS promoted itself as an indispensable part of postwar monetary collaboration in Europe. Among Europeans financial leaders, the BIS also fashioned itself as a defender of their desire to rule Europe financially. Per Jacobsson captured this sentiment by saying that “it was important some institution inside Europe tries to evolve suitable principles and take the work in hand, instead of the impetus coming the whole time from outside.”⁵⁵ While BIS officials opposed the creation of the International Monetary Fund, the bank’s success in the early postwar years necessitated their support for the Bretton Woods institutions. Consequently, they urged American and British decision-makers to link the Bretton Woods institutions to the BIS in order for them to “try to inherit some of the standing B.I.S. has acquired at least in Europe.”⁵⁶ They also believed that “one of the advantages of the B.I.S. was that Germany was a member and that the B.I.S. might allow friendly collaboration even with a beaten Germany. In money matters willing support was worth more than command and control from outside.”⁵⁷

⁵⁴ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Dairies, AI 34, November, 16, 1941; NL 324, Per Jacobsson Diaries, A I 34, November 18, 1941.

⁵⁵ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, AI 71, December 31, 1947.

⁵⁶ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 50, October, 13, 1944.

⁵⁷ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 48, August

Given that the Bretton Woods institutions were world-wide in scope, BIS managers and central bankers believed that as a regional institution for Europe the BIS could be usefully fitted into the broader international financial scheme envisioned by the Bretton Woods Agreement. According to Per Jacobsson, “[t]here will be two difficult areas after the war – the European continent and the Far East. The B.I.S. ought to act for Europe.”⁵⁸ In this regard, the BIS fashioned itself in European central and private banking circles as a promoter of distinctly European financial and economic interests, including monetary unification that would develop in Basle in the decades following World War Two. But the bank also promoted itself as an important link between the West and the East. All of the Soviet Union’s satellite countries were members of the BIS at the end of the war. Firmly believing in the value of bringing the United States and the Soviet Union into the same international monetary institution, BIS managers reasoned that its status as one of the strongest institutional links between Western and Eastern Europe provided an additional reason for the Americans to renounce their support for the BIS’s dissolution.⁵⁹

Like BIS managers, European central bankers desired that there would be a financial institution for Europe, if not Western Europe. European central bankers thus strongly supported the continuation of the BIS, arguing that it could “carry out specific European tasks.”⁶⁰ While they supported the creation of global economic institutions, they valued the services the BIS had been providing them since 1930. For example, European central

31, 1944.

⁵⁸ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 50, June 7, 1944.

⁵⁹ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 51, December 14, 1944.

⁶⁰ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 61, March 19, 1946; and NL 324, Per Jacobsson Collection, International Chamber of Commerce (ICC), Box IV, “The Bank for International Settlements,” July 15, 1952.

bankers valued the monthly meetings in Basle because the encounters allowed them to exchange views with one another on developments throughout Europe. Moreover, the BIS was a well-established, flexible and efficient bank that could adapt itself to their changing needs. While European central bankers were willing to serve alongside treasury officials as directors of the Bretton Woods institutions in Washington, they saw these institutions as being strongly influenced by American interests. This belief gave them an additional reason for wanting to retain the BIS as a uniquely European institution to expressly serve them as Europeans and as central bankers. Accordingly, Sir Otto Niemeyer of the Bank of England captures the sense of solidarity that European central bankers felt toward the BIS by saying “the various countries in Europe will need advice. They are not likely to go to the Monetary Fund in Washington for this advice. They [will] continue to go to the B.I.S. if the B.I.S. is maintained.”⁶¹

In the early postwar years European central bankers did precisely that: they continued to draw on the BIS’s unparalleled expertise in European economic and financial conditions through its annual reports, monthly meetings with other central bankers and visits by BIS officials in their capitals. In December 1946 the BIS had its first full meeting of its board of directors since July 1939. Moreover, as they had before the war, European central banks continued to request and receive from the BIS specialized studies on the economic and financial position of individual countries. By 1946, even the *Financial Times*, which for several years had been a severe critic of the BIS, remarked that “the predominant sentiment among central bankers, at least in Western Europe, is that the B.I.S. plays a useful

⁶¹ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Dairies, A I 53, September 23, 1945.

role in providing a meeting place for such bankers and should be preserved.”⁶² One month later the same newspaper wrote:

There is a widespread feeling that in spite of the establishment of the International Monetary Fund and the International Bank for Reconstruction and Development there is fair scope for the continued existence of the B.I.S. For one thing it possesses a certain amount of funds which are available for small stop-gap credits such as the Finnish transaction... It is more elastic than either of the two Bretton Woods institutions, and it has 16 years of experience. It is in a position to carry out transactions from which the [Bretton Woods institutions] are debarred by their statutes. Moreover, owing to its more convenient geographic situation it provides easier and more frequent opportunities for central bankers to foregather in order to exchange views. Apart from the Bank of Japan, all banks represented on the Bank are European.⁶³

The BIS also benefited from the fact that European directors of the Bretton Woods institutions had served or were then serving on the board of directors of the BIS. For example, the governors of several European central banks, including the Bank of France and the Bank of Belgium, were at the same time directors of the Bretton Woods institutions. Camille Gutt, who was appointed the first IMF managing director in 1946, had been a member of the BIS board of directors from 1944 to 1945. Stafford Cripps, Chancellor of the Exchequer who was representing the Britain government in negotiations at the IMF in the mid-1940s, had been stationed at the BIS for part of the war. According to Jacobsson, the overlap in personnel between the Bretton Woods institutions and the BIS “gives a personal link.”⁶⁴

American Politics and the Survival of the BIS Although the Bretton Woods Agreement was signed in July 1944, the US Congress did not begin considering it for approval until early

⁶² *Financial Times*, November 25, 1946, quoted in Schloss, p. 121.

⁶³ *Financial Times*, December 27, 1946, quoted in Schloss, p. 121.

⁶⁴ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson, A I 64, January 1, 1947.

1945. By then, American foreign economic policy had already begun shifting away from the Bretton Woods framework.⁶⁵ Roosevelt's death in April 1945 set the wheels of change in American financial politics in motion. President Harry Truman, Roosevelt's successor, was subjected to criticism from the left and the right. Whereas the left criticized Truman's labor policies, conservatives attacked him for inflationary economic policies. Between April 1945 and November 1946, Truman's approval ratings dropped from 87 to 32 percent. Meanwhile, as Helleiner points out, the main architects of the Bretton Woods Agreement, Morgenthau and White, "suddenly found themselves without influence in the new Truman administration, whereas the bankers who had opposed the agreement soon emerged in prominent positions and guided the making of foreign economic policy."⁶⁶

In the midterm Congressional elections of November 1946 Republicans gained 11 seats in the Senate and 56 in the House and took control of Congress for the first time since 1928. The election outcome, in turn, had a significant and positive effect on the American government's policy towards the BIS. In fact, Federal Reserve of New York President Alan Sproul associated the Republican Party's strong showing in the midterm Congressional elections with a general improvement in Washington's attitude toward the BIS.⁶⁷ Under the influence of such figures as Aldrich of Chase National Bank, a strong supporter and shareholder of the BIS, the US Treasury began to look more favorably upon the idea of employing the BIS as an instrument of its economic goals in Western Europe. While the BIS's network of influential and loyal supporters in the United States failed in their attempt to encourage a rapid return to convertibility throughout Western Europe between 1945 to

⁶⁵ Helleiner, *States and the Reemergence of Global Finance*, p. 52.

⁶⁶ Ibid., p. 52.

⁶⁷ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 68: August 21, 1947.

1947, they undoubtedly succeeded in softening the United States government's stance toward the BIS. While they were trying to pressure Britain to restore convertibility of the pound and the dollar as part of the key currency plan, the New York bankers pressed for more orthodox internal economic policies in Western Europe. Fundamental to these efforts were the New York bankers' goals of establishing formal ties between the Bretton Woods institutions and the BIS and of "transform[ing] the Bretton Woods institutions...into more conservative bodies by appointing orthodox American and Western European bankers to important positions in them."⁶⁸

In the political sphere, the growing tension between the Soviet Union and the Western Allies also helped soften the American government's opposition to the BIS. Russian behavior in Eastern Europe toward the end of the war was viewed in Washington as contradicting the principles of self-determination and independence that were embodied in Roosevelt's declaration of the Atlantic Charter. Franklin D. Roosevelt based his wartime planning for Europe on the naïve assumption that the Soviet Union would define its security needs in Eastern Europe "in *minimal* terms" and that it would pursue friendly regimes as neighbors without contradicting the principles of the Atlantic Charter.⁶⁹ Although newly Roosevelt and his advisors came to an agreement with Joseph Stalin at the Yalta Conference in February 1945 on "providing a 'cosmetic' façade to the...pro-Soviet regimes in Poland and other Eastern European countries by going through the process of 'free elections,'" the agreement was superficial and could not arrest the growing tensions between the two countries over postwar Europe. The momentum towards the Cold War was gaining speed.

⁶⁸ Helleiner, *States and the Reemergence of Global Finance*, p. 53. See also Richard Gardner, *Sterling-Dollar Diplomacy in Current Perspective: The Origins and the Prospects of Our International Economic Order* (New York: Columbia University Press, 1980), pp. 298-99.

⁶⁹ Gordon A. Craig and Alexander L. George, *Force and Statecraft: Diplomatic Problems of Our Time* (New York: Oxford University Press, 1995), p. 93. No emphasis added.

In the United States Congress and among the American public Soviet behavior in Eastern Europe was increasingly perceived as being “expansionary” and “untrustworthy.”⁷⁰ While Moscow indeed was intent on ensuring its security to the West by installing pro-Soviet regimes, it was also intent on supporting communist elements in Western European societies. Distrustful of Moscow’s motives in regard to Europe as a whole, Washington set out in support of all forms of capitalism and democratic government on the European continent, especially in Western Europe.

Meanwhile, influential supporters of the BIS in New York and Washington urged key decision-makers in Washington that the BIS stood for American national interests in Western Europe, especially in regard to supporting capitalist development. In fact, while Congress was debating the Marshall Plan, influential New York bankers repeatedly argued that the BIS could be “extremely useful in helping to carry out the intentions of the Marshall Plan for European rehabilitation.”⁷¹ As Milward shows, the Marshall Plan, or Economic Recovery Program, which led to the creation of the Organization for European Economic Cooperation in Paris, aimed not just to solve a crisis in the world payments system, but also to

prop up in America’s strategic interests all forms of Western European capitalism and democratic governments, even socialists and planners, against communists and the Soviet Union. These strategic necessities meant that what the government of the United States paid for with Marshall Aid was not to increase the rate of recovery in European economies and to prevent Europeans in dislocated and deteriorating economies from starving, but to sustain ambitious, new, expansionary economic and social policies in Western European countries.⁷²

⁷⁰ Ibid., p. 93. For a more detailed discussion of why Roosevelt’s policy toward the Soviet Union was naïve, see Ibid., pp. 87-94.

⁷¹ Ibid., p. 16.

⁷² Alan S. Milward, *The Reconstruction of Western Europe, 1945-1951* (Berkeley: University of California Press, 1984), p. 54.

Writers like Alan Milward have convincingly shown that while the ultimate purposes of the European Recovery Program were largely political, reflecting American interests in strengthening all forms of capitalism and democratic government in Western Europe, its mechanisms were almost entirely economic.⁷³ The machinery set up to handle the program, the Economic Cooperation Administration, was headed by an American, Paul G. Hoffman, and its central mechanism was joint administration of the funds by all recipient countries.⁷⁴ Despite the US Treasury's campaign against the BIS, Washington soon realized that the BIS could usefully serve its political and economic goals for Western Europe through financial means.

In Basle the developments in Washington were greeted with cautious optimism. One month after the November 1946 elections, Jacobsson informed Allen Dulles that "the future of the B.I.S. seems somewhat more assured. No definite decisions have as yet been taken but we seem to enter into collaboration with various institutions. We may be said to form a kind of observation centre for the continent of Europe."⁷⁵ From early 1947 onwards, high-ranking decision-makers in Washington and American representatives in the Bretton Woods institutions began traveling to Basle in greater numbers and frequency to discuss conditions in Europe and to work out possible lines of collaboration between the new institutions and the BIS.⁷⁶ In this connection, on the occasion of the Annual General Meeting of June 1947, "five distinguished Americans from the Chase National Bank" including "Mr. Aldrich, Mr.

⁷³ Ibid., pp. 54-61.

⁷⁴ At the outset of the European Recovery Program, W. Averell Harriman was the United States government's ambassador-at-large and was specifically charged with the representation of the United States in negotiations inside Europe.

⁷⁵ Basle University Library, Department of Manuscripts, Jacobsson Collection, Box D, Jacobsson to Allen W. Dulles, December 20, 1946.

⁷⁶ See, for instance, Per Jacobsson's letter to L. Werner Knoke, Vice President of the First National Bank of New York. Basle University Library, Department of Manuscripts, Jacobsson Collection, Box K, Jacobsson to Knoke, October 22, 1947.

Dewey, Mr. Shepard Morgan, Mr. Thomas McKittrick and Mr. David Rockefeller” spent a week in Basle meeting with high-ranking BIS officials.⁷⁷

While the political landscape of American foreign economic policymaking was undergoing change, and while critics of the BIS were slowly disappearing from the public scene, American representatives in the Bretton Woods institutions were slowly being replaced by bankers. Most notably, Harry Dexter White’s departure as an American delegate to the International Monetary Fund in early 1947 removed one of the chief antagonists of the BIS. At the same time, BIS managers were preoccupied with trying “to prove its value afresh as a specific European institution with a niche to fill, side by side with other world-wide organizations.”⁷⁸ The United States government supported this trend in order to assure “smooth cooperation between domestic and international financial institutions.”⁷⁹

The influence of New York banks in American financial politics was considerable in the early postwar years. For decades New York banks had been the principal source of American lending to Europe. The position of these bankers in support the establishment of formal links between the BIS and the Bretton Woods institutions was strengthened by their reluctance to resume lending to Europe in 1945 and 1946, by the fact that the United States government alone could not finance European reconstruction, and by the slow development of the Bretton Woods institutions. Although the International Monetary Fund’s Articles of Agreement were signed at Bretton Woods in July 1944, it did not begin operations until March 1, 1947, and it took several more years for it became full operational. In addition,

⁷⁷ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Collection, Box C, Per Jacobsson to Lewis Douglas, June 12, 1947.

⁷⁸ Basle University Library, Department of Manuscripts, Per Jacobsson Collection, ICC, Box IV, “The Bank for International Settlements,” July 15, 1952.

⁷⁹ BIS Archives, H.S. 170, Ernest H. Weinwurm, “The Future of the Bank for International Settlements and the Marshall Plan,” p. 4.

while these institutions were becoming functional in Washington, they had virtually no presence in Europe.

Thus, with the State Department, the Federal Reserve Bank of New York and prominent New York bankers aligned in support of the BIS, the absence of comparable institutions for economic cooperation in Europe, European support for the BIS, and the Cold War rivalry with the Soviet Union on the horizon, the US government had little choice but to renounce its support of the Bretton Woods resolution to abolish the BIS and enlist the BIS's support for its policies in Western Europe. Before an agreement for formal collaboration between the BIS and the World Bank was formalized on April 17, 1947, prominent New York bankers had outlined the plan with Treasury officials. On December 19, 1946, McKittrick, then vice president of Chase National Bank, telegraphed BIS President Frère to say

Have reached understanding for collaboration between World Bank and B.I.S. on line well outworked in Basle. [World] Bank officials here are anxious [to] study Danish position at once and will approach Basle directly with view to sending somebody there on his way to Denmark for this purpose before end of year. Because of resignation Eugen Meyer in reply to your letter leave any decision to his successor but for my part consider ultimate approval assured....Highly satisfied with this result.⁸⁰

Per Jacobsson began working furiously on questions concerning Denmark saying "It is in the interest of the B.I.S. that the first effort of the I.B.R.D. should succeed. Only if we are helpful will they work with us. They must have the glory."⁸¹

Several months later, on November 18, 1947, the BIS completed an agreement between a number of European countries to serve as agent of a intra-European payments

⁸⁰ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Dairies, A I 64, January 1, 1947. Quote based on a telegram Thomas McKittrick sent to BIS President Maurice Frère, dated December 19, 1946.

⁸¹ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 64, January 1, 1947.

system. This initiative, undertaken in connection with the European Recovery Program, was the brainchild of a small group of prominent New York bankers. The plan for a multilateral payments system in Europe officially materialized when representatives of sixteen European countries met in Paris on July 12. In the weeks following the Paris Conference European and American authorities developed a multilateral payments system to help facilitate trade among European countries.

The BIS was selected over the IMF to administer the compensation scheme for several reasons. Fforde correctly points to the role played by European central bankers in backing the BIS as agent of the scheme.⁸² Per Jacobsson corroborates this claim by saying that “[t]he appointment of the B.I.S. as agent for the ERP Compensation Scheme instead of the International Monetary Fund...shows a resolution in Europe to take into its own hands as many of the functions as possible – not leaving them to Washington.”⁸³ However, Jacobsson, who was at the center of these negotiations, also attests to the important role played by prominent New York financiers. He notes that “[i]t was as a matter of fact [that] [Winthrop] Aldrich, [Allen] Dulles, Dean Acheson and many typical New Yorkers who started the idea [of the European Compensation Scheme]! Many of them Republicans!”⁸⁴ Jacobsson goes on to say that the fact the BIS “observed bank secrecy” was a strong point in its favor.⁸⁵ Regardless of why the BIS was selected over the IMF, its appointment as agent of the intra-European payments system solidified its place in European economic

⁸² John Fforde, *The Bank of England and Public Policy, 1941-58* (Cambridge: Cambridge University Press, 1992), pp. 177-78 and 205-06.

⁸³ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 71, September, 17, 1948.

⁸⁴ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 74 July 11-November 5, 1948. No emphasis added. As a matter of fact, Dean Acheson was a moderate Democrat.

⁸⁵ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson, A I 71, November 6, 1948.

reconstruction and made it an integral part of American foreign economic policy towards Western Europe in the early postwar years.

Although some high-ranking officials in the US Treasury still “spoke disparagingly” about the BIS in the spring of 1948, the governing principle of the Treasury’s policy toward the BIS in early postwar years soon became one of political expediency.⁸⁶ Between 1944 and the winter of 1948, the Soviet Union had had been systematically taking over Central and Eastern Europe. And when the Czechoslovakian coup occurred in February 1948, the West Allies led by the United States realized that their collective policies in Western Europe had to be bolder and more effective. As a result, these countries formed the North Atlantic Treaty Organization to present a unified military front to prevent the westward expansion of communist Russia. It was in this political context that Frank Southard of the US Treasury pointed out to Jacobsson that “the B.I.S. may not have behaved very well at the beginning of the war, but now after all it is a question of the future.”⁸⁷

Consequently, on May 13, 1948, nearly four years after Bretton Woods, the National Advisory Council announced that “[t]he United States Government will no longer urge the implementation of Bretton Woods Resolution V and that unless any other member country desires to pursue the matter further, the United States Government regards the issue as closed.”⁸⁸ This announcement officially ended the efforts to abolish the BIS after the Second World War. Only weeks after this decision, BIS President Maurice Frere and General Manager Roger Auboin reached an agreement with the United States Treasury authorizing the release of BIS assets in the United States after it surrendered to the Tripartite

⁸⁶ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 72, March 5, 1948.

⁸⁷ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 72, February 27, 1948.

⁸⁸ BIS Archives, AUB 1/5, 7.18(6), “Decision of the National Advisory Council,” No date.

Commission looted gold which it had received from the Reichsbank.⁸⁹ According to Per Jacobsson, this agreement gave the BIS “greater freedom to run our affairs and also a greater responsibility in contributing to recovery in Europe.”⁹⁰

Conclusion

Drawing on Per Jacobsson’s diaries, Erin Jacobsson concludes that Andrew Overby, who went from the Federal Reserve Bank of New York to the US Treasury to become assistant for international finance, single-handedly convinced Treasury Secretary John Snyder and the US government to renounce the Bretton Woods resolution to abolish the BIS.⁹¹ While Per Jacobsson acknowledges that “Overby probably did more to save the B.I.S. than any other person,” the BIS was not saved by any one individual at or after Bretton Woods.⁹² Nor did the BIS survive Resolution V because of it was a legal entity of Switzerland and it would have been impossible to obtain the votes of three-fourths of the BIS’s shareholders. Given that the majority of BIS shares were held by central banks that were either aligned with the United States and/or lacked independence from their governments, liquidation could have been achieved through indirect pressure.⁹³

This chapter has attributed the BIS’s survival in the early postwar years to several factors. Between 1945 and 1947 the BIS and its supporters successfully deflected charges, especially in the United States and England, that the BIS was pro-Nazi during the Second

⁸⁹ BIS Archives, AUB 1/5, 7.18(6), Frère to Snyder, May 13, 1948; and AUB 1/5, 7.18(6), Snyder to Frère, May 13, 1948. See also, Box R, Per Jacobsson to Ivar Rooth, May 21, 1948.

⁹⁰ Basle University Library, Department of Manuscripts, Jacobsson Collection, Box R, Per Jacobsson to Ivar Rooth, May 21, 1948.

⁹¹ Erin Jacobsson, *A Life for Sound Money*, p. 188-90.

⁹² Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 73, March 27, 1948.

⁹³ Helleiner also reaches this conclusion in Helleiner, *States and the Reemergence of Global Finance*, p. 53, fn. 5.

World War. By cooperating with the governments of France, the United States and the United Kingdom during these years and returning looted gold that had been delivered to it by the Germans, BIS officials satisfied official claims against it. Moreover, the “bonds of monetary solidarity” that European and American central bankers and prominent international financiers showed in support of the BIS presented a formidable opposition to Keynesian-minded treasury officials, especially in the United States, who wished to do away with the BIS because it represented a pre-Depression alliance among orthodox central bankers. While European central bankers associated the BIS with having influence over their own monetary affairs in the postwar period, these bankers also shared with prominent New York bankers and the Federal Reserve Bank of New York a desire to recreate international finance on the foundation of the BIS and not on new institutions linked to treasuries.

The BIS’s survival is also attributable to the political change that occurred in Washington, especially in the US Treasury, in the mid-1940s. This shift, which began with Roosevelt’s death in 1945 and gained momentum after the Republican Party’s strong showing in the midterm Congressional election in November 1946, resulted in prominent bankers and BIS supporters assuming leadership positions in Treasury and State Department as well as the Bretton Woods institutions. Hard-line critics of the BIS, such as Morgenthau and White, were replaced by officials who looked more favorably upon, or openly supported, the BIS. This change in top personnel, which was also intended to support American foreign economic policy by facilitating cooperation between American domestic institutions and international agencies, paved the way for official collaboration between the Bretton Woods institutions and the BIS.

Perhaps most importantly, the BIS and its supporters in the United States and Western Europe convinced the US government that the BIS could (and would) duly serve its

strategic political and economic interests in Western Europe in the postwar period, especially in regard to European economic reconstruction, which was one of the central means by which Washington sought to prevent the spread of communism in that region. The American government's wartime policy on the postwar role of the BIS was influenced greatly by White's plan, which included no role for the BIS. Key decision-makers in the US Treasury, which held a dominant position in the US government with regard to American foreign economic policy, thus did not associate the BIS with American strategic national interests in Western Europe after the war. This fact comes as no surprise considering that the Roosevelt administration conducted its postwar planning on the naïve assumption that the Soviet Union would cooperate with it on such economic problems as trade and currency stabilization and such political problems as satisfying its security needs in Central and Eastern Europe in accordance with the principles of the Atlantic Charter. Given that members of the Truman administration and the United States Congress perceived Moscow's motives with regard to Europe as untrustworthy and expansionary, in the early postwar years key policy makers in Washington became convinced of the urgency of promoting capitalism and democracy in Western Europe. Yet, recognizing that it would take several crucial years for the new Bretton Woods institutions to become fully operational and to establish a presence in Europe, the BIS's remaining critics in Washington, especially in the Treasury, had little choice but to alter their stance. Committed to preventing the spread of communism in Western Europe, Washington lawmakers slowly withdrew its support for Resolution V. By the spring of 1948, not only had the US government's reversal of its policy ensured the BIS's continued existence as an international financial institution, but it paved the way for the US government to assign the BIS financial tasks in support of the European Recovery Program. To outlast Resolution V and to obtain the unofficial, yet strong, support

of the United States government, the BIS and its supporters had to engage in political expediency of their own. While BIS officials and supporters had to accept “political entanglements” in the early postwar years, it would not be long until they would reassert themselves in Europe. With the restrictive framework of the Bretton Woods Agreement endorsing capital controls, the BIS would quickly focus its efforts on championing the speedy return to convertibility in Europe. The path would be uncertain and challenging, but eventually attainable within one decade of the US government’s official withdrawal of its support for Resolution V in May 1948.

Chapter 6

Classical Liberals Versus Embedded Liberals: Championing the Return to Convertibility in Postwar Western Europe

“The BIS has no powers, only influence.”¹

“Influence is often more important than power, but to exert influence one must be free to speak one’s own mind, for one cannot persuade without oneself being convinced.”²

- Per Jacobsson, Economic Advisor and Head of the Monetary and Economic Department, the Bank for International Settlements

After the BIS survived efforts to abolish it in the early postwar years, the institution began to reemerge as a significant force for financial globalization from the late 1940s onwards. Although the BIS sought to persuade Western governments to move rapidly following the war toward instituting policies it thought were necessary preconditions to building a flexible and open world economy, its influence in the monetary sphere was constrained by the political context of the Bretton Woods financial order. During these years ultimate authority in Western European monetary affairs continued, as it had since the middle of the 1930s, to be vested in finance ministers who increasingly managed European finance through such international bodies as the Organization for European Economic Cooperation (OEEC), the Managing Board of the European Payments Union (EPU), and the Bretton Woods institutions in Washington. While central bankers also served on the managing boards of these new institutional creations, the latitude for independent and concerted central bank

¹ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 108, March [?], 1956.

² Basle University Library, Department of Manuscripts, NL 324, Jacobsson Collection, Box F, Jacobsson to Maurice Frère, October 7, 1947.

action through the BIS continued to be restricted by political arrangements holding sway in the advanced industrialized countries.

Indeed, during the decade after the war, there was a hard-fought and bitter campaign in Western Europe and the United States among embedded liberals, who advocated government intervention in the economy, and classical liberals, who opposed such intervention, about what constituted a proper economic policy. This battle affected and was affected by the activities of the BIS. The central issues of debate were the role of capital controls and fiscal and monetary policy in the economic system. Yet, in spite of the political constraints within which the bank was operating, from the late 1940s onward the BIS contributed to the shift toward more orthodox economic policies throughout Western Europe, thus facilitating the gradual liberalization of finance in the 1950s. It encouraged and facilitated this process by (1) hosting monthly meetings of bankers, predominantly central but also commercial, in Basle; (2) conducting site consultations in key industrialized countries; (3) by espousing a doctrine of “sound” credit and monetary policy through its reports and correspondence with key national decision-makers; and (4) operating the European Payments Union, which provided a system for liberalizing Western Europe’s finance and restoring convertibility of its major currencies with the dollar. By the middle of the 1950s all Western European countries were using, to varying degrees, some form of monetary policy. By 1956 many countries were *de facto* convertible on current account, and by the end of 1958 this convertibility was officially recognized. The decisions by Western European governments to reinstitute a form of orthodox monetary policy, to moderate their socialist policies, and to restore convertibility of their currencies with the dollar, clearly were political. The BIS’s success in promoting such policies in the late 1940s and first half of the 1950s was aided by the rise of strong center-right governments throughout Western Europe,

which looked more favorably on the policy prescriptions of BIS senior officials, namely BIS Chief Economist Per Jacobsson.

BIS activities in managing Western European financial relations in the early Cold War years are attributable to two basic factors. First, politically constrained by the Bretton Woods financial order and the growing tensions between the United States and the Soviet Union, senior BIS managers and central bank governors associated the BIS's postwar success over the long-term with making a constructive contribution to the financial and economic goals of Western Allied governments in the shorter term. Second, itself a fervent supporter and advocate of principles of free market economy, the BIS's interests in promoting capitalist development dovetailed, however imperfectly, with the national economic and political interests of the Western Allies, which sought to prevent the spread of communist rule in Europe. Yet while the BIS supported capitalism and democratic rule in Europe, by no means was the BIS sympathetic to embedded liberal ideas in national and international financial policymaking. Rather, as advocates of financial orthodoxy senior managers and central bank governors of the BIS encouraged the gradual loosening of state restrictions on the international movement of capital, especially through the creation and operation of the European Payments Union, which culminated in the restoration of convertibility of Western European currencies by 1958.

The BIS and the Birth of a New Monetary System

Before the Second World War international financial collaboration was loosely coordinated, historically through ad hoc arrangements among central bankers and prominent international financiers. Despite the institutionalization of central bank cooperation under the auspices of the BIS in Basle in 1930, the management of international finance

increasingly developed on an ad hoc basis among finance ministries throughout the 1930s. After the war there was a widespread belief among key Western decision-makers that economic and political instability in the interwar years was caused by a breakdown in international cooperation and disequilibrating capital flows as investors sought to protect themselves from losses resulting from currency depreciations, economic downturns and government controls. With the emergence of Keynesian ideas of state intervention in markets, the nature of international financial organization changed. Macroeconomic planning and welfare activism that had grown out of the Great Depression and Keynesian revolution of the early 1930s very much prefigured postwar monetary planning. Led by British and American representatives at Bretton Woods, embedded liberals succeeded in building a new global monetary order that differed from the classical gold standard in that it endorsed, however imperfectly, state capital controls and placed monetary policy in the hands of treasury officials as opposed to independent central bankers with strong ties to prominent private financial leaders.³

Chapter 3 outlined the historical antecedents of this important shift in domestic and international financial politics. In effect, the Great Depression diminished the authority and influence of bankers, central as well as commercial, and the classical model of central bank action that was manifested in the establishment of the BIS.⁴ Increased political support for Keynesian ideas of activist government intervention in the economy through national planning resulted in the scaling back of central bank independence in BIS member countries, which in turn, weakened the BIS as an instrument of those very banks. The Second World

³ For a discussion of the nature and role of “embedded liberals” in this period, see Eric Helleiner, *The Making of National Money: Territorial Currencies in Historical Perspective* (Ithaca: Cornell University Press, 2003), p. 187; and “Economic Liberalism and Its Critics: The Past as Prologue?,” *Review of International Political Economy* 10(4) (2003), pp. 685-96.

⁴ See Harold James, *The End of Globalization: Lesson from the Great Depression* (Cambridge: Harvard University Press, 2001), especially chapter 2.

War, which necessitated the maintenance of direct national controls on financial and economic activity, marginalized the BIS as a promoter of central bank collaboration still further. The previous chapter showed how the BIS spent the first three years after the war struggling for its survival, a struggle that had its roots in the New Deal antagonism of the early 1930s between American Treasury officials, on the one hand, and American and European central and private bankers, on the other hand, who had contrasting ideas and interests with regard to the reconstruction of the postwar international financial order as well as the BIS's place in that order.

While the classical liberal bankers retained some authority in the advanced industrialized countries in the latter half of the 1940s, leading policy makers in Western Europe and the United States demonstrated their belief that “economic and political collaboration formed a connected whole.”⁵ As in other periods, monetary policymaking during these years amounted to an intensely political process.⁶ US Treasury Secretary Morgenthau even went so far as to proclaim “a New Deal in international economics.”⁷ John Ruggie shows that state behavior during this period was predominantly shaped by an embedded liberal framework of thought, which led governments to pursue policies that differed fundamentally from those pursued in the 1920s.⁸ Unlike their predecessors,

⁵ BIS Archives, H.S. 114, “The International Monetary Fund: Lord Keynes’ Statement on Money Policy in the House of Lords on Tuesday, May 23, 1944.” This statement appeared in the *London Times* on the following day.

⁶ For a modern exposition of the interrelationship between the management of money and politics, see Jonathan Kirshner, “Money Is Politics,” *Review of International Political Economy* 10(4) (2003), pp. 645-60.

⁷ For Morgenthau’s statement, see Armand Van Dormael, *The Birth of a Monetary System* (London: Macmillan, 1978), p. 52, quoted in Eric Helleiner, *States and the Reemergence of Global Finance*, p. 31. Also see Leo Panitch and Sam Gindin, “Finance and American Empire,” in Leo Panitch and Colin Leys, eds., *The Empire Reloaded* (New York: Monthly Review Press, 2005), p. 49. Panitch and Gindin argue that the restrictive nature of the Bretton Woods financial order is significantly overstated in the literature on this period.

⁸ John Ruggie, “International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order,” in Stephen Krasner, *International Regimes* (Ithaca: Cornell University Press, 1983), pp. 195-

government decision-makers did not try to separate politics and economics; national and international economic policies were not predicated on the foundation of open financial markets; fiscal measures like taxation and government spending were preferred over balanced budgets and monetary policy as methods of promoting full employment; and industrial policy was favored over financial policy. The compromise of embedded liberalism meant that multilateralism would be predicated upon domestic interventionism and that while the postwar international institutions were designed to support an internationalist, market-oriented order, they also included “mechanisms, safeguards and escape clauses through which states would not be forced to sacrifice domestic social policies in order to maintain international equilibria.”⁹ Macroeconomic policy autonomy of the new welfare state became widely preferred over liberalized finance, which was seen as confounding rather than ensuring economic development.

These changes in economic policymaking were rooted in the experience of the interwar years and the concomitant belief that short-term speculative capital flows had destabilized capital markets and encouraged exchange controls, competitive devaluations, and a turn to trade protection. As Eichengreen points out, the framers of the Bretton Woods Agreement sought to construct a international monetary system that differed from the classical gold-exchange system in three basic ways.¹⁰ First, government-pegged exchange rates would be adjustable. According to Article IV of the Articles of Agreement of the IMF, exchange rates were fixed to a par value expressed in terms of gold or dollars. But in cases of fundamental and unsustainable imbalances in a country’s balance of payments, governments

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⁹ Jonathan Kirshner, “Keynes, Capital Mobility and the Crisis of Embedded Liberalism,” *Review of International Political Economy*, 6:3 (Summer 1999), p. 317.

¹⁰ Barry Eichengreen, *Globalizing Capital: A History of the International Monetary System* (Princeton: Princeton University Press: 1996), pp. 93-96.

could increase or decrease the value of their currency in consultation with the IMF. Second, the Bretton Woods system also differed in that state controls on the international movement of capital were explicitly endorsed. Finally, a new institution was created, the International Monetary Fund, in order to provide short-term financing to countries experiencing significant balance of payments deficits.

The Articles of Agreement represented a compromise between the British and American plans. Whereas the Americans favored the creation of a multilateral payments system based on stable exchange rates and the limited but eventual convertibility of currencies, the British sought more flexible exchange rates and freedom from external constraints. From the perspective of European governments and central banks, financial assistance *à la* the American plan included an effective lever of control over a country's national policy solutions and priorities, for it required them to submit a letter of intent to the IMF detailing the economic reforms that they intended to use to restore equilibrium in the country's balance of payments. Given that the US government emerged from the war a superpower, and that New York emerged as the world's principal financial center, the postwar international financial regime more closely resembled the American plan. Nevertheless, state-controlled exchange rates, combined with permission to impose capital controls, allowed members of the Bretton Woods institutions and the BIS to pursue national economic strategies that deviated from White's plan. The exception of capital controls from demands of liberalization was stated in Article VI, Section 3 of the Agreement:

Members may exercise such controls as are necessary to regulate international capital movements, but no member may exercise these controls in a manner which will restrict payments for current transactions or which will unduly delay transfers of funds in settlement of commitments.¹¹

¹¹ IMF Articles of Agreement can be found at <http://www.imf.org/external/pubs/ft/aa/aa06.htm>.

While the Bretton Woods Agreement endorsed the use of capital controls by governments, their use was seen as a temporary measure to help countries experiencing payments imbalances during a transition period in which domestic capital was needed for reconstruction purposes. Even more important, prominent American bankers succeeded in removing a clause from the agreement that would have allowed for “obligatory joint controls” or “cooperative capital controls.”¹² Keynes and White had argued at Bretton Woods that in order to create an open trading system, there needed to be a system by which governments could cooperate in enforcing controls on capital flight. In addition to governments’ controlling the flight of capital from their banking systems, they would be obliged to prevent the inflow of capital *to* their own banking systems. As a result of opposition from leading figures in the American banking community, commercial and central alike, this idea was not endorsed at Bretton Woods or acted upon thereafter.

Thus, the central question revolved around the role that capital controls would play in the postwar period. While capital controls were endorsed at Bretton Woods, private banking representatives of the United States delegation who were avid supporters and/or founding shareholders in the BIS ensured that the embedded liberal victory at Bretton Woods would not become permanent. Just how temporary a measure state controls on the international movement of capital would be put to the test by the key currency plan, which was advocated by the Federal Reserve Bank of New York and prominent New York bankers and received considerable support from the BIS, which argued for the reconvertibility of sterling as the centerpiece of European economic recovery. The early move to convertibility of the pound was done in haste and exposed the limitations of the Bretton Woods arrangements for restricting capital flight.

¹² Helleiner, *States and the Reemergence of Global Finance*, pp. 47-49. See also Armand Van Dormael, *The Birth of a Monetary System*, p. 185; and Panitch and Gindin, “Finance and American Empire,” pp. 48-54.

The Key Currency Plan

Following the Second World War prominent New York bankers who were instrumental in ameliorating the US Treasury's stance against the BIS, emerged as prominent figures in American foreign economic policymaking. While the bankers were embroiled in a struggle with embedded liberals, by no means did they represent an ineffective force in financial politics, especially in the United States.¹³ Perhaps the most significant proposal to emanate from these bankers was the key currency plan.¹⁴ According to Helleiner

the most important objective of this strategy was to pressure Britain to restore convertibility between the pound and the dollar. It was hoped that stability in the relationship between these two key currencies would revive international trade and reestablish traditional patterns of international financing in London and New York.¹⁵

Before the war international settlements were effected mainly through two currencies: the dollar and the pound sterling. As a result of the war the pound became inconvertible and its finances were in shambles, with private and official holdings of gold and sterling in Britain having dwindled to a fraction of their prewar level. Despite the dire financial straits in which Britain found itself in the early postwar years, the United States government sought to force Britain to quickly restore sterling convertibility. Consequently, in 1947, it extended to the Britain government a \$3.75 billion loan on the condition that it would restore current-account convertibility no later than one year after the loan was

¹³ Leo Panitch and Sam Gindin, "Finance and American Empire," p. 50; Helleiner, *States and the Reemergence of Global Finance*, p. 31; and Thomas Ferguson, "From Normalcy to New Deal: Industrial Structure, Party Competition, and American Public Policy in the Great Depression," *International Organization* 38 (1984), pp. 41-94.

¹⁴ The New York bankers' proposal was strongly influenced by the views of John H. Williams, who was a professor of economics at Harvard University and a key advisor on international finance to the Federal Reserve Bank of New York. Williams argued that exchange stability should be pursued one currency at a time, beginning with sterling. For Williams's views on this subject see, Jacob J. Kaplan and Günther Schleiminger, *The European Payments Union: Financial Diplomacy in the 1950s* (Oxford: Clarendon Press, 1989), p. 15, 174-75, 177, and 183.

¹⁵ Helleiner, *States and the Reemergence of Global Finance*, p. 52.

approved. On Keynes's recommendation, the House of Lords and the British Labour government agreed with the American plan to restore dollar-sterling convertibility. As Eichengreen shows, the decision not only was an American one; it was reckless.¹⁶ Massive capital flight from the British banking system ensued, especially to New York, which resulted in the near depletion of British reserves. Six weeks after the sterling was made convertible with the dollar, the British government reintroduced exchange restrictions. The policy to return to convertibility earlier than the British government had anticipated after the war was a complete failure, in part because the measures for preventing capital flight in the Bretton Woods Agreement were inadequate, and in part because the policy was not accompanied by the introduction of a more general set of economic and monetary policies that were capable of inducing capital to flow back into the British banking system.

The latter was the essence of the BIS's policy. While the BIS was an avid supporter of a speedy return to convertibility in general and the pound in particular after the war, it advised the Bank of England, the British Treasury and other Western European central banks on the importance of pursuing convertibility in tandem with a range of conservative economic policies, the primary purpose of which was to add flexibility to the economy, create an *internal* balance between costs and prices, and employ monetary instruments to fight inflation.¹⁷ As economic advisor of the BIS, Jacobsson was the chief architect of the bank's policy with regard the return to convertibility in Western Europe. In the case of Britain in 1947, Jacobsson argued that internal conditions were the most critical factors in explaining the external deterioration in Britain's external balance of payments position and

¹⁶ Eichengreen, *Golden Fetters*, p. 103.

¹⁷ Per Jacobsson reiterated these points in his discussions with economists, treasury officials, central and private bankers, and officials of the Bretton Woods institutions. See, for instance, Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 85, April 27-July 21, 1951. For additional insight into Jacobsson economic philosophy, see Erin Jacobsson, *A Life for Sound Money: Per Jacobsson* (Oxford: Oxford University Press, 1979), pp. 207-221.

thus rapid deterioration in the value of the pound. According to him, excessive spending by the Labour government deterred private investment, which in turn, made it impossible for Britain to increase its exports to meet the high levels of imports that flooded into the country for reconstruction purposes. Forever suspicious of industrialists and disliking of labor unions, Jacobsson thought that “while the socialists wanted to invest, they did not like to establish conditions propitious for private savings.”¹⁸ Consequently, Jacobsson advised the Bank of England that if the Labour government would control its level of expenditure, and thus arrive at “an internal balance between expenditure and resources, the problem of external balance [would] almost solve itself automatically.”¹⁹ He also advised the Bank of England that reconvertibility was the best way for England to maintain its high standard of living and welfare policies. Jacobsson thought that “it was necessary to get commerce and convertibility again [and that] it could easily be proved that convertibility would increase the real income of Great Britain and thus help to keep the standard of living.”²⁰ Going back to a convertible pound was also seen by him as “the only way to maintain London’s position as a banking and trading center.”²¹

Therefore, seeing high levels of government expenditure as causing inflation and impeding monetary stabilization and economic recovery, the BIS intensified its efforts aimed at encouraging the restoration of conservative economic policies in Britain and elsewhere in Western Europe in the late 1940s. Though its writings, monthly meetings in Basle and site

¹⁸ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 69, September 11-22, 1947. See Also, Diary A I 81, March 26-November 29, 1950, Loose notes. For Jacobsson’s feeling toward industrialists and labor unions, see Erin Jacobsson, *A Life for Sound Money*.

¹⁹ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 69, September 11-22, 1947.

²⁰ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 76, March 26, 1949.

²¹ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 78, November 8, 1949.

consultations, the BIS played an important part in the introduction of orthodox stabilization programs throughout Europe between 1947 and 1950. These programs, which corrected external balances, laid the groundwork for the gradual restoration of *de facto* multilateral convertibility with the dollar by the middle of the 1950s and official recognition in 1958.

A Decisive Turn Toward Convertibility

In the late 1940s the BIS reemerged as an authoritative and influential force in European financial affairs, as a technical agent of the intra-European payments system, as a provider of short-term financial services to central banks, and as a site for the formulation and promulgation of orthodox economic policies. Through the monthly meetings of central bank governors in Basle, BIS site consultations in key BIS member countries, and specialized writings and annual reports, the BIS was remarkably influential in encouraging the introduction of orthodox economic policies in Western Europe and laying the groundwork for early return to the convertibility with the dollar by 1958. The BIS's success in promoting such policies in the late 1940s was aided by the rise of strong center-right governments throughout Western Europe, which looked more favorably on the policy prescriptions of BIS senior officials, particularly Jacobsson.

Monthly Meetings of Central Bank Governors and Site Consultations The Second World War accentuated rather than weakened the character of the BIS as an institution for managing the financial affairs of just one region, Western Europe. First, the BIS monthly meetings of bankers, commercial as well as central, which helped foster close personal relations and an informal exchange of views on common economic and financial problems, became after the war more strictly Western European than before. In the 1930s, the BIS's

direct connections with the Bank of England, the Bank of France, and the Bank of Netherlands conferred on the monthly meetings a genuine international character because London, Paris and Amsterdam were premier centers of international finance along with New York. With the postwar shift of the center of international finance to New York and Washington, the regional character of the BIS was further accentuated. Although the BIS business with the Federal Reserve Bank of New York and with New York banks was substantial, the great majority of the bank's free resources having been invested in dollars or gold in the United States, the bank had never actively intervened in the Western Hemisphere. And while the BIS maintained strong informal ties and collaboration with the Federal Reserve System though its international correspondent bank, the Federal Reserve Bank of New York, the US government decided against official representation on the bank's board of directors. Japan's participation in the BIS, which grew out of its involvement in the German reparations settlements of 1930, was discontinued after the war. Meanwhile, German membership in the BIS, suspended just after the war, was reestablished at the Annual General Meeting of May 1948.²² Secondly, the creation of the Bretton Woods financial institutions, with universal membership and operations, relegated the BIS to the rank of regional institutions.

However, the regional character of the BIS did not make it any less useful to many liberal bankers, politicians and intellectuals in Western Europe from the late 1940s onward. These individuals responded to the financial crises throughout Western Europe between 1947 and 1948 by demanding for a return to more orthodox economic policies. Through

²² While the statutory rights of the German Reichsbank was transferred to the Bank Deutscher Länder and German participation on the BIS Board of Directors resumed in December 1948, the Bank of Japan's rights under the Hague Agreements of 1930 were terminated by the 1951 Peace Treaty of San Francisco. See BIS, HA, 7.6, B.I.S. Shares, "Exercise by the Bank Deutscher Länder of the Rights Attached to the Shares at Present Registered in the Name of the Reichsbank," January 6, 1950; and BIS Archives, 1/19H, Japanese Participation in the BIS, Maurice Frère to Cameron F. Cobbold, June 27, 1948.

monthly meetings of central bankers in Basle and site consultations by BIS staff, the BIS was able to keep a sense of identity, purpose and solidarity among Western European and American bankers, central as well as commercial. BIS senior managers not only formulated and publicly espoused orthodox economic policies, they influenced the central banking representatives by questioning them each time they visited Basle on the progress they were making toward implementing a “sane” economic policy.²³ These senior managers also influenced the central bank governors by submitting memoranda to them at the monthly meetings on Sundays. These memoranda and personal conversations, in turn, influenced the decisions that the central bankers formalized at the Monday board meetings and pursued in their national settings.

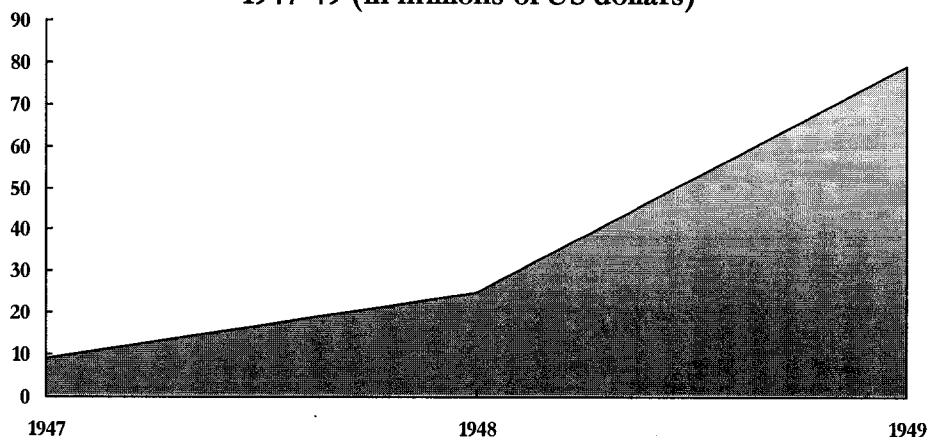
It is difficult to overstate the value that central bankers placed on the monthly meetings in Basle. From their perspective, the BIS meetings allowed them to exchange views on economic and political developments in one another’s countries and to develop common lines of action. An important characteristic of these meetings was that they were being held outside of the watchful eye of the media and general public. The BIS was behind the scenes of international finance. According to the central bankers, whereas the gatherings of treasury officials “upset [market] confidence instead of reassuring the public, for all those who [are] not present speculate a great deal on the machiavellian [sic] plans which might have been laid down by those who [are] present,” the regular meetings in Basle “do not arouse the same suspicion and give a much better opportunity for discussion along common lines.”²⁴ In the late 1940s, central bank governors used the monthly Basle meetings to devise ways of

²³ Erin Jacobsson, pp. 207-221. At a meeting at the IMF with Edward Bernstein of the US Treasury in early 1950, Per Jacobsson likened fiscal policy methods with “permanently unbalanced budgets which was an emanation of permanently unbalanced minds.” See Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson, A I 79, February 1950.

²⁴ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Collection, Box “C,” Per Jacobsson to Norman Crump, May 2, 1933.

placing European trade and financial relations on a multilateral as opposed to bilateral basis. The high value that European central bank governors placed on these meetings and the BIS's contribution to reconstruction efforts was quickly reflected in the bank's financial accounts. As a profit-making institution that did not derive its income from government grants, BIS income depended on central banks using it as a depository of funds and a supplier of financial operations at short term. During the 1948-1949 financial year alone, the volume of operations undertaken by the BIS was more than two and a half times the previous year. As Graph 6.1 shows, between 1947 and 1949 BIS operations rose from \$9 million to \$79 million per year.

**Graph 6.1: Volume of Annual BIS Banking Operations,
1947-49 (in millions of US dollars)**



Source: BIS Archive

Site consultations with central bankers, prominent private bankers and select government officials constituted another important method by which the BIS spread its economic and monetary doctrine throughout Western Europe. A central ingredient in the work of BIS senior managers was to travel to BIS member countries to become better acquainted with economic and political developments in those centers; site consultations also

provided BIS officials with the opportunity to advise, and sometimes preach to, decision-makers on the merits of such orthodox policies as balanced budgets and use of interest rates to combat inflation. As in previous periods, Per Jacobsson played a central role in BIS's practice of conducting consultations and through them, garnering support for the BIS policies in Western European capitals.

Even though the United States government continued its policy of not being formally represented on the BIS Board of Directors, BIS officials met with representatives of the Federal Reserve System in Basle and maintained strong informal relations with the Federal Reserve System and the New York banking community. According to Jacobsson, "for us in the BIS, it was, of course, of some importance to keep friendly relations with leading people in these two large banks in New York."²⁵ The two banks he was referring to were the Chase National Bank and the National City Bank of New York.

BIS Philosophy and the Reintroduction of Orthodox Economic Policies in the late 1940s Another way in which the BIS encouraged a shift toward more orthodox economic policies in Western Europe throughout in the late 1940s was through its writings. The writings of Jacobsson – correspondence, BIS annual reports, and specialized reports – influenced the thinking and decisions of key Western European policymakers, even though the prevalence of embedded liberal ideas meant that he and other high-ranking BIS officials were fighting against a tidal-wave of public opinion.

To Jacobsson and his colleagues at the BIS, economic policy could and should be divorced from political considerations. In the latter half of the 1940s they argued for the reconstitution of flexible and free market economies throughout Western Europe. Monetary

²⁵ Basle University Library, Department of Manuscripts, Jacobsson Collection, Box "N," Per Jacobsson to Montagu Norman, April 8, 1947.

policy and interest rates were to be set by independent central banks. Moreover, for them, the best way of increasing the volume of production and achieving full employment was not by such direct “physical” controls as deficit spending and taxation but by such “financial” controls as the interest rate. During these years Jacobsson became a tireless defender of the free market system in which the price mechanism was thought to ensure that costs, including a “reasonable” profit, would not exceed prices.²⁶ For Jacobsson, “the BIS was probably the institution in Europe which exerted its influence...most in conformity with American ideas of free enterprise” and that “BIS plays a role as a post for spreading ‘true’ economic thought.”²⁷

Classical liberals at the BIS firmly believed that the greatest danger of embedded liberal policies was that they caused inflation, which in turn, led to economic and political instability. By approaching economic development in this way, however, Jacobsson and his counterparts at the BIS were in a tenuous position, for most analysts and policy makers saw this fear as anachronistic by the middle of the 1940s.²⁸ The vast majority of support for the idea that inflation was the worst danger facing Western societies after the war was found mainly among central and commercial bankers and industrialists in, for example, the International Chamber of Commerce. Nevertheless, support for this idea spread “fairly quickly” in Western Europe in the latter half of the 1940s.²⁹

At the same time, Per Jacobsson “became a fanatical champion of the policies he

²⁶ Erin Jacobsson, *A Life for Sound Money*, p. 207.

²⁷ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 71, December 31, 1947; and Diary A I 79, February 1950.

²⁸ Irving S. Friedman, *Inflation, a World-Wide Disaster* (London: Hamish Hamilton, 1973), p. 87.

²⁹ Erin Jacobsson, *A Life for Sound Money*, p. 208.

believed would counter inflation.”³⁰ Using every means at his disposal to promote his doctrine of monetary policy, Jacobsson “imbued [his writings] with a strong faith in the efficacy of orthodox economic policies which [had] been followed during the early phases of the interwar period with considerable, though temporary, success.”³¹ Moreover, recognizing the challenge posed by embedded liberals who held sway throughout Europe, Jacobsson intensified his private discussions with the central and commercial bankers who visited Basle. He and other senior BIS managers also made it their business to regularly travel to various national capitals to hold policy consultations with key decision-makers. As they had been since the BIS’s early years, site consultations helped promote sound money and credit policies the bank was advocating.³² While BIS Annual Reports contained the same themes and policy prescriptions, these reports reached a limited audience of technocrats and already avid BIS supporters in central and commercial banking circles. Recognizing that something “radical” needed to be done, Jacobsson “mobilized the willing help” of the Committee on Monetary Relations of the International Chamber of Commerce, whose brochures reached millions of businessmen and bankers throughout the world, and whose “members could form important pressure groups in their countries.”³³

In teaming up with the Monetary Committee of the International Chamber of Commerce, Jacobsson and the BIS were joining old friends who shared their doctrine of sound money. The committee’s chairman, W. Randolph Burgess, then vice president of the National City Bank of New York, was an old friend of Jacobsson’s who had represented the

³⁰ Ibid., p. 209.

³¹ Federal Reserve Bank of New York, BIS File, Memorandum, “The BIS Study of the Marshall Proposal,” August 15, 1947, p. 6.

³² Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 18, May 22, 1933.

³³ Erin Jacobsson, *A Life for Sound Money*, p. 209.

Federal Reserve Bank of New York as one of the founders of the BIS. Among the fourteen members of the committee was the BIS's former President, McKittrick, then vice president of the Chase National Bank. Therefore, two of the three American members were specialists on European finance, while all European members were drawn from leading commercial or private banks.³⁴ In drafting *Monetary Problems in the World Today*, an International Chamber of Commerce resolution and report which was officially adopted in December 1946, Jacobsson created a blueprint for monetary policy that encouraged the introduction of orthodox economic policies in Western Europe in the late 1940s. Jacobsson was to tailor this document in subsequent years to fit a number of specific countries contemplating policies changes.³⁵ According to Jacobsson, flexibility needed to be the cornerstone of monetary and economic policy. To deny it to one was to deny it to the others. "Rigidity," Jacobsson argued, "is not the same as stability: in fact the two are often mutually exclusive."³⁶

Meanwhile, BIS annual reports, which effectively targeted government policy-makers, were important vessels for carrying BIS ideas about the need for flexibility and currency convertibility. For example, the BIS's 21st *Annual Report* expressed dissatisfaction with the state of affairs in international finance:

The next task must, indeed, be to put an end to the present artificial situation and to re-establish real exchange markets in which currencies can be bought freely at single rates. The B.I.S. thus champions convertibility, and it wants to see steps taken in that direction without undue delay.³⁷

Jacobsson and his colleagues at the BIS also championed convertibility and orthodox economic policies on the grounds that such measures would prevent the spread of

³⁴ Ibid., p. 210.

³⁵ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Collection, ICC, Box IV, Per Jacobsson, *Monetary Problems in the World Today*, Resolution of the ICC Council, December 1946.

³⁶ Per Jacobsson, *Monetary Problems in the World Today*, p. 22.

³⁷ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Collection, "The Bank for International Settlements," International Chamber of Commerce, Box IV, July 15, 1952.

communist rule in Western Europe in the early Cold War years.³⁸ Jacobsson expressed this sentiment in one of his many letters to high-ranking United States government officials:

Convertibility is not just a combination of monetary and economic factors but a philosophy of economic behavior. Therefore, a return to convertibility constitutes one of the best safeguards of the free world, not only against totalitarian governments but also against pronounced state Socialism. It will, however, be such a safeguard only if the new convertible system can withstand the recurrence of a great crisis....Convertibility is such an important objective that it is worth some special arrangement. Of course, I do not look for aid to alleviate the task for European countries. I think you will admit that nobody has preached the doctrine of a sound money and credit policy more than we here in the BIS.³⁹

While Jacobsson's ideas had no inherent power in themselves, they were backed by the clout of the BIS as a monetary institution with two decades of experience. They were also backed by the supporters of those ideas: prominent Western European and American central and commercial bankers who in varying degrees and ways exerted pressure on their governments to pursue more conservative economic policies. "The BIS has no powers, only influence," remarked Jacobsson.⁴⁰ Nor was he the only European or American monetary authority to think of the BIS in this way. Marius W. Holhop, governor of the Bank of Netherlands in the late 1940s, remarked that "the BIS has had very great influence on post-war monetary developments. And that is mainly your [Per Jacobsson's] influence, for it is you [who] has written what has influenced people."⁴¹

While there is little doubt that BIS officials played an important role in encouraging a

³⁸ NL 324, Per Jacobsson, A I 112, Nov. [?], 1956. See also T. Balough, "Partial Impartiality," *New Statesman and Nation*, May 29, 1954.

³⁹ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Collection, Box "O," Per Jacobsson to Andrew Overby, December 30, 1953.

⁴⁰ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson, A I 108, March [?], 1956.

⁴¹ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson Diaries, A I 102, November 15, 1954.

shift toward more conservative economic policies in Western Europe beginning in the late 1940s, their success in the domestic setting depended greatly upon political conditions and thus the receptiveness of Western European decision-makers to the policies they were so stridently advocating.

The Rise of Center-Right Governments in the Late 1940s The BIS efforts at promoting the return to orthodox policies in Western Europe in the late 1940s received a major boost from domestic political developments throughout Europe. These years witnessed the rise strong center-right governments, which were more amenable to conservative economic ideas than their counterparts on the left. Helleiner captures the rise of these governments:

The seriousness of the 1947-48 economic crisis on the continent led many prominent politicians, intellectuals, and bankers in Western Europe to demand a return to more orthodox economic policies. Faced with the stark alternatives presented by the crisis, Europe's middle classes gave their support to these figures. Elections in 1947-48 throughout continental Europe marked this shift; the shaky middle-left coalitions of 1945-47 gave way to strong center-right governments. By 1948, of the sixteen countries involved in the European Recovery Program, only three (Britain, Norway, and Sweden) were headed by socialist governments.⁴²

While it is tempting to ascribe this shift in economic policies to the American government's use of Marshall Plan aid was political leverage to challenge more radical socialist programs, this outcome was instead the result of internal political and economic developments. As Milward shows, the defeat of "more radical aspirations for economic and social change" in Western Europe in the late 1940s was not the result of American intervention through Marshal Aid but "part of the course of internal political development" in the countries concerned.⁴³ The resurgence of orthodox policies Western Europe in the late 1940s was particularly strong in the Benelux countries, Switzerland and France, where

⁴² Helleiner, p. 65.

⁴³ Milward, p. 91.

supporters of orthodoxy were able to retain a considerable amount of the authority that they had possessed in the 1930s. In Italy and West Germany, by contrast, orthodox thinking reemerged in response to these countries' experience with fascism. A significant number of classical liberals from political, intellectual and business circles in these countries, and especially among the increasingly independent West German central banking institution, the Bank Deutcher Laender, were "unwilling to accept the embedded liberal ideas" that were being promoted in various political quarters, and especially the European Cooperation Administration of the Organization for European Economic Cooperation in Paris.⁴⁴

Liberal thinkers were growing in number and influence. Inspired by prominent thinkers of the Freiburg and Austrian schools and such thinkers as Wilhelm Ropke and Friedrich Hayek, the individuals assumed important policymaking positions in their respective countries. They stressed that "more strict monetary discipline and a move toward free market convertibility were necessary if a return to totalitarianism was to be avoided."⁴⁵ The efforts of the actors reinforced and were reinforced by the writings, monthly meetings, site consultations and other activities of the BIS, which also served as a center for the formulation of orthodox economic and monetary policies during this period. Jacobsson joined prominent European thinkers like Hayek and American thinkers like Milton Friedman in convening liberal thinkers and politicians in such fora as the Mont Pelerin Society, which Friedman later referred to as the "'rallying point' for the neoliberal cause."⁴⁶ An unyielding defender of policies he thought would counter inflation, Jacobsson used his position in the BIS during these years to ensure that Marshall aid was used to facilitate a return to more

⁴⁴ Helleiner, p. 65.

⁴⁵ Ibid., p. 65.

⁴⁶ George Nash, *The Conservative Intellectual Movement in America since 1945* (New York: Basic Books, 1976), p. 27, in Helleiner, p. 66.

orthodox policies instead of funding increased government expenditure, which he saw as causing inflation and crowding out private investment. In addition to his writings and personal exchanges in Basle with bankers, he lobbied US officials and European central bankers and government officials in their domestic settings. Many of these officials were not only heavily influenced by Jacobsson; they turned to him for advice on specific problems they were encountering in implementing disciplined monetary policy.⁴⁷

Other high-ranking officials of the BIS used their close relations with their national central banks and governments to facilitate a move toward more conservative economic and monetary policies. During this period it is difficult to distinguish between the interests, motives and roles of Western European central bank governors as national and international actors. For example, Maurice Frère, who was BIS president and chairman of the board of directors in the late 1940s, played an instrumental role in Belgium between 1947 and 1949 in carrying out orthodox stabilization policies that were being advocated by the BIS, even while Paul-Henri Spaak, a socialist, led a coalitional government in Belgium.⁴⁸ A similar situation obtained in the Netherlands, where like Frère, Bank of Netherlands Governor Marius Holtrop introduced BIS policies aimed at controlling the level of government expenditure and establishing an equilibrium in Holland's external balance of payments while he was a director of the BIS.

Thus, various BIS activities, which were aimed at encouraging a shift toward more orthodox economic policies in Western Europe in the late 1940s, reinforced and were reinforced by important political developments in the countries concerned. The most significant levers for BIS influence remained its monthly meetings of central bank governors

⁴⁷ Ibid., p. 67; Kaplan and Schleiminger, *The European Payments Union*, p. 64; Erin Jacobsson, pp. 246-58.

⁴⁸ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson, Box "H," Per Jacobsson to Sir Edmund L. Hall-Patch, June 28, 1948.

in Basle, its interactions with the managing board of the OEEC in Paris, its site consultations throughout Western Europe and the United States, and its writings. Jacobsson, who was widely regarded as an authority on economic and monetary affairs, was a towering figure in the BIS, featuring prominently in each of these areas of activity. However, these efforts of the BIS aided and were aided by important political changes throughout Western Europe from the late 1940s onward. The rise of strong center-right governments contributed to the defeat of more radical, socialist measures in Western Europe and laid the groundwork for incremental financial liberalization by the middle of the 1950s. In order to achieve this, though, the BIS and its supporters needed more than ideas and political support; they needed the technical financial machinery to manage the growing volume of intra-European financial transactions resulting from expanding regional trade. This system, which would facilitate the removal of current-account restrictions between 1950 and 1958, manifested itself in the European Payments Union, a system whose creation and subsequent management were greatly influenced by the BIS. It is to the BIS's role in that aspect of European financial history of the 1950s that we now turn.

The European Payments Union and Incremental Steps Toward Convertibility

After the Second World War, the BIS set out for itself the goal of reestablishing itself as an active instrument of cooperation between European central banks.⁴⁹ But there were new institutions on the scene in Europe, and the BIS had to work with rather than against them if it wanted to reestablish itself as the center for monetary collaboration on the European continent. Yet while the bankers had been granted their wish to preserve the BIS, finance ministries, led by the US Treasury, saw to it that they established an institution of

⁴⁹ BIS Archives, H.S. 223, "Bank for International Settlements," p. 1.

their own. The creation of the OEEC in Paris in 1947 provided a new institutional framework for European economic cooperation, especially in connection with Marshall aid from the United States. Yet, from the perspective of Western European central banks, the great advantage of the BIS was that it was a flexible institution that respected banking secrecy. In addition, its statutes allowed it to accept deposits from central banks and perform banking operations that the new international institutions, including the Bretton Woods institutions in Washington, could not. Finally, among European political and monetary leaders alike, there was an expressed desire to take policy challenges into their own hands, thus resisting foreign, particularly American, influence over policy choices.

As a result, European leaders rallied support in Washington and Paris for the OEEC to appoint the BIS rather than the IMF as agent of the First Agreement on Multilateral Monetary Compensation, which was signed by Belgium, Luxembourg, France, Italy, and the Netherlands on November 18, 1947. Determined to reassert itself in the international monetary sphere, the BIS efficiently operated the payments scheme in its first year. Consequently, it was asked by the OEEC to extend the scheme and become the agent for the Inter-European Payments and Compensations. Intra-European payments agreements of 1948-49 and 1949-50 paved the way for the creation of the EPU. This payments union, which was created as a mechanism for multilateral settlement in Europe between 1950 and 1958, therefore had its origins in practical compensation operations that began in Basle in December 1947.

The creation of the EPU marked a significant turning point in Western Europe's postwar financial history and the BIS's role in it, insofar as it placed the BIS more squarely at the center of a more determined attack on financial barriers in Europe. The BIS operated the scheme by providing a clearing house that handled the monthly compensations, calculated

net positions and effected their settlement among central banks. The EPU clearing mechanism created transferability among European currencies, a modest percentage of the surpluses and deficits originating from monthly clearing was settled in gold, dollars or other convertible currencies. The major part of these surpluses and deficits were converted into credit, through the EPU, to cushion member countries' limited reserves, which were depleted by the war and had been relocated to more stable financial centers like New York or were tied up in the massive reconstruction effort. As the monetary reserve positions of these Western European countries improved in the 1950s, the BIS pressed for and received an agreement to progressively increase the proportion being cleared in this manner. These BIS operations led to a gradual increase in the monetary reserves of Western European countries and thus the convertibility of major European currencies with the dollar.

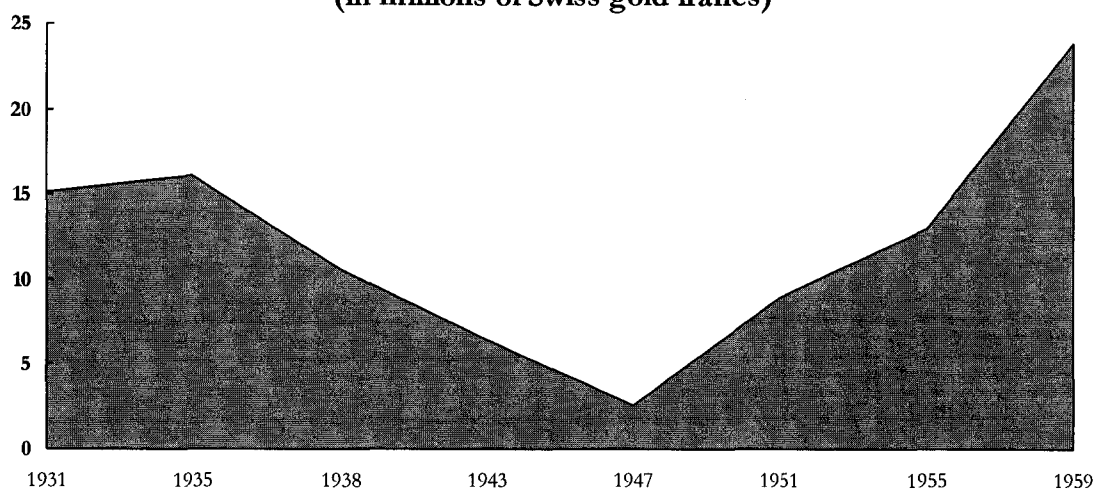
It is difficult to overstate the importance of these “technical” operations of the BIS. By operating the EPU so efficiently, the BIS was in large part responsible for placing Western European financial liberalization on a certain, systematic track. In other words, the EPU scheme helped build the financial preconditions for the gradual *de facto*, and later *de jure*, political choice of restoring convertibility of Western European currencies. The gradual loosening of state restrictions on capital in the 1950s, in addition to the increased volume of operations that the BIS was undertaking in connection with deposits central banks were making with it, was reflected in the BIS financial position. Graph 6.2 shows a quite positive correlation between the existence of state controls on capital movements and the BIS financial position. As state controls in Western Europe gradually eased from the late 1940s onward, BIS assets increased. These assets increased from 555 million Swiss gold francs in 1948 to 1.5 billion in 1954 to 3.5 billion by the end of February 1959. Graph 6.3 shows BIS income increasing in tandem with the increase in the bank's financial operations.

Graph 6.2: Financial Position of the BIS, 1931-1959
(in billions of Swiss gold francs)



Source: BIS Annual Reports, 1931-1959

Graph 6.3: BIS Net Income, 1931-1959
(in millions of Swiss gold francs)



Source: BIS Annual Reports, 1931-1959

While the EPU ensured the eventuality of a return to multilateral convertibility of European currencies, there were still important disputes over when and how to proceed. In addition to its monthly meetings, site consultations and writings, the meetings of the EPU's Managing Board in Paris offered the BIS an important vehicle for influencing the policy choices of Western European governments in the 1950s. Again, while the loosening of direct economic controls and convertibility depended upon national political acceptance, BIS officials were influential in encouraging the move toward more orthodox economic policies, including the use of interest rates, which in turn, made the return to convertibility a reality. The meetings of the EPU's managing board provided the BIS with direct access to a Western European political body that could take decisions that did not require national ratification. The OEEC was deliberately designed to have influence over domestic policies of its member governments. Indeed, the US government sought this arrangement in order to ensure that there would be political collaboration in European economic affairs.⁵⁰ While the EPU's managing board was responsible for all final decisions, BIS officials had a certain and substantial input into the policies being prescribed to governments in the decade following its establishment in 1947. Jacobsson explains how the BIS influenced but did not have power over policy decisions being taken in the OEEC:

The B.I.S. can indirectly influence decisions through the governors of the various central banks – or rather the governors can in their talks in Basle agree upon certain lines of policy which they then try to get adopted by their ministers of finance, whom they regularly meet....That the BIS keeps out of politics does not mean that one cannot discuss politics at the B.I.S. One talks freely but is careful in one's actions.⁵¹

The case of the US Treasury's support in the 1950s for a "federal reserve system for

⁵⁰ Kaplan and Schleminger, *The European Payments Union*, p. 64.

⁵¹ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson, A I 110, November 4, 1956.

Europe” provides another example of BIS officials using their access to central bankers and the managing board of the EPU to stave off international proposal they opposed. Paul Hoffmann, who was representing the US Treasury in Paris in the 1950s, was pushing the idea of an “integrated Europe” or “a Federal Europe” in both the United States Congress and in Western Europe. American treasury officials supported the idea of European monetary unification and the idea of establishing a central-banking institution for Europe that would have had authority over the BIS board of directors. Naturally, senior BIS managers were irate over the proposal. Jacobsson captures this sentiment among the bank’s upper management:

[BIS President Roger] Auboin is on the war path....He is afraid of a new institution and he feels sure that the idea of [Robert] Marjolin is to want to prevent convertability i.e., a return to a free system which Marjolin being a socialist instinctively hates.⁵²

As with some other proposals they opposed, senior BIS managers were able to defeat the proposal to create a federal reserve bank for Europe because they were able to “successfully stir up the Governors” who they felt “don’t want to find an institution above their heads!!”⁵³ Indeed, the BIS was capable of rallying opposition to some, but by no means all, of the major international policies they opposed.⁵⁴

As elsewhere, Jacobsson and his colleagues at the BIS launched a sustained campaign in Paris in the 1950s in support of conservative economic policies, which complemented the

⁵² Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson, A I 83, November 6, 1952. Robert Marjolin was a member of the French Socialist Party and a high-ranking government official from 1941 to 1955. Martjolin also served as Secretary General, Organization for European Economic Cooperation between 1948 and 1955.

⁵³ Ibid.

⁵⁴ Evidence of this phenomenon is repeated in multitudinous places throughout Jer Pacobsson’s diaries. See, for instance, the entries regarding the BIS successful opposition to the American proposal to create a European central bank in the 1950s. See, for example, NL 324, Per Jacobsson Diaries, A I 83, October 30, 1953.

liberalization of trade and finance and aided the functioning of the EPU payments scheme. For them, while government controls presented the greatest obstacle to liberalization, progress was also complicated by monetary reserves that were in short supply, rearmament programs that were fiscally burdensome, exports levels that were growing moderately.⁵⁵ Moreover, in Basle, the EPU's progress was hampered because of "too much central bank credit instead of market financing."⁵⁶ These officials advocated a step-by-step approach to convertibility, the final step of which would present the recognition of an existing state of affairs rather than something entirely new. This was the argument that Jacobsson and other senior BIS officials used repeatedly to persuade governments to implement the orthodox measures they were advocating. Moreover, Jacobsson encouraged the International Chamber of Commerce to launch a program on the "speedy return to convertibility" and provided the Chamber's technical advisor with a paper that he could "re-baptise as you like to fit into your scheme of agenda."⁵⁷

By the middle of the 1950s, BIS officials and supporters had succeeded in persuading Western European governments to liberalize an increasing volume of their trade and finance. At the same time, these governments were increasingly using interest rates to influence economic activity. Through the use of the interest rate, these governments became more adept at managing their debt burden; their reserves of gold and domestic and foreign currencies also increased appreciably. While budget levels remained large, Western European governments began achieving balanced budgets. Convertibility for current transactions for residents and non-residents alike gradually increased as these countries' reserves of currency

⁵⁵ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson, A I 82, February 1951.

⁵⁶ Basle University Library, Department of Manuscripts, NL 324, Per Jacobsson, A I 83, November 1952.

⁵⁷ Per Jacobsson to Richard Barton, October 13, 1952, quoted in Erin Jacobsson, p. 247.

and gold increased. Moreover, between 1954 and 1955 neoliberal policies of reducing government investment were enacted, especially in the construction sector, thus reducing the size of government budgets. In 1954, such Western European countries as Belgium, the Netherlands and Western Germany, the countries that followed the BIS policy prescriptions most closely, reached a position to make their currencies completely convertible.⁵⁸ Meanwhile, France was putting up political resistance. Almost imperceptible to the general public, gradual and incremental steps toward convertibility were begun. For example, Britain continued to open up its commodity markets. In March of 1954 the Transferable Account was created, meaning that sterling accounts for current transactions became almost completely transferable. In the end, an administrative approach was adopted that provided *de facto* external current account convertibility by 1955. *De jure* current account convertibility followed in concert with the rest of Europe at the end of 1958, when EPU member countries agreed to begin fully settling their payment balances in dollars, thus dismantling the remaining barriers between the EPU and dollar areas.⁵⁹ On December 27, 1958, EPU countries declared their currencies fully convertible to non-residents. As a result, the EPU was terminated, and outstanding credits and deficits were converted into bilateral claims.

The EPU is widely regarded as one of the most successful schemes in post-World War Two financial history.⁶⁰ Integral to its conception and subsequent operation, BIS bankers heavily influenced the EPU's sponsorship of policies to correct European payments imbalances and negotiation of a joint European approach to currency convertibility. The

⁵⁸ Erin Jacobsson, p. 257.

⁵⁹ BIS, *The Bank for International Settlements and the Basle Meetings* (Basle: Boehm AG, 1980), p. 14.

⁶⁰ Robert Triffin believed that the EPU was so successful that it should be preserved indefinitely and transformed in a clearing house for all European central banks, in which they would be required to hold all their currency reserves. See Robert Triffin, *Europe and the Money Muddle: From Bilateralism to Near-Convertibility, 1947-1956* (New Haven: Yale University Press, 1957), p. 46.

IMF, one of its severest critics, recognized its significance by saying that “to many observers, for some years following the establishment of the EPU, the focal point of important monetary decisions was that organization rather than the Fund.”⁶¹ While the treasuries dominated the Bretton Woods financial order, by no means were bankers, central as well as commercial, devoid of influence.

Conclusion

The restoration of convertibility of Western European currencies at the end of 1958 represented an important victory for the Bank for International Settlements. Founded on the eve of the Great Depression, which ushered in an era of state controls on the international movement of capital, the BIS was the institutional embodiment of the classical economic doctrine, a principal tenet of which was a belief in the value of freedom of exchange. While the relaxation of state restrictions on the use of capital in the middle of the 1950s was viewed by BIS officials as being incomplete, it marked for them the beginning of the end of a state of financial affairs that the BIS fundamentally opposed. State controls on the movement of capital had become the norm, while the BIS remained a bastion for financial orthodoxy, including capital mobility. A repository for the ideas and interests of classical liberals, and a rallying point for influencing government policy, the BIS had to work within the Bretton Woods framework from 1947 to 1958 and accept a move toward convertibility in Western Europe that was much slower than it otherwise wanted.

The restoration of convertibility of Western Europe currencies also revealed the intensely political nature of money. Even Per Jacobsson, the most ardent supporter of the

⁶¹ Margaret De Vries and John Horsefield, eds., *The International Monetary Fund 1945-1965 Twenty Years of International Monetary Cooperation*, Vol. 2 (Washington, DC: International Monetary Fund, 1969), p. 317.

idea of separating economics and politics, understood full well that the achievement of convertibility in Western Europe in the 1950s depended upon national political acceptance of free market economy. After all, the decision was a conscious policy choice of Western European governments.

Still, this chapter has shown how the BIS encouraged and facilitated that choice. In the decade after 1947, when it appeared certain that the BIS would not be abolished, the institution continued to be part and parcel of, and thus restricted by, the hard-fought and bitter campaign in Western Europe and the United States among embedded liberals and classical liberals about what constituted a proper economic policy. While classical liberals retained some of the authority and influence that they had had in decades past, the latitude for independent and concerted central bank action through the BIS continued to be restricted by political arrangements.

Nevertheless, the BIS made important contributions toward the introduction of more orthodox economic policies in Western Europe from the late 1940s onward, including the gradual loosening of state restrictions on the international movement of capital. It influenced these outcomes through its monthly meetings of bankers in Basle, its site consultations in key industrialized countries, its specialized reports and correspondence with key national decision-makers, and its financial operations in connection with the European Payments Union. Without these activities, there is no telling when, how and perhaps even if, Western European governments would have taken steps toward liberalizing their financial systems. After all, socialism presented a popular and viable alternative to free market capitalism on the European continent from the 1930s onward. Even though capital controls and national economic planning, both basic features of the postwar economic order, were antithetical to BIS policies, the BIS's postwar success depended on its willingness to support

the macroeconomic goals of the new interventionist welfare state in Europe. This involved working with rather than against the new institutional creations of government treasuries. In this regard the interests and policies of the BIS dovetailed, however imperfectly, with the interests of political and financial elites who sought to prevent the spread of communism in postwar Western Europe.

The BIS's success in promoting orthodox economic policies and the restoration of convertibility also received an important boost from the emergence of strong center-right governments throughout Western Europe beginning in the late 1940s. This development was particularly significant because these governments looked more favorably upon the policy prescriptions of BIS officials, namely BIS Chief Economist Per Jacobsson, who tirelessly opposed the introduction of more radical socialist policies in Western Europe. Yet while treasuries continued to consolidate their control over international financial policymaking during the decade following the Second World War, by no means were bankers, central as well as commercial, influential forces in domestic and international decision-making circles. To paraphrase Jacobsson, what the bankers lacked in power they made up for with influence.

Chapter 7

Conclusion: The BIS and the Prefiguring of Financial Globalization

To many specialists and casual readers of globalization, it appears as though the rapid expansion of global markets in recent decades has resulted of factors that transcend human choice. Advancements in technology and communication are most typically seen as producing a virtuous cycle of uncoordinated economic and financial activity that makes harnessing markets seem impossible. In particular, governments are now widely thought to be defenseless against the disciplining effects of open and free international capital markets, surrendering a considerable amount of autonomy in formulating national economic policies and goals.¹ However, one scholar of international finance has stated: “If developments [go] wrong, government officials could blame ‘independent’ central bankers, central bankers could blame the IMF, and both could blame ‘the markets.’ The problem with this convenient formula is that modern markets do not run themselves.”²

The Politics of Global Finance

Analysis of the genesis of the Bank for International Settlements (BIS) from 1930 to 1958 shows quite clearly that the functioning of financial markets are greatly influenced by the policy choices of governments and central banks. Not only are markets composed of people, some more inherently powerful than others, they are much less haphazard than they have come to be seen. Chapter 2 detailed the long-standing pattern of international bankers

¹ See, for example, David M. Andrews, “Capital Mobility and State Autonomy: Toward a Theory of International Monetary Relations,” *International Studies Quarterly*, 38 (1994), pp. 193-218; and Walter Wriston, “Technology and Sovereignty,” *Foreign Affairs* (1988).

² Louis W. Pauly, *Who Elected the Bankers?: Surveillance and Control in the World Economy* (Ithaca: Cornell University Press, 1997), p. 131.

influencing the governance of international finance. It also showed that these bankers shared a broad common interest with central bankers in managing the expansion of the world economy. Advocates of the liberal proposition that economic peace and prosperity are best built on the foundation of open and free international financial markets, the founders of the BIS clearly saw the need for broader system-management of international finance. Intergovernmental disputes over war debts and reparations arising from the First World War provided the occasion, but by no means the sole purpose, for creating the BIS. Rather, the BIS's founding bankers possessed a profound understanding for the need for well-organized and efficient international institutions, whose *raison d'être* would be to manage the destabilizing effects of expanding world markets for trade and finance. Indeed, immediately after opening for business in May 1930 in the throes of the Great Depression, the founders of the BIS, many of them prominent international bankers, aspired for the BIS to minimize the reparations character of the bank and instead focus its resources and energy on promoting and facilitating the stable development of a modern global financial system.

During the first two decades of the BIS's history, this objective was confounded by intergovernmental disputes over reparations, intellectual and political conflict over what constituted a proper economic policy, economic crises and, above all, world war. It is difficult to deny that without the strong political backing of governments, international financial institutions like the BIS encounter serious difficulties in carrying out their objectives. Chapters 2 through 6 illustrated the power and authority that governments can wield over markets. The BIS proved incapable of restoring confidence in international capital markets during the Great Depression precisely because of the limited political support that governments granted the institution – that is, political support both in terms of governments' recognition of the authority of the BIS and the policies it was recommending,

and in terms of providing the bank with enough financial resources to prevent the spread of the economic and financial crises in Europe. Ironically, the bankers' move to formally insulate the BIS from politics by linking the institution to central banks instead of treasuries, stymied the development of the BIS during the 1930s. While this institutional feature was supposed to ensure the BIS's effectiveness as a financial institution, it ultimately caused a great deal of resentment on the part of treasury officials, who identified the BIS with their ongoing struggle with central and private bankers over economic policymaking in the national setting. Unwilling to cede any measure of control over their monetary and economic policymaking to a multilateral institution, governments granted the new institution limited support.³ Moreover, the volume of funds that the BIS could marshal to stabilize currencies and promote economic recovery was insufficient. Under these circumstances, it was impossible for the BIS to perform the role of lender of last resort in the international financial system. After all, governments themselves were not ready to devote the necessary resources and political support for the stable functioning of a modern international financial system. As Pauly reminds us, "well-functioning markets that span discrete political jurisdictions must themselves rest on a foundation of political collaboration."⁴

Despite the advocacy of and belief in the merits of shielding economic policymaking from politics, analysis of the BIS exposes the tenuousness of that dichotomy.⁵ For example, Chapter 3 showed how the ineffectiveness of the BIS as an instrument of central bank

³ Beth A. Simmons, "Why Innovate?: The Establishment of the Bank for International Settlements," *World Politics*, 45 (April 1993), 361-405; and Kevin Ozgercin, "When Bankers Were Diplomats and Diplomats Were Bankers: Private Authority and the Establishment of the Bank for International Settlements," (revise and resubmission stage, *RIPE*).

⁴ Louis W. Pauly, "The League of Nations and the Foreshadowing of the International Monetary Fund," *Essays in International Finance*, No. 201, Department of Economics, Princeton University, December 1996, p. 3.

⁵ Richard Hemmig Meyer, *Bankers' Diplomacy: Monetary Stabilization in the Twenties* (New York: Columbia University Press, 1970), p. x.

cooperation in the 1930s coincided with deeper changes in relations among governments, central banks and prominent international bankers. The economic shock of the Great Depression led to the discrediting of bankers, central as well as commercial, as leaders in providing solutions to economic and monetary problems. It also encouraged a fundamental rethinking of the role of government in the economy and how relations among these three groups of actors should be structured. The diminution of authority and power of bankers in the governance of global finance, as well as the rise in stature of treasury representatives beginning in the early 1930s, was exemplified by the Tripartite Agreement of 1937. The tradition of central bankers brokering international monetary agreements was shattered when the treasuries of France, Britain and the United States brokered an agreement to stabilize the value of the franc, the pound and the dollar. From then onwards, treasury officials solidified their formal control over international financial decision-making. Accordingly, the latitude for independent central-bank cooperation through the agency of the BIS, which had already been limited throughout the 1930s, became even more circumscribed.

The outbreak of war in Europe further solidified direct government control over markets and, in turn, relegated the BIS, an institution dedicated to championing the cause of free market economy, to a marginal force in international finance through the end of the Second World War. Yet, Chapter 5 showed that supporters of the BIS – predominantly central and commercial bankers in Europe and the United States – remained influential forces in domestic financial politics in the advanced industrialized countries, even in the middle of the 1940s, at the time that there was a hard-fought and bitter campaign to abolish the BIS. The inseparability of economics and politics was further exemplified by the international negotiations over the construction of a new international economic and monetary order while war was still raging in Europe. International negotiations over the role

for the BIS in the postwar monetary order were bound up in the political struggle between classical liberal bankers and embedded liberal treasury officials. The bankers aspired to return to the classical gold standard, reestablish open and free capital markets, and predicate the management of the international financial system on cooperation among pragmatic central bankers at the BIS. The BIS indeed was the institutional embodiment of financial orthodoxy and central bank activism. At the same time, embedded liberals, who occupied powerful positions in government treasuries, wished to curb the authority and influence of central bankers and prominent commercial bankers in the formulation of national and foreign economic policies. Opposition to the role of bankers in governing international finance during and immediately following the war was particularly fierce in the United States.

Nevertheless, as Chapter 5 showed, changing political circumstances after the war, particularly in regard to the growing tensions between the United States and the Soviet Union, resulted in a relaxation in the US Treasury's opposition to the BIS. Ultimately, the United States government abandoned its support for the Bretton Woods resolution to liquidate the BIS, a resolution that it had orchestrated at Bretton Woods. European and American central and private bankers who supported the BIS, presented effective and convincing arguments in favor of retaining the BIS and employing it in connection with postwar economic reconstruction efforts in Western Europe. The lobbying efforts of these bankers, coupled with the political change that occurred in Washington beginning in the middle of the 1940s, paved the way for the BIS's reemergence as an influential international financial institution in the decade following the end of World War Two. The Republican Party's strong showing in the midterm Congressional election in November 1946 resulted in prominent bankers and BIS supporters assuming leadership positions in the US Treasury and State Department as well as the Bretton Woods institutions. Hard-line critics of the BIS,

particularly Treasury Secretary Henry Morgenthau and Harry Dexter White, were replaced by officials who looked more favorably upon, or openly supported, the BIS. This change in top personnel, which was also intended to facilitate cooperation between the American government and the Bretton Woods institutions, led to establishment of formal ties between the Bretton Woods institutions and the BIS. But most importantly, the BIS and its supporters in Western Europe and the United States convinced the United States government that the BIS would duly serve its strategic interests in Western Europe, especially in regard to European economic reconstruction, which was one of the principal means by which Washington sought to prevent the spread of communism in that region.

A Return to Bankers' Diplomacy?

Mainstream international political economy scholarship tells us that the current multilateral system for governing global financial markets and coordinating the monetary policies of leading countries originated with the creation of new international economic institutions after the Second World War. In other words, the collective memory of the majority of such scholars largely begins in 1944. While the mandates and activities of such postwar institutions as the International Monetary Fund and the World Bank are important to understanding the evolution of global finance in recent decades, overemphasis on these institutions has obscured the important contributions that the BIS has made to the development of global finance as we know it today. This dissertation suggests that the BIS offers a unique vantage point for comprehending deeper changes in the global finance over the course of the twentieth century. Through analysis of the BIS, it is possible to understand not only why the current system for governing global finance is not entirely novel, but also how and why the activities of the central and commercial bankers who supported the BIS

from the late 1920s through the late 1950s are important to understanding the liberalization of global finance in more recent times.

Since its creation in 1930 the BIS has been a major international proponent of the liberal tradition in international financial affairs. In fact, a compelling argument can be made that the BIS has contributed significantly to the liberalization of global finance in recent decades. Specifically, the bank has promoted liberal policies in the area of international finance through its writings, monthly meetings of central bank governors and site consultations with key policymakers in the advanced industrialized countries. The BIS has also promoted open and free capital markets; independent central banks; the use of monetary policy in regulating the economy; a sense of solidarity and purpose among central bankers; and the role for private financial experts in establishing rules and standards governing global finance. All these features of the current global financial system were commonplace in the financial politics of advanced industrialized countries during the 1920s, which culminated in the creation of the BIS. Given the growing acceptance of neoliberal ideology, there is reason to believe that there is growth potential for the BIS as the principal global center for central bank action.

Mainstream international political economy scholarship also associates the growing authority and influence of private financial experts with the expansion of world markets for trade and finance since the 1970s. Today, prominent commercial bankers periodically meet with central bankers and BIS officials in Basle to devise global rules and standards for regulating and supervising global finance. Under the auspices of the BIS, private financial experts perform important roles in promoting market discipline and international financial stability. This dissertation suggests that this contemporary phenomenon has certain historical antecedents. Chapter 2 demonstrated the historic role leading international bankers have

performed in managing international finance, including the institutionalization of central bank cooperation in the BIS. Analysis of the circumstances surrounding the BIS's founding illustrate that private-sector actors had exercised legitimate authority in the international affairs decades earlier than the 1970s. While the Great Depression fundamentally restructured relations among governments, central banks and leading commercial banks, prominent private bankers regained influence and authority in the international financial system from the early 1950s onward. This development coincided with the emergence of the BIS as an influential institution in the international financial system. The creation of the European Payments Union in 1950, which had its origins in the intra-European payments scheme operated by the BIS from 1947 to 1950, marked a significant turning point in Western Europe's postwar financial history and the BIS's role in it. The assignment of the BIS as the agent of the multilateral payments union placed the BIS more squarely at the center of a more determined attack on financial and trade barriers in Europe. Over the course of the 1950s, the BIS performed an instrumental role in encouraging the acceptance of more orthodox economic policies throughout Western Europe. The adoption of more conservative policies laid the groundwork for the gradual restoration of convertibility among European currencies by the end of 1958. The return to convertibility in Western Europe in the middle of the 1950s, in turn, marked an important turning point not only in the evolution of global finance during the twentieth century but also in the history of the BIS, which had championed liberal values in finance since its creation in 1930.

Indeed, in a world ever more committed to neoliberal policies in the area of global finance, including market-determined exchange rates, the stability of financial markets has become an increasingly pressing issue. By pursuing an angle of enquiry that focuses on relations among major international financial institutions, governments, central banks and

leading commercial banks, this dissertation has sought to contribute to a growing interest in unpacking state behavior in the international financial system. Examining the origins, evolving mandates and impact of international financial institutions like the BIS provides a powerful vantage point from which to explore deeper changes in the world economy. It is not coincidental that more visible institutions like the International Monetary Fund, the World Bank and a number of other formal and informal institutional arrangements currently are at the heart of policy and academic debate on the new “architecture” of international finance. By focusing on the first thirty years of the history of the BIS, this dissertation has aimed not only to fill a considerable void in the literature on international financial institutions, but also to encourage further debate and analysis of the future role of the BIS in the global political economy.

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