

ESSAYS IN INTERNATIONAL FINANCE

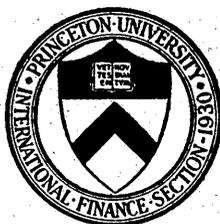
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THE BANK FOR INTERNATIONAL  
SETTLEMENTS, 1930-1955

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INTERNATIONAL FINANCE SECTION

DEPARTMENT OF ECONOMICS AND SOCIOLOGY

PRINCETON UNIVERSITY

Princeton, New Jersey

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*Monsieur Roger Auboin, the author, has for many years been General Manager of the Bank for International Settlements as well as Alternate of the President of the Bank. This essay, however, has no official character and commits nobody but the author.*

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*International Finance Section*

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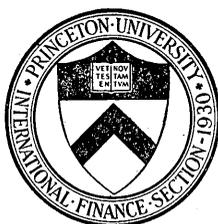
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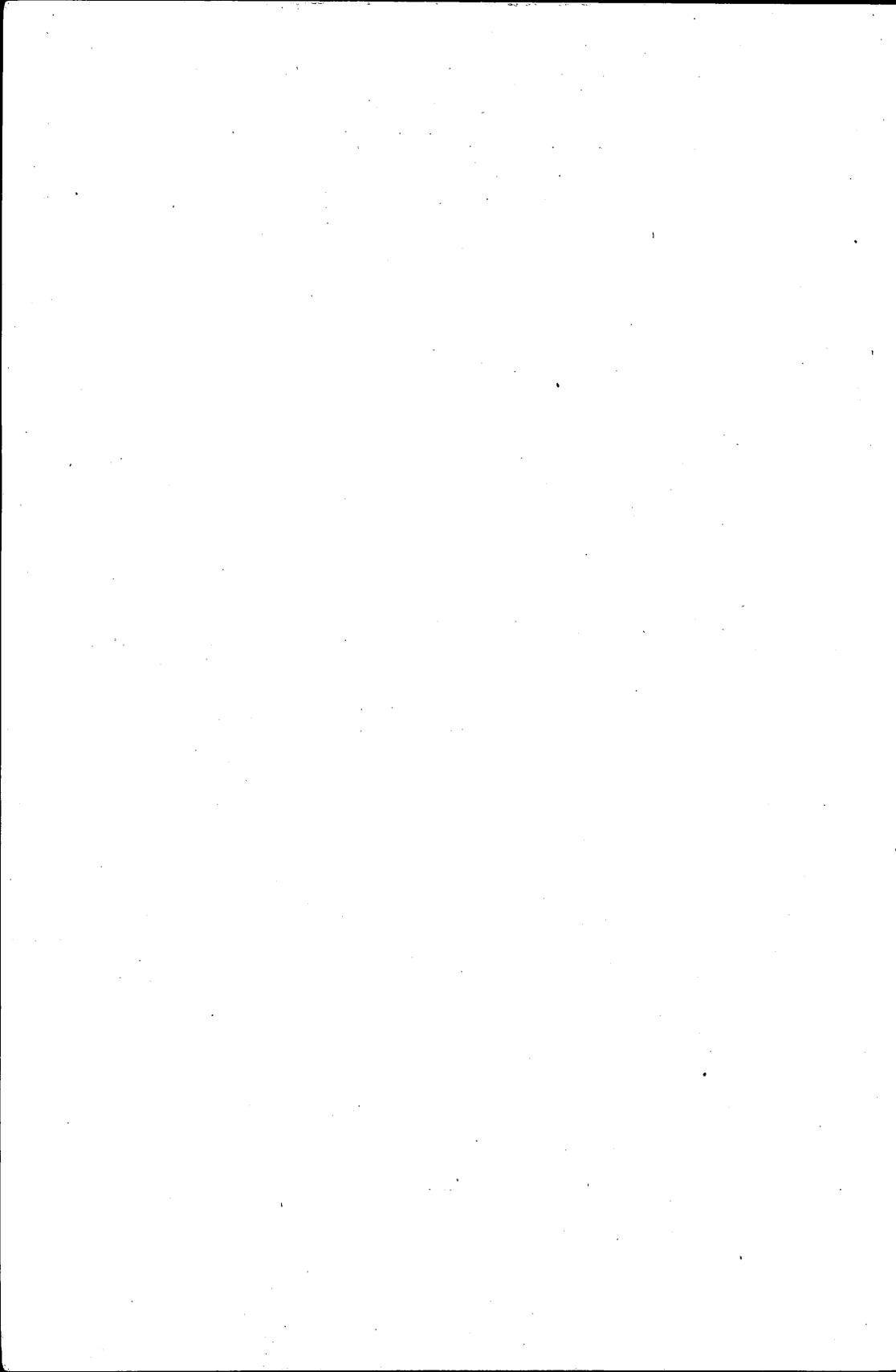


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# THE BANK FOR INTERNATIONAL SETTLEMENTS, 1930-1955

ROGER AUBOIN

**T**HE Bank for International Settlements has just completed its twenty-fifth year. The quarter of a century during which the Bank has been in existence has not only seen a great depression and a great war but has also been marked by a significant evolution of ideas regarding the questions with which the Bank itself is especially concerned, those relating to the principles of monetary policy and the rôle of central banks.

By its structure and functions the Bank for International Settlements is a permanent organization for cooperation between central banks and within this technical sphere it has endeavored to create and maintain, in particularly difficult circumstances, a truly European spirit.

The Bank's history, therefore, may well be of general interest; but relatively little is known about it or its work. The reason for this is not that there is anything mysterious or secret about its activities but that these are technical and that by the very nature of its tasks it keeps aloof from politics and avoids publicity, with the result that there is little opportunity for persons outside the narrow circle of central banks to form any clear idea of what the Bank has been doing. My aim in this brief survey, therefore, is to give an account of the character and scope of the Bank's work, without attempting to discuss all the technical and legal questions involved, in the hope that it will provide those who take an interest in questions of monetary policy and international cooperation with additional material which may be helpful to them in forming an opinion on these matters.

## I. ORIGIN, OBJECTS AND ORGANIZATION

Even before 1914 there had been occasions when central banks had found it useful to cooperate with one another in order to facilitate international settlements. But this had happened only in exceptional circumstances. After the first world war, however, and especially during the currency stabilizations of the period 1922-1930, the principal central banks frequently joined forces for the purpose of granting special "stabilization credits" either in connection with the reconstruction work

undertaken by the Financial Committee of the League of Nations or independently of these schemes.

It was therefore natural enough that the monetary and political authorities soon became interested in the idea of substituting for such ad-hoc and temporary associations a more permanent system of cooperation. This idea took practical shape in the course of the negotiations on the problem of reparations owed by Germany after the first world war. These resulted in what became known as the Young Plan, which provided for a reduction (as compared with the earlier Dawes Plan) and also a "commercialization" of the annuities to be paid by Germany and made possible, moreover, the partial mobilization of these annuities through the issue of international loans. It was deemed necessary for the attainment of this purpose that an international organization should be set up possessing official status and at the same time sufficiently commercial in character to be independent of political considerations and able to work in direct contact with the financial markets.

It was therefore decided to create, under the name of "Bank for International Settlements,"\* an international bank to be founded by the principal central banks of the countries involved, whose permanent function would be to promote cooperation between central banks and to facilitate international financial settlements and to which could also be entrusted the task of executing the Young Plan as the agent of the governments concerned.

The Young Plan was officially accepted at the Conference held at The Hague in January 1930. The Plan contained a general description of the nature and functions of the international bank which was to be set up and the Annexes to the Hague Agreements included drafts of the bank's Charter and its Statutes, as well as other relevant documents. By virtue of a special Convention signed on the same day the Government of the Swiss Confederation undertook to grant to the BIS a Constituent Charter having force of law.† The next month the Governors of the founding central banks and representatives of an American banking group met in Rome and signed the instrument by virtue of which the BIS was constituted. The Bank began operations on 17th May, 1930.‡

\* Commonly referred to as "BIS" in English, "BRI" in French and Italian, and "BIZ" in German.

† The Governments of Belgium, France, Germany, Great Britain, Italy, and Japan signed the Convention with Switzerland. In 1951 the Japanese Government renounced all rights acquired by it under the Hague Agreements and in particular under the Convention concerning the BIS.

‡ The task of drawing up the final documents concerning the BIS, which were annexed to the Hague Agreements, was entrusted to an Organization Committee, which

The Charter of the Bank cannot be altered except with the agreement of all the parties to the Convention; and the same applies to the essential articles of the Bank's Statutes, which are annexed to the Charter. The registered office of the Bank is in the town of Basle. By virtue of its Charter the Bank possesses in Switzerland a special status guaranteed by an international agreement.

The BIS has a twofold task. Firstly, under Article 3 of its Statutes, the duty of the Bank is "to promote the cooperation of central banks and to provide additional facilities for international financial operations." The chief activity of the Bank consists therefore in the carrying-out of such banking operations as are requested by the central banks. The Bank's own operations on the various markets and any arrangements which it may make with private banks are merely accessory to its primary business with the central banks, and it is laid down that these dealings must always be such that they do not give rise to any objection on the part of the central banks.

Secondly, the Bank can under its Statutes "act as trustee or agent in regard to international financial settlements entrusted to it under agree-

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met in Baden-Baden from 3rd October to 13th November 1929 under the chairmanship of Mr. Jackson E. Reynolds. It was composed as follows:

Members designated by the central banks: Belgium: Mr. Louis Franck, Mr. Delacroix and later Mr. Paul van Zeeland; France: Mr. Clément Moret, Mr. Pierre Quesnay; Germany: Dr. Hjalmar Schacht, Dr. Wilhelm Vocke; Italy: Prof. Alberto Beneduce, Dr. V. Azzolini; Japan: Mr. T. Tanaka, Mr. S. Sonoda; United Kingdom: Sir Charles Addis, Sir Walter T. Layton. Co-opted members: United States: Mr. Jackson E. Reynolds, Mr. Melvin A. Traylor.

After the conclusion of the Hague Agreements and the signing, on 27th February 1930 in Rome, of the instrument by virtue of which the BIS was constituted, the members of the Board of Directors held two unofficial meetings in Basle on 22nd and 23rd April 1930. At these meetings note was taken of the Swiss law promulgating the Convention concerning the Bank for International Settlements and of the instrument signed in Rome. The Bank having thus been duly constituted, the first official meeting of the Board took place on 12th May 1930.

The original members of the Board of Directors were: Mr. Gates W. McGarrah, United States, Chairman; Sir Charles Addis, United Kingdom, Dr. Carl Melchior, Germany, Vice-Chairmen; Dr. V. Azzolini, Italy; Prof. Alberto Beneduce, Italy; Baron Brincard, France; Mr. Louis Franck, Belgium; Mr. Emile Francqui, Belgium; Mr. Leon Fraser, United States; Mr. Hans Luther, Germany; Mr. Clément Moret, France; Mr. D. Nohara, Japan; Mr. Montagu Collet Norman, United Kingdom; Mr. Paul Reusch, Germany; Mr. T. Tanaka, Japan; the Marquis de Vogüé, France. Alternates: Mr. Charles Farnier, France; Mr. H. A. Siepmann, United Kingdom; Mr. Pasquale Troise, Italy; Dr. Wilhelm Vocke, Germany; Mr. Paul van Zeeland, Belgium.

The following members were elected to the Board in May 1931: Mr. G. Bachmann, Switzerland; Mr. Ivar Rooth, Sweden; Mr. L. J. A. Trip, Netherlands.

Mr. Leon Fraser was the Alternate of the President; Mr. Pierre Quesnay, General Manager; Mr. Ernst Hülse, Assistant General Manager; Mr. Francis R. Rodd (later Mr. R. H. Porters), Manager; Mr. R. Pilotti, Secretary General; Mr. Marcel van Zeeland, Manager.

ments with the parties concerned." It was by virtue of this function that the Bank was originally entrusted with the technical execution of the Young Plan and subsequently assumed other duties, such as its present work in connection with the European Payments Union and the European Coal and Steel Community.

The Bank's capital was fixed at 500 million gold francs (one gold franc equals 0.2903 grammes of fine gold, or approximately one-third of a present United States dollar), this being the monetary unit of Switzerland at the time and the unit then often employed for various international settlements. This capital, which is divided into 200,000 shares, has been paid up to the extent of one-quarter, that is, 125 million gold francs, equal to about 41 million present United States dollars.

Initially the subscription of the capital was guaranteed in equal parts by five central banks: the National Bank of Belgium, the Bank of England, the Bank of France, the Bank of Italy, and the Reichsbank, and by two banking groups, one acting in the place of the Bank of Japan and another formed by three United States banks—J. P. Morgan and Company, the First National Bank of New York, and the First National Bank of Chicago. The other central banks were given the opportunity of subscribing to the capital of the BIS within a period of two years but owing to various circumstances, in particular the suspension of the gold standard in a great many countries, not all the European central banks took up shares. The European character of the Bank having been demonstrated in practice, even though this character is not legally defined, an amendment to the Statutes was made in 1950 authorizing the Bank to accept subscriptions of capital from further central banks. Now that Portugal, Ireland, Turkey, and Iceland have subscribed, the membership of the BIS consists of all the European central banks with the exception only of the State Bank of the USSR and the Bank of Spain. On the other hand, the shares held by the Japanese banking group were repurchased by those of the European central banks which were founder members.

The central banks had the option either of subscribing for the shares themselves or of offering them for subscription by the public on their respective markets. The great majority of the central banks did, in fact, choose to subscribe for the shares themselves and central banks now own three-quarters of the Bank's shares. Most of the shares of the American issue, all of which were originally sold on the United States market, have since been repurchased in Europe.\*

\* The Bank's shares are registered; the Bank is entitled to decline to accept any transferee of its shares and it may not give its assent to a transfer without the prior consent of the central bank concerned.

In order to ensure that the BIS shall always retain its essential character as a "central banks' bank," the Statutes contain a special provision making the rights of representation and of voting completely independent of the ownership of shares, these rights being exercised solely by the central banks of the countries in which the shares were originally subscribed. The central banks thus possess the voting rights on the entire share capital.

With the object of enabling the BIS to play its proper role in international affairs it has been given certain special advantages under the Hague Agreement and the Bank's Constituent Charter. The most important of these privileges is that the Bank, its property and assets and all deposits and other funds entrusted to it are immune in time of peace and in time of war from any measure such as expropriation, requisition, seizure, confiscation, prohibition or restriction of gold or currency export or import, and any other similar measures. Other governments, which were not signatories to the Hague Agreements, have by separate dispositions given a similar undertaking. In its relations with the U.S. Federal Reserve System and the U.S. Treasury the BIS enjoys the same status as do central banks and is thus able, for instance, to buy gold from or sell gold to the U.S. Treasury.

The BIS is administered by a Board of Directors, which elects a President and appoints a General Manager. Since 1948 the Chairman of the Board of Directors has also held the office of President of the Bank, and the General Manager has been the Alternate of the President. This arrangement ensures close and permanent liaison between the Board of Directors and those responsible for the technical management of the Bank. The Governors of the founding central banks are ex-officio members of the Board of Directors, which also includes members appointed by these Governors and of the same nationality as themselves (there being at present five such members appointed), together with members elected from among the Governors of the other central banks which are members of the BIS or of persons nominated by these Governors. In point of fact, the latter group have been up to the present the Governors of the central banks of the Netherlands, Sweden, and Switzerland, these countries possessing the most important money and capital markets after those of the founder banks and having participated in the issue of the Young Loan.\*

The United States monetary authorities have never taken up the seats on the Board of the BIS to which the original American subscription entitled them. For the periods 1930-1935 and 1940-1946, however, the

\* A list of the members of the Board of Directors may be found in each *Annual Report* of the Bank.

Board elected as President of the Bank persons of American nationality, and it has always appointed a New York bank to exercise at General Meetings the right of voting carried by the shares of the American issue. In addition, close personal contact is maintained between the principal officials of the BIS and officers of the U.S. Federal Reserve System. The Federal Reserve Bank of New York is the Bank's correspondent as regards the American market.

The Board of Directors of the BIS, which holds monthly meetings, determines the nature of the operations to be undertaken by the Bank under the provisions of its Statutes. The Bank may, in particular: buy, sell, exchange or hold gold for its own account or for the account of central banks; make advances to or borrow from central banks; discount, rediscount, purchase or sell, with or without its endorsement, bills of exchange and other short-term obligations of prime liquidity; buy and sell exchange; buy and sell negotiable securities other than shares; discount for central banks bills from their portfolio, and rediscount with central banks bills from its own portfolio. Further, the Bank may accept deposits from central banks on current or deposit account, government deposits in connection with special agreements, and such other deposits as, in the opinion of the Board, come within the scope of the Bank's functions.

On the other hand, the Bank is prohibited by its Statutes from issuing notes payable at sight to bearer, accepting bills of exchange, making advances to governments, acquiring a predominant interest in any business concern, or retaining ownership of any real property other than that necessary for the conduct of its own business. The Bank is required to pay particular attention to its liquidity.

The Statutes also stipulate that the operations of the BIS must be in conformity with the monetary policy of the central banks of the countries in question. Before carrying out an operation on any market or in any currency the BIS must give all the central banks directly concerned an opportunity to dissent. In the case of the United States the authority which has thus to be consulted is the Federal Reserve Bank of New York.

The BIS has no direct contact with the public. It has neither counters nor tills nor strong-rooms; its gold, its funds, and its securities are kept at the central banks which are its correspondents.

The BIS comprises a Banking Department, which carries out the banking operations, a Monetary and Economic Department, which does research and prepares the *Annual Report*, and a General Secretariat, which performs the administrative work. The staff is not large, consisting at present of some 150 employees and about 30 officials and heads

of section. Members of the staff, though presently consisting of persons of ten different nationalities, are selected for their individual qualifications and not as representatives of particular countries.

The BIS is, then, an international bank, and both "international" and "bank" deserve emphasis. It was founded by central banks which at one and the same time are its shareholders and customers and provide its directors. It has grown up as a truly *European* organization, although maintaining close technical relations with the American market. It is an official organization possessing a Charter guaranteed by international convention and enjoying certain special advantages.

But even so, the BIS is essentially a bank and needs to be mindful of its standing, the liquidity of its balance sheet, and the results shown by its profit and loss account. The BIS receives no instructions from any government, except when it is acting in the capacity of agent in the performance of some specific function, and it is not subsidized by any country. The methods which it employs are essentially commercial.

## II. EARLY OPERATIONS

The BIS owes a great debt to those wise men who, twenty-five years ago, drew up its Statutes. They made them simple and did not attempt to provide for every possible eventuality. While taking special care to formulate clearly and concisely the general aims, they left to the new institution a large measure of flexibility. The result has been that the Bank has been able to show a remarkable degree of adaptability in contending, as it has had to do from the very first years of its existence, with a series of extraordinary and unforeseeable developments.

When the Bank opened in 1930, the great depression had already begun. In May 1931 came the outbreak of the central European financial crisis. In July the execution of the Young Plan was suspended by the Hoover Moratorium. And in September the United Kingdom, followed by a considerable number of other countries, suspended the gold standard. The Bank's activities were profoundly affected by these events.

As already mentioned, one of the original tasks of the BIS was to cooperate in the carrying-out of the Young Plan, under which it was entrusted with the duty of receiving and distributing the reparation payments provided for in the Hague Agreements. During its first year of operation the Bank received and distributed in the agreed manner the monthly instalments paid by Germany. It acted, in addition, as agent in connection with the issue of the German Government International 5½% Loan 1930 (Young Loan), for the service of which it had agreed to perform the functions of trustee. This loan was placed on nine different markets and yielded in all a net amount of about the equivalent

of \$300 million. Under the Hague Agreements, one-third of this amount was received by the German Government and the remaining two-thirds went to six countries, creditors of Germany, which thus mobilized part of their reparations claims.

The duties of the BIS as trustee for the governments concerned were not confined, however, to the mere collection and distribution, in accordance with the Hague Agreements, of the payments made by Germany. Its function was much wider, for it was also to play an essential part in the execution of the Young Plan by setting up "machinery which will provide an elastic element between the payments to be made by Germany and their realization." It was, in particular, the task of the Bank to help to prevent a suspension of the transfers by granting direct aid to the Reichsbank in the form of foreign currency credits or by giving indirect aid through the investment in Reichsmarks of part of the annuity receipts on the German market in agreement with the Reichsbank. Thus, in order to ensure the regular flow of the transfers, the BIS was to influence the exchange markets by the purchase of Reichsmarks in periods of strain and by a reduction of its investments in Reichsmarks when conditions for transfer were more favorable.

It was left to the Bank itself to decide when and to what extent it ought to intervene, it being merely stated in the Young Plan that the Bank was to act within the limits of the funds at its disposal and with due regard to its liquidity. But the very freedom of action which was thus allowed made it a duty for the Bank to intervene actively in periods of difficulty, as far as its means permitted.

Since the entry into force of the Young Plan coincided with the beginning of the world crisis, the difficulties which arose soon became far greater than those associated with periods of temporary strain attributable to seasonal or other factors. The Bank's interventions in the form of purchases of Reichsmarks and of investments on the German market, although technically at short term, were in fact for an indefinite period, since the date of the termination of these operations depended on the German foreign exchange situation, except in the case of the amounts in Reichsmarks earmarked for the payment of reparations in kind, which were cancelled automatically as the deliveries took place.

When, in 1931, the financial crisis broke over Europe and through the Hoover Moratorium the machinery of the Young Plan was brought to a standstill as from 1st July, the BIS, having acted in conformity with the obligations imposed upon it, had invested on the German market an amount corresponding to the long-term deposits which had been placed at its disposal by the various Creditor Governments for this purpose, as

well as a portion of its own funds.\* At an international conference which was held in London in July 1931, the Governments of Belgium, France, Germany, Great Britain, Italy, Japan and the United States recommended that the volume of credits already granted to Germany should be maintained. In conformity with this recommendation, the Bank's investments on the German market were left undiminished and were subsequently reduced only by the amounts earmarked for the payment of reparations in kind as the deliveries were made.

The total amount of the Bank's investments in Germany, which had been as high as 444 million gold francs (equal to about 148 million present United States dollars) in June 1931, had by the end of 1932 been reduced to about 300 million gold francs (about 100 million present United States dollars), and it has remained almost unchanged at that level ever since. A definitive settlement of these investments and the long-term deposits of the governments, which were also made under the Hague Agreements, should take place in 1966 under an arrangement concluded in 1953 between the Bank and the Federal Republic of Germany, a brief outline of which is given in Section IV below.

From 1931 onwards, the BIS took an active part in the attempts which were made to counteract the effects of the financial crisis.

The International Conference which met in London in July 1931 recommended, *inter alia*, that the BIS should set up a committee of experts to enquire into the immediate credit requirements of Germany and the possibility of consolidating part of the short-term credits already granted to that country. The committee convened by the Bank was composed of representatives appointed by the central banks of Belgium, France, Germany, Great Britain, Italy, Japan, the Netherlands, Sweden and Switzerland and by the Federal Reserve Bank of New York. It held its meetings in Basle and its report was issued in August 1931.

Moreover, at the Committee's invitation, representatives of German private banks and of private banks of other countries also met in Basle, and on 17th September 1931 a first Standstill Agreement was concluded, covering six months' short-term banking credits to Germany. At the same time, at the request of the contracting parties, the BIS appointed an Arbitration Committee, which was entrusted with the task of settling

\* Under the Hague Agreements and the Trust Agreement annexed thereto the amounts due to the governments which were creditors under the Young Plan were credited to Trust Accounts opened for them in the books of the BIS. These governments were required to leave in their Trust Accounts a certain minimum amount as an interest-free long-term deposit. The German Government for its part was to make a similar deposit equal in amount to fifty percent of the deposits of the Creditor Governments. Since 1931 the aggregate amount of these minimum long-term deposits has stood at the equivalent of 229 million gold francs (equal to about 76 million present U.S. dollars).