

## BEYOND PRIVATE AUTHORITY: SHARED AUTHORITY IN THE CREATION OF THE BANK FOR INTERNATIONAL SETTLEMENTS

This article examines the creation of the Bank for International Settlements (BIS) during a period of international financial instability in the late 1920s. It challenges the conventional wisdom that the existence of private authority in the global financial system is a relatively recent phenomenon. While countless studies have detailed how globalization has caused a shift in power away from states toward markets, including what I call ‘shared authority’, this change is associated almost exclusively with structural changes in the distribution of power among states and between states and market actors since the 1970s. However, analysis of the founding of the BIS demonstrates quite clearly that prominent features of the international financial system in the late 1920s-- e.g., a high degree of institutionalization (and legitimacy) of private participation in global financial governance; a widespread belief in market-based solutions to financial market problems; the blurring of the line demarcating the public and private spheres of activity; and, finally, the influence of private norms on public norms—were also salient features of the global financial system in the early 21<sup>st</sup> Century. Thus, analysis of the BIS’s founding offers important insights not only into different types of institutional innovation during times of systemic crisis, but also into patterns of state-market interaction in governing global finance.

**Key words:** Bank for International Settlements, (global) financial regulation, bank regulation, private authority, central banks, state-market relations

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“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.<sup>1</sup>

- 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.

## 1. Introduction

Recent scholarship has investigated new patterns and agents of change in the regulation of the global financial system since the emergence of financial globalization in the early 1970s.<sup>2</sup> Studies have identified ample evidence of market actors exercising greater power and authority in the setting of rules and standards by which the global financial system is governed.<sup>3</sup> While global financial integration has largely been encouraged by states, powerful market players have greatly influenced the shift in recent decades from a state- to market-led system for regulating global finance, even in setting international standards.<sup>4</sup> 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. Broadly, this article challenges the conventional wisdom that private authority in the global financial system is a relatively recent phenomenon caused by structural changes in the distribution of power among states and between states and market actors stemming from globalization of finance since the 1970s.

Historically, states have been presumed to be the sole source of authority in the international system. Consequently, the fields of International Relations and Economic History have had strong state-centric biases. However, in recent decades, there has been a more obvious and growing disconnect between empirical evidence and academic treatment of authority in international affairs. Stud-

<sup>1</sup> Jackson Reynolds, “Summary of Conversation of 25 October, 1929,” J.P. Morgan Papers, Pierpoint Morgan Library (PML), Box 178. Also see Morgan to Young, October 25, 1929, J.P. Morgan Papers, PML, Box 178/3.

<sup>2</sup> Stijn Claessens, Geoffrey R.D. Underhill, and Xiaoke Zhang, “The Political Economy of Basle II: The Costs for Poor Countries,” *The World Economy*, 31(3) (2008), pp. 313-344; and Susanne Soederberg, *The Politics of the New International Financial Architecture: Reimposing Neoliberal Domination in the Global South* (London: Zed Books, 2004).

<sup>3</sup> Benjamin J. Cohen, Cohen, *International Political Economy: An Intellectual History* (Princeton: Princeton University Press, 2008).

<sup>4</sup> Michael King and Timothy Sinclair, “Private Actors and Public Policy: A Requiem for the New Basel Capital Accord,” *International Political Science Review*, 24 (July 2003), pp. 345-362.

ies have shown nonstate 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.”<sup>5</sup>

Much of the literature on the state conceptualizes sovereignty in terms of control, or the ability of states to control activities within and across national frontiers.<sup>6</sup> Defining sovereignty in terms of authority, Janice Thompson developed the concept of “meta-political authority,” arguing 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.”<sup>7</sup> Yet, the primary shortcoming of this and other rationalist interpretations of authority in the international political economy is their tendency to view authority as a relative 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 so many to over-emphasize the role of states in shaping outcomes in the international system. Instead of presuming that authority is monopolized by states, this study simultaneously employs its relative and absolute dimensions. Even though states have historically monopolized 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 of the BIS demonstrates that theoretical gains about institution-building at the international level and about 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 is attempting to conceptualize the emergence of nonstate actors in international affairs. Some have pointed to the existence of

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<sup>5</sup> 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.

<sup>6</sup> 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.

<sup>7</sup> Janice Thompson, “State Sovereignty in International Relations: Bridging the Gap Between Theory and Empirical Research,” *International Studies Quarterly*, 39 (1995), pp. 214.

“private authority.”<sup>8</sup>To this, one may add the notion of “shared authority” among state and nonstate actors over a particular political, economic or social function or process. States, as Thompson asserts, may even possess “ultimate authority.” But insofar as states defer to or consult with private-sector actors in devising public policies or effecting desired outcomes in markets, such behavior itself attests to the existence of private authority. 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 and right.

Shared authority among state and market actors is particularly observable in the area of banking and finance. Historically, commercial banks have regularly been central to the process of rescheduling government debt.<sup>9</sup> In addition, state behavior often reinforces the market 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.”<sup>10</sup> The role of private-sector actors in reaching a “final and complete settlement to the German debt problem,” which resulted in the proposal to create the BIS, is one glaring case in point.

This article analyzes the creation of the BIS, a remarkably understudied subject compared to organizations like the International Monetary Fund and the World Bank.<sup>11</sup> In her seminal article on its founding, 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.”<sup>12</sup> According to this approach, “the impulse to innovate...flows from the structural inability of states

<sup>8</sup> 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*.

<sup>9</sup> Susan Strange, “Territory, State, Authority and Economy: A New Ontology of Global Political Economy,” in Robert W. Cox (ed.) *The New Realisms: Perspectives on Multilateralism and World Order* (Tokyo: United Nations Press, 1997), p. 9.

<sup>10</sup> Hall and Biersteker, “The Emergence of Private Authority in the International System,” p. 6.

<sup>11</sup> For exceptions, see Simmons, “Why Innovate? Founding the Bank for International Settlements,” *World Politics*, 45 (April 1993), 361-405; 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).

<sup>12</sup> Simmons, “Why Innovate?,” p. 362.

to make credible commitments under anarchy.”<sup>13</sup> Also, the costs of enforcement and default to citizens of creditor states force governments to consider 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.”<sup>14</sup> 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.<sup>15</sup>

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 private bankers played such a prominent role in designing and organizing the world’s first and oldest international financial institution.<sup>16</sup>

Do the vested interests of private creditors 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 realist and rationalist bargaining models 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 view. The evidence shows this approach to be inadequate. By introducing ‘shared authority’ as a concept, it is possible not only to explain why governments complied with private bankers’ normative appeals to take leadership roles 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.<sup>17</sup> Only by placing the creation of the BIS in a longer historical

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<sup>13</sup> Ibid., p. 372.

<sup>14</sup> Ibid., p. 373.

<sup>15</sup> Ibid., p. 400. In this article, 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.

<sup>16</sup> Ibid., p. 373.

<sup>17</sup> Paolo Baffi, *The Origins of Central Bank Cooperation: The Establishment of the Bank for International Settlements*. Historical Publications of the Bank of Italy. Rome, Laterza & Figli.; Barry Eichengreen, *Golden Fetters: The Gold Standard and the Great Depression*,

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 actors performed public functions by proposing and designing new international institutions.<sup>18</sup>

## 2. 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.<sup>19</sup> 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 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.<sup>20</sup> 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.<sup>21</sup> 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

1919-1939 (New York: Oxford University Press, 1995); Simmons, esp. pp. 361-364; and Costigliola.

<sup>18</sup> Craig N. Murphy, *International Organization and Industrial Change: Global Governance Since 1850* (New York: Oxford University Press, 1994), particularly pp. 1-10.

<sup>19</sup> Only eighteen central banks existed by 1900. See Forrest Capie, "The Evolution of Central Banking," in *Reforming the Financial System: Some Lessons from History* (Cambridge: Cambridge University Press, 1997).

<sup>20</sup> 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.

<sup>21</sup> BIS, HA, Fraser to Reynolds, May 30, 1930, 7.18(2), MCG7/49.

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.”<sup>22</sup> In short, before World War I there was a well-established norm of private actors regularly performing public functions, particularly in fostering and regulating financial and industrial development and promoting the international expansion of the regulatory role 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. 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.<sup>23</sup> 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.”<sup>24</sup>

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.<sup>25</sup> 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

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<sup>22</sup> Murphy, pp. 48-49.

<sup>23</sup> Frank C. Costigliola, “Anglo-American Financial Rivalry in the 1920s,” *The Journal of Economic History*, 37 (December, 1977), p. 911; Eichengreen, *Golden Fetters*, pp. 127-28.

<sup>24</sup> See Louis W. Pauly, *Who Elected the Bankers? Surveillance and Control in the World Economy* (Ithaca: Cornell University Press, 1997), p. 35.

<sup>25</sup> 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).

achieved, by forces entirely divorced from politics, through “the healing power of assistance of private finance and commerce.”<sup>26</sup>

Many trace the origins of central bank cooperation to the BIS’s founding.<sup>27</sup> But as Charles Kindleberger points out, central bank cooperation predated the BIS.<sup>28</sup> A considerable amount of coordinated international financial assistance occurred before 1930, by central banks and private individuals like the Rothschilds, 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 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.<sup>29</sup> Bankers particularly wanted to economize gold movements by developing an international clearing union predicated on nondiscrimination, convertibility and symmetry in adjustment obligations between surplus

<sup>26</sup> Herbert Hoover to Benjamin Strong, August 30, 1921, Herbert Hoover Papers, Herbert Hoover Presidential Library, Box 284, cited in Costigliola, p. 912.

<sup>27</sup> This view is espoused by a number of publications by one-time BIS officials. See Paolo Baffi and the BIS, Fn. 17; 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).

<sup>28</sup> Charles Kindleberger, “Introduction,” in Paolo Baffi and BIS, pp. xxv-xxxiv.

<sup>29</sup> Stephen V. O. Clarke, *The Reconstruction of the International Monetary System: The Attempts of 1922 and 1923* (Princeton: Princeton University, 1973), pp. 4-18.



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 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.<sup>30</sup>

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 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

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<sup>30</sup> Eichengreen, *Golden Fetters*, pp. 9-12.

state” in the international arena.<sup>31</sup> Central banks typically collaborated with prominent internationalist-minded financiers to develop, as in the case of the BIS, a more coherent global financial system. 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.<sup>32</sup>

### 3. 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.<sup>33</sup> 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 American banker Charles G. Dawes, was created to resolve this problem. It deferred part of Germany’s reparations

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<sup>31</sup> Pauly, p. 35. Also see, Jeffry Frieden, *Banking on the World: The Politics of American International Finance* (New York: Harper & Row, 1987), esp. chs. 1-2.

<sup>32</sup> 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).

<sup>33</sup> 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).

obligation and reduced its debt service payments.<sup>34</sup> 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 reorganize its central bank under Allied supervision and earmark money from transportation, excise, and custom taxes for reparations payments.<sup>35</sup> Initially, the Dawes Plan was successful, as it “unleashed a wave of foreign lending by the United States that inundated international financial markets for the next four years.”<sup>36</sup> Yet as lending to Germany decreased, its annual payments became unbearable.<sup>37</sup> 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.<sup>38</sup> Finally, in late 1928, Agent General for War Reparations S. Parker Gilbert persuaded creditor governments to restart German reparations negotiations.<sup>39</sup> 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 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

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<sup>34</sup> The Dawes Plan set Germany’s annuity at RM2.5 billion.

<sup>35</sup> The Reparations Commission employed over 150 foreign agents in Berlin.

<sup>36</sup> Eichengreen, *op. cit.*, pp. 150-51.

<sup>37</sup> 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 *ibid.* p. 151

<sup>38</sup> 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 “The Bank for International Settlements: Committee of Experts Report (Part 6),” June 7, 1929, J. P. Morgan Papers, PML, Box 179/5; “Course of the Proceedings,” [no date] J. P. Morgan Papers, PML, Box 179/5; Simmons, p. 364.

<sup>39</sup> 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.

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.<sup>40</sup> 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.*<sup>41</sup>

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 foreign currency potentially overlapped with similar central bank operations.<sup>42</sup> 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 loyal

<sup>40</sup> 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.

<sup>41</sup> Addis to Norman, October 31, 1929, Addis Papers, ADM16/1, Bank of England Archives.

<sup>42</sup> Leffingwell to Morgan and Lamont, March 12, 1929, J. P. Morgan Papers, PML, Box 178/3.

to central banks.<sup>43</sup> 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 post-war reconstruction costs and debts. Inter-Allied debts amounted to an astounding sum of \$26 billion. As debt 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.*<sup>44</sup>

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. The second was the decision to support the creation of the BIS. Saddled with reparations payments,

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<sup>43</sup> 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 Jacobsson Diaries, November 4, 1956, *Hanschriftenabteilung*, Basel University Library, NL 324, A I 110.

<sup>44</sup> *Foreign Affairs*, February 1929, p. 79.

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 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.<sup>45</sup>

#### 4. German reparations and the BIS from the perspective of the United States, Britain, France, and Germany

This section will begin with an analysis of various American parties involved in the creation of the BIS.

##### 4.1. The 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.<sup>46</sup> 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."<sup>47</sup> The BIS also promised social and political benefits, as some European bankers had hoped that the BIS would help ease their "vexing...social questions."<sup>48</sup> The American bankers plainly announced the BIS in United States as "a powerful barrier against the spread of Bolshevism."<sup>49</sup>

<sup>45</sup> 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.

<sup>46</sup> See footnotes 1, 44, 68, and 91.

<sup>47</sup> Morgan to Young, October 25, 1929, J. P. Morgan Papers, PML, Box 178/3. 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), Leon Fraser (First National Bank of New York), Thomas Perkins (Boston banker), Walter Burgess, Dean Jay, Shepard Morgan, David Sarnoff, and Walter Stewart.

<sup>48</sup> Morgan and Lamont to J. P. Morgan and Company, March 11, 1929, Lamont Papers, 178/18, in Frank C. Costigliola, *Awkward Dominion: American Political, Economic, and Cultural Relations with Europe, 1919-1933* (Ithaca: Cornell University Press, 1984), p. 211.

<sup>49</sup> Owen D. Young Speech, June 11, 1929, 462.00R296/3000, Record Group 59, United States National Archives, cited in *Ibid.*, p. 211.

European central and private bankers clearly understood that a profit-making BIS would guarantee the unimpeded participation of the American financial community.<sup>50</sup> 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.<sup>51</sup> European bankers even repeatedly criticized the New York bankers for their profit motive.<sup>52</sup> 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."<sup>53</sup>

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 between the Federal Reserve System and the BIS.<sup>54</sup> 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."<sup>55</sup> 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.<sup>56</sup> 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

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<sup>50</sup> 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, *op. cit.*, p. 381.

<sup>51</sup> Simmons, *ibid.*, p. 381.

<sup>52</sup> *Ibid.*, p. 381.

<sup>53</sup> Memo, "Notes on the Capital of the Bank," March 13, 1929, BIS file, FRBNY, 797.3. 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."

<sup>54</sup> "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 Memo, "The Bank for International Settlements and the Federal Reserve Bank of New York," FRBNY, BIS file, 797.3.

<sup>55</sup> Memo, "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, BIS file, FRBNY, 797.3,

<sup>56</sup> *Ibid.*; Harrison to Moreau, August 13, 1929, BIS file, FRBNY, 797.3; Harrison to Schacht, August 13, 1929, Harrison Papers, FRBNY, 3013; Burgess to Harrison, July 25, 1929, BIS file, FRBNY, 797.3.

Settlements will have to be in or with this market.”<sup>57</sup> 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.<sup>58</sup> 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 the lines of those established with other banks of issue throughout the world.”<sup>59</sup> It did, however, agree to keep key agencies in Washington abreast of developments in its relations with the BIS.<sup>60</sup>

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.”<sup>61</sup> Consequently, it insisted that all BIS transactions affecting the New York market be made with its consent.<sup>62</sup> 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.”<sup>63</sup> As regards the location of the BIS, the FRBNY chose not to take a position.<sup>64</sup>

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 prevailing inter-Allied arrangements.<sup>65</sup> 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

<sup>57</sup> Memo, “Views and Comments,” *op. cit.*, p. 2.

<sup>58</sup> 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.

<sup>59</sup> Memo, “Views and Comments,” *op. cit.*, p. 2.

<sup>60</sup> Memo, “J. E. Crane to Files,” by J. E. Crane, February 27, 1930, BIS file, FRBNY, 797.2.

<sup>61</sup> Memo, “Views and Comments,” *op. cit.*, p. 3.

<sup>62</sup> Burgess to Harrison, July 25, 1929, BIS file, FRBNY, 797.3.

<sup>63</sup> Harrison to Moreau, August 13, 1929, BIS file, FRBNY, 797.3; Harrison to Schacht, August 13, 1929, BIS file, FRBNY, 797.3; Memo, “Views and Comments.”

<sup>64</sup> Harrison to Moreau, *op. cit.*, fn. 56.

<sup>65</sup> Young to Kellogg, October 26, 1928, J. P. Morgan Papers, PML, Box 178/3; Young to Kellogg, January 2, 1929, J. P. Morgan Papers, PML, Box 178/3.



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.<sup>66</sup> 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."<sup>67</sup> The American bankers had grand visions for the BIS, including its ascendance to a position as the leading player in the international bullion market.<sup>68</sup>

American banker Jackson Reynolds 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."<sup>69</sup>

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<sup>66</sup> Stimson to Young and Morgan, April 8, 1929, J. P. Morgan Papers, PML, Box 34/5; Young to Hoover, Stimson and Mellon, April 10, 1929, J. P. Morgan Papers, PML, Box 34/5; and Jon Jacobson, *Locarno Diplomacy*.

<sup>67</sup> Morgan to Young, October 25, 1929, J. P. Morgan Papers, PML, Box 178/3.

<sup>68</sup> *Ibid.*; Lamont from Leffingwell, May 16, 1929, J. P. Morgan Papers, PML, Box 178/4; Memo, "Summary of Conversation of 25 October, 1929," J. P. Morgan Papers, PML, Box 178.

<sup>69</sup> For an record of the meetings of the Organization Committee, see "Typed Notes," [No Author or Date], J. P. Morgan Papers, PML, Box 178/3.

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.<sup>70</sup> For it, the primary functions of the BIS were “politico-financial” in nature. Moreover, the FRBNY predicted that British influence would be prominent on the Board of Directors.<sup>71</sup> 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,<sup>72</sup> 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.*<sup>73</sup>

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.”<sup>74</sup> For the United States’ part, the degree of private authority was considerable.

#### 4.2. 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. For starters, unlike the Bank of England, the British

<sup>70</sup> Memo, “Observations Suggested by The Bank for International Settlements [hereafter “Observations”],” by Foreign Information Division, July 12, 1929, BIS file, FRBNY, 797.3, p. 1.

<sup>71</sup> Ibid., p. 1.

<sup>72</sup> 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.

<sup>73</sup> Memo, “Observations,” *op. cit.*, p. 2.

<sup>74</sup> Memo, “The Bank for International Settlements and the Central Banks,” June 27, 1929, BIS file, FRBNY, 797.2, p. 10.

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.<sup>75</sup> 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.<sup>76</sup> 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.<sup>77</sup> 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 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

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<sup>75</sup> Memo, "German Reparations," November 14, 1931, BIS file, Bank of England Archives, 61/451.

<sup>76</sup> Simmons, *op. cit.*, pp. 386-90.

<sup>77</sup> 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, *ibid.* p. 385.

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.”<sup>78</sup>

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’ profit motives with regard to the BIS,<sup>79</sup> 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.<sup>80</sup>

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.<sup>81</sup> 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.<sup>82</sup> 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

<sup>78</sup> “Fourth Draft of the Bank Plan,” March 5, 1929, BIS file, Bank of England Archives, G1/451.

<sup>79</sup> 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, *op. cit.*, p. 381.

<sup>80</sup> “Observations,” *op. cit.*, fn. 70, pp. 7-8.

<sup>81</sup> Jeremiah Smith Jr. to Lamont, Sept. 9, 1929, BIS file, FRBNY, 797.3.

<sup>82</sup> Leading British private-sector representatives included: Sir Charles Addis (banker), Lord Revelstroke (Barings and Brothers), Walter Layton (Editor, *The Economist*).

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 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.<sup>83</sup> Above all, the British Treasury opposed the BIS because "it establishes uncontrolled financial autocracy of Central Bankers ... and with authority to fix their powers."<sup>84</sup>

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.<sup>85</sup> The American bankers adamantly opposed any link between the two institutions and made their support for any commercialization scheme contingent on this.<sup>86</sup> 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.

#### *4.3. 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

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<sup>83</sup> "The B.I.S.: Criticisms by R. G. Hawtrey," July 27, 1929, B.I.S., Bank of England Archive, 667/2; R. G. Hawtrey, "International Clearing House," BIS file, Bank of England Archive, 667/2.

<sup>84</sup> Smith Jr. to Lamont, op. cit., fn. 81.

<sup>85</sup> Gilbert to Young and Lamont, Sept. 10, 1929, BIS file, FRBNY, 797.3.

<sup>86</sup> Ibid.

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 post-war 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.<sup>87</sup> 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 Boche 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.<sup>88</sup>

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

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<sup>87</sup> Barry Eichengreen, *Globalizing Capital: A History of the International Monetary System* (Princeton: Princeton University Press, 1996), pp. 29-30.

<sup>88</sup> 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.

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 Plan would further complicate the international payments system.<sup>89</sup> 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."<sup>90</sup> 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.<sup>91</sup> Accordingly, France demanded the first BIS president be an American with a private financial stake in avoiding the Young Plan's collapse.<sup>92</sup> 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. The location of the BIS in Basel, "a neutral city of German language," also motivated this request.<sup>93</sup>

Most opposition to the BIS in France came from Socialists who wanted to 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.<sup>94</sup> 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.

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<sup>89</sup> Moreau to Young, November 29, 1929, BIS File, FRBNY, 797.3.

<sup>90</sup> Simmons, p. 392.

<sup>91</sup> 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.

<sup>92</sup> Moreau to Young, fn. 89.

<sup>93</sup> *Ibid.*

<sup>94</sup> The Young Plan included transfer protection for Germany by dividing its annuities into two categories, a transferable and non-transferable portion.

## 4.4. 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.<sup>95</sup> 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.<sup>96</sup> 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 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.<sup>97</sup>

The idea of creating a new international bank was roundly criticized by Germans of different professional and political backgrounds.<sup>98</sup> When towards the

<sup>95</sup> Eichengreen, *Golden Fetters*, p. 127.

<sup>96</sup> The main architects of Germany’s reparation policy were Rudolf Hilferding, Hermann Müller, Hjalmar Schacht, and Karl Stresemann.

<sup>97</sup> Jon Jacobson, *Locarno Diplomacy: Germany and the West, 1925-1929* (Princeton: Princeton University Press, 1972), p. 257. US 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.

<sup>98</sup> 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.



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 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.<sup>99</sup>

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."<sup>100</sup> 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 Germans were not experiencing difficulties in securing short-term credits.<sup>101</sup> Unable to create credit by issuing notes, the BIS would have a minor effect on expanding the volume of

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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. In Norman to Harrison, September 3, 1929, BIS file, Federal Reserve Bank of New York Archive (FRBNY), 797.2, Bank of England Governor Montagu Norman writes of "widespread criticism of the Bank for International Settlements here."

<sup>99</sup> For a survey of critical German economic opinion of the BIS, see "Memo," by Dr. Hjalmar Schacht, [No Date], BIS file, FRBNY, 797.2; 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; Memo, "Germany and the Bank for International Settlements," by the Foreign Information Division, February 19, 1930, BIS file, FRBNY, 797.2.

<sup>100</sup> Schacht, "Memo."

<sup>101</sup> *Ibid.*

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.<sup>102</sup> 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.<sup>103</sup> 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 France's short-term holdings in Germany.<sup>104</sup> 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.<sup>105</sup> 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.<sup>106</sup>

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<sup>102</sup> 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.

<sup>103</sup> Jacobson, *Locarno Diplomacy*, p. 262. This finding is based on a study of German cabinet protocols.

<sup>104</sup> Paul Einzig, *Behind the Scenes of International Finance*.

<sup>105</sup> 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.

<sup>106</sup> 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.

## 5. 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 central bankers or governments, but rather complemented the regulatory objectives of central banks and treasuries.

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 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.<sup>107</sup> 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

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<sup>107</sup> 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.

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 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.<sup>108</sup> 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.<sup>109</sup>*

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.<sup>110</sup> Further complicating matters, the support of the broader American financial community depended in large measure on the participating American bankers', especially Morgan's, attitude 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,<sup>111</sup> 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

<sup>108</sup> Christian Science Monitor, January 14, 1929.

<sup>109</sup> Morgan to Stimson, Mellon and ?, March 19, 1929, J. P. Morgan Papers, PML, Box 34/5.

<sup>110</sup> "Typed Notes," [No Author or Date], J. P. Morgan Papers, PML, Box 34/5.

<sup>111</sup> London joined New York as the second most important center for the sale of these bonds.

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.<sup>112</sup>*

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, 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

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<sup>112</sup> Morgan to Reynolds, Morgan Papers, PML, October 29, 1929, Box 34/5.

was compounded by American, British, and French creditors' fears that Germany would default on its loans and obligations to pay war reparations.<sup>113</sup>

The authority of American bankers in German debt negotiations was also a function of the geographic nature of the problem of German reparations. Post-war 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:

*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.*<sup>114</sup>

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."<sup>115</sup> 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.

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<sup>113</sup> 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.

<sup>114</sup> Gilbert to Young and Lamont, Morgan Papers, PML, Sept. 10, 1929, Box 34/5.

<sup>115</sup> "Past Consideration of the Question [of BIS Membership], 1929-30," Foreign Information Division, FRBNY, BIS file, 797.3.

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 also shaped its ultimate form.

## 6. 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 bankers were formidable, authoritative forces in international financial affairs.

Still, although private bankers' exercise of 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 the bank's 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.

To understand the historical development of international financial organization in the BIS, it is necessary to underscore just how far its architects went to institutionalize private-sector participation in the regulation of international finance. For example, membership on the Board of Directors and management was not limited to central bankers, dispelling the popular perception of the BIS as the "central bankers' central bank." Whereas Article 27 of the BIS Statutes vests 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 Board of Directors is 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 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 private sector, typically in the form of a leading banker from each country. This characteristic of the BIS is critically important, for it demonstrates how central bankers at the time of the BIS's founding viewed private bankers as possessing technical financial authority that deserved representation in the BIS, the world's first "world bank." 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 BIS represented the extension internationally of the regulatory role of the state in the world economy.

While the Keynesian model took center-stage at Bretton Woods, its victory was by no means complete. The BIS not only survived the war and the United States Treasury's attempt to liquidate it; it became the vehicle for the European Payments Union that inaugurated European integration. Moreover, over the subsequent half century, the BIS increasingly became the place where central



and private bankers met to coordinate their management of the international economy, and this has even more so as global finance has evolved over the past decade and a half. Given most states' acceptance of the independence of central banks from elected governments in recent decades, and the continuing close links between central banks and major financial firms, the age of private authority may yet be far from over.

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