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Central Bank Cooperation 1930-1932, A Reappraisal¹

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Abstract

The literature on interwar monetary history has argued that the lack of central bank cooperation contributed to the pervasive economic outcome of the 1930s. The reasons for this failure are still an object of debate. In this paper, we revisit the attitude of individual central banks to the attempts led by the Bank for International Settlements (BIS) to institutionalise central bank cooperation. We present original archival evidence to show that the 1931 crisis in central Europe emerged as an exogenous shock, prompting the BIS to become an international lender of last resort and increase the resources at its disposal. However, the BIS relied on member central banks' discretionary behaviour and did not impose a rules-based system. We observe a contrasting attitude towards international cooperation between central banks from creditor and borrowing countries. Some governments prevented their central banks from supporting the BIS' attempts to increase its financial resources. We conclude that this interference was a relevant means through which politics hindered a multilateral response to the crises of the 1930s.

JEL codes: E50, F33, G01, N14, N44, N24

Keywords: central banking, Great Depression, financial crises, international monetary cooperation.

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Historically, international cooperation has been crucial in maintaining the stability of the world's monetary system. Today's central banks are in constant communication and have conceived a cooperative framework through the existence of short- and medium-term agreements that facilitate the exchange of information, promote the coordination of monetary policies, and foster the central banks' capacity to intervene during turbulent periods. International Financial Institutions (IFIs), such as the Bank for International Settlements (BIS) and the International Monetary Fund (IMF) have materialised this willingness to cooperate in a more ambitious and multilateral approach. In the most recent periods of financial distress, central banks and IFIs have occupied a prominent role in averting higher damage to the world's real economy.

Unfortunately, international monetary cooperation has frequently fallen short of expectations. History has shown rather that episodes of central banks' cooperative behaviour have been the exception rather than the norm. This paper analyses the shortcomings of international cooperation during the onset of the Great Depression. We show how certain governments and central banks hindered the efforts of the BIS to institutionalise an emerging multilateral framework of central bank cooperation and to develop its role as an international lender of last resort (ILOLR). At the height of the banking and currency crises of the 1930s, central banks were unable to collaborate on a systematic and regular basis and provide mutual assistance.

According to Eichengreen, the interwar period's failures stand in sharp contrast to the pre-1914 period, when cooperation amongst central banks emerged as the keystone of the successful gold standard regime.² Nevertheless, this distinction has been criticised by other economic historians.³ As underlined by Harold James, it was the 1920s and not the prewar gold standard period that gave birth to the modern pattern of central bank cooperation.⁴ While before 1914 central bank cooperation was exceptional and limited to periods of crisis, during the 1920s central bankers' relationships became increasingly frequent and systematic.

The question that naturally arises, and yet has never really been properly addressed, concerns the reasons behind the incapacity or unwillingness of central banks to face the financial meltdown of the 1930s. A consensus in the literature characterises the embryonic central bank cooperation of the 1920s as flimsy, thus succumbing to the Great Depression and to the succession of banking crises that shuttered Europe in 1931⁵. Until now historians have claimed that central

² Eichengreen, *Golden Fetters*.

³ For critiques on central bank cooperation during the pre-1914 gold standard period see Mouré, 'The Limits to Central Bank Co-Operation, 1916–36'; Flandreau, 'Central Bank Cooperation in Historical Perspective'.

⁴ James, *International Cooperation and Central Banks*, 2013; James, 'International Cooperation and Central Banks', 2016.

⁵ Chandler, *Benjamin Strong, Central Banker*; Clarke, *Central Bank Cooperation, 1924-31*; Eichengreen, *Golden Fetters*; Borio et al., *Past and Future of Central Bank Cooperation*.

bank cooperation reached its apex in 1927. At that time, and as a consequence of the Long Island summit, the Federal Reserve Bank agreed to cut the rediscount rate to relieve pressure on the British balance of payments. Furthermore, the French and German central banks agreed to refrain from implementing any kind of policy that could have temporarily weakened sterling.⁶

Scholars have identified three factors that limited central bank cooperation thereafter. A first personal reason was the passing of Benjamin Strong, the charismatic chair of the New York Federal Reserve Bank in 1928. His international profile stood in sharp contrast to the more domestic stance of his successor, George Harrison. The second factor was of a political nature. Some central banks lacked autonomy from their respective governments, leading them to prioritise national rather than global interests (Clarke 1967). Furthermore, rivalries between the Banque de France—which emerged as a major actor in the arena of central bank diplomacy in the late 1920s—and the Bank of England, triggered a number of disputes over the leadership of the cooperation process. This resulted in a fragile basis for collaboration.⁷ The third factor was the persistence of bilateral and 'ad hoc' relationships between central banks and the failure to institutionalise a standard cooperation process⁸.

While all these factors might have contributed to the failure of international cooperation, we still do not know how these factors interacted, and why the process of institutionalisation that began in the late 1920s was not fulfilled. In this paper, we focus on the breakdown of cooperation as embodied in the early history of the BIS. The literature has described the BIS' experience as singularly ineffectual given the financial rivalry amongst the core countries' central banks, the lack of experience of central bankers as crisis managers, the limited resources of the institution, and the central bankers' sacerdotal faith in the gold exchange standard.⁹ More importantly, previous literature has emphasized the BIS' poor performance as an international lender of last resort during the 1931 banking crisis, when both the timing and the scale of BIS emergency loans proved to be largely inadequate.¹⁰

⁶ Eichengreen, *Golden Fetters*; Cooper, 'Almost a Century of Central Bank Cooperation'.

⁷ Kindleberger, *The World in Depression, 1929-1939*; Mouré, 'The Limits to Central Bank Co-Operation, 1916-36'.

⁸ Eichengreen, *Golden Fetters*.

⁹ See, for example, Clarke, *Central Bank Cooperation, 1924-31*; Kindleberger, *The Politics of International Money and World Language*; Eichengreen, *Golden Fetters*; De Cecco, 'Central Bank Cooperation in the Inter-War Period: A View from the Periphery'; Baffi, *The Origins of Central Bank Cooperation*; Borio and Toniolo, 'One Hundred and Thirty Years of Central Bank Cooperation: A BIS Perspective'; Singleton, *Central Banking in the Twentieth Century*; James, 'International Cooperation and Central Banks', 2016; Bordo and Schenk, 'Monetary Policy Cooperation and Coordination'.

¹⁰ Toniolo and Clement, *Central Bank Cooperation at the Bank for International Settlements, 1930-1973*, pp. 113-14.

These arguments are at odds with the fact that central banks' reciprocal credits reached a historical peak in 1931.¹¹ Furthermore, focusing on the volumes of the BIS loans overlooks other significant problems rooted in the institutional design of the BIS which strongly limited the set of interventions that this institution could mobilise. From our perspective, the arguments about the BIS failure emerge from an anachronistic perspective on its institutional functions. Using new archival material from major central banks and the BIS, this paper demonstrates that the role of the BIS as an international lender of last resort was *not* envisaged in 1930 when the BIS was supposed to fulfill multiple roles, including acting as a clearing house, an advisory body and a reparation agent.¹² When the Austrian banking crisis erupted in May 1931, the BIS attempted to transform itself into a different type of organisation.¹³ However, the BIS maintained a discretionary-based cooperation framework and never imposed hard rules on the funds to be deposited in its coffers. A major claim of this paper is that the BIS lacked the necessary instruments to deal with the crisis and did not obtain the support from governments to endow it with greater ammunition. In fact, while central banks agreed with the BIS' proposal to expand its financial resources, their lack of autonomy hindered them from increasing the amount of the reserves deposited at the BIS. These deposits were the main funds that the BIS utilised to support central banks facing banking and currency crises.

Our historical narrative focuses on the instruments set up by the BIS that were designed to foster cooperation between central banks and limit the effects of the 1931 financial crisis aiming at fostering cooperation between central banks and contain the effects of the 1931 financial crisis.¹⁴ The great bulk of the BIS' international actions were devoted to stabilisation loans while a new set of tools was being conceived which aimed to facilitate credit to the private sector via central banks and provide medium-term credit to the agricultural sector. Nevertheless, during the height of the

¹¹ According to Ilzetzi, Reinhart, and Rogoff, 'Rethinking Exchange Rate Regimes', p. 14., reciprocal credits between central banks exceeded 3 % of United States GDP in 1931.

¹² According to BIS Statutes (art. 22) the BIS was allowed to: buy and sell gold coin or bullion for its own account or for the account of central banks; buy and sell securities and other instruments either for central banks or for its own account; make short-term advances to, or borrow from, central banks; open current accounts with central banks and accept their deposits; act as a central bank's agent or, in extraordinary cases, act as its own agent, and, most importantly, act as a trustee in connection with international settlements. See Bank for International Settlements, 'Charter and Statutes of the Bank for International Settlements; Committee Organizing Bank for International Settlements Completes Labors; Charter Signed by Delegates; Basle, Switzerland, Chosen as Site for the Bank'. See also Clement, 'Institutionalizing Central Bank Cooperation: The Norman-Schacht Vision and Early Experience of the Bank for International Settlements, 1929-1933'.

¹³ The fact that BIS officials never viewed their institution as an international lender of last resort was confirmed in its 1935 annual report, which stated that the extension of emergency loans between central banks was "spectacular evidence of central bank inter-relationship, nevertheless these exceptional measures, though useful, do not constitute the real kernel of central bank collaboration, which is or should be evident in continuous and daily practice rather than as an emergency manifestation". See Bank for International Settlements, 'Fifth Annual Report'.

¹⁴ About the importance of the instruments of central bank cooperation see Bordo and Schenk, 'Monetary Policy Cooperation and Coordination'; Bordo, Monnet, and Naef, 'The Gold Pool (1961–1968) and the Fall of the Bretton Woods System'. for an overview.

crisis from June until September 1931, the BIS struggled to fortify and institutionalise its international lender of last resort role and to use its power by prompting member central banks to increase the portion of their foreign exchange reserves at the BIS' disposal.

We provide evidence from new and original archival material that shows that the BIS' effectiveness as international lender of last resort (ILOLR) was jeopardised by the fact that some central banks' attitudes were driven by domestic interests dictated by their own governments, rather than by a disposition to engage in an institutionalised process of reciprocal assistance. This evidence is based upon central banks' reserves and monthly BIS balance sheets which allows us to identify individual central banks' attitudes towards the BIS' successive proposals. We focus particularly on the BIS Special Account, a fund that was intended to provide financial support to central banks facing currency and banking crises. We find that central banks from creditor countries were unwilling to increase the reserves deposited at the BIS, while central banks from borrowing countries were more inclined to cooperate. Our archival research shows that central banks refused to participate in the Special Account, citing a variety of reasons including economic and institutional factors. We also observe governments' influence on certain central banks' decisions. The most relevant central banks remained sceptical and only participated reluctantly.

The paper is organised as follows. In the next section we present a brief literature review on the history of international monetary cooperation in the interwar period and on the history of the BIS as an international organisation. In Section II we analyse how central bank cooperation was perceived by contemporaries and show that the secondary literature has overlooked the press' positive assessment of the BIS in the early 1930s. We emphasise how the BIS' perception of itself as an international lender of last resort evolved after its establishment and how the Credit-Anstalt crisis prompted the BIS to accelerate its transformation. In Section III we describe the main BIS foundations. highlight the different arrays of technical financial arrangements it built up in order to reach its targets, and the evolution of the financial resources the BIS had at its disposal. Section IV describes the setting up of the BIS Special Account and focuses on the reasons why some central banks refused to participate. Section V concludes.

I

The crisis that erupted in Austria in May 1931 became a turning point in the history of the Great Depression. It started with the failure of the Credit-Anstalt, a major commercial bank based in Vienna. Its fall had effects on other Central and Eastern European countries, including

Germany, Hungary, Yugoslavia and Romania.¹⁵ The literature on these crises has emphasised the parsimony with which central banks intervened in countries under financial distress. This crisis led governments to introduce exchange controls starting with Germany and Hungary but which would eventually affect other countries including Britain and ultimately triggered its abandonment of the gold standard.¹⁶

A major bone of contention is the role of international cooperation and the lack of an international lender of last resort. The capacity of the BIS to function in this role has been described as a failure by generations of scholars. For instance, Kindleberger argued that after the Austrian crisis of May 1931, "the niggardliness of the sum [of the BIS credit] and the delay together proved disastrous."¹⁷ Other authors agree, arguing that the BIS was at least somewhat to blame for the central European financial crisis of mid-1931 and, by implication, the spreading of the Great Depression. While James claimed that "the major failure of the BIS was the mishandling of the Austrian Crisis",¹⁸ Eichengreen defined the BIS' interventions as "singularly ineffectual."¹⁹

In this paper, we provide a more nuanced perspective on the BIS' experience and analyse the reasons for its limited capacity to intervene in the countries affected by the 1931 crisis. We distinguish two contrasting stages of institutional building. A first, and rather successful, stage was the founding of the BIS, while a second "downfall" stage concerns its constricted adaptation to the circumstances of the early 1930s. According to the literature on international organisations, certain factors may favour the birth of new institutions while others act as obstacles to their transformation. Among the first set of factors, the establishment of a new institution stems from states' desire to make credible commitments allowing for mutually beneficial cooperation that could not be sustained without it.²⁰ Simmons utilised dynamic contracting theory to show the rationale behind the BIS' creation.²¹ She emphasised the convergence of interests between creditor and borrowing governments —particularly with regard to Germany's debt obligations— but also those

¹⁵ The historiography of each crisis has led to an abundant literature. The Credit Anstalt crisis and the international efforts to mitigate its international effects can be found in Aguado, 'The Credit Anstalt Crisis of 1931 and the Failure of the Austro-German Customs Union Project'; Macher, 'The Austrian Banking Crisis of 1931'; Marcus, *Austrian Reconstruction and the Collapse of Global Finance, 1921-1931*. and (Schubert 1991). For Germany, see Schnabel, 'The Role of Liquidity and Implicit Guarantees in the German Twin Crisis of 1931'; Ritschl, 'The German Transfer Problem, 1920–33', and more recently Straumann, *1931, Debt, Crisis, and the Rise of Hitler*. For Hungary, see Macher, 'The Hungarian Twin Crisis of 1931'. For Yugoslavia, see Jevtic, 'Gold Rush'.

¹⁶ Accominotti, 'London Merchant Banks, the Central European Panic, and the Sterling Crisis of 1931'; Accominotti, 'International Banking and Transmission of the 1931 Financial Crisis'.

¹⁷ Kindleberger, *The World in Depression, 1929-1939*, p. 131.

¹⁸ James, *The End of Globalization*, p. 65.

¹⁹ Eichengreen, *Golden Fetters*, p. 295. Also Schubert, *The Credit-Anstalt Crisis of 1931*, p. 163 stated that the BIS and other international agencies' story as lenders of last resort was "ultimately one of failure".

²⁰ Martin, 'International Institutions'.

²¹ Simmons, 'Why Innovate?'

of central banks and private financiers, all of which shared the common goal of capital and currency market stability. In this regard, it is perhaps unsurprising that the BIS' foundation was achieved in such a brief period as compared to post-World War II international institutions.²²

The BIS' second, "downfall" stage took place almost simultaneously. The onset of the 1931 crisis tested the BIS' capacity to adapt to new circumstances and its attempt to act autonomously, thereby lowering the transaction costs in the implementation of multilateral monetary policy decisions. Scholars in international relations have shown that certain factors may impede the transformation of multilateral organisations while others may accelerate it. Kapur posits that international institutions are inherently sticky and change occurs only gradually over longer periods of time.²³ On the other hand, the sources of change can be endogenous—due for instance to institutional learning—or exogenous, such as a natural disaster or a financial crisis. As we will show below, institutional stickiness did not appear to be a major impediment to the BIS as the institution did not operate under a hard-law regime. On the contrary, the 1931 crisis led to accelerated changes regarding the tools to which the BIS could resort to support central banks in distress.

Another factor impeding the transformation of international organisations is domestic politics. However, this is at odds with the fact that international cooperation in monetary issues was supposed to be isolated from politics. Current literature on central banking has recognised that central bank independence facilitates central bank cooperation when monetary authorities share a common understanding of economic and financial matters.²⁴ In this regard, the literature defines cooperation as an operational concept related to the gathering and dissemination of information, the sharing of data, and the best central banks' practice with the unique and final goal of setting some common ground of action and enhancing the functioning of the international financial system.²⁵

Domestic politics can also have an influence on the level of commitment to cooperation. In accordance with this, scholars have differentiated cooperation (low commitment) from coordination (high commitment), which requires not only the sharing of general information, but also the unanimous application of rules and common standards.²⁶ Both cooperation and coordination are preconditions for the establishment of a multilateral agency charged with the goal

²² The protocol of Agreement of the International Monetary Fund (IMF) went into effect on 27 December 1945. Nevertheless, there were no IMF lending programs in the first seven years after its creation. See Horsefield et al., *The International Monetary Fund*; De Vries, *The IMF in a Changing World, 1945-85*.

²³ Kapur, 'Processes of Change in International Organizations'.

²⁴ Irwin, *The Alchemists*.

²⁵ See Cooper (2009) for an overview.

²⁶ Frankel (2015) and Bordo and Schenck (2016) highlighted the differences between coordination and cooperation.

of providing liquidity to central banks during financial crises. As we shall see, these characteristics can be found in the BIS' debates on international cooperation.²⁷ However, a major difference between today's cooperation concepts and those raised by the BIS was the role attributed to an ILOLR. While an ILOLR occupies a major role in today's concept of international cooperation, it did not lie at the core of the first debates on the BIS and would only emerge in the aftermath of Austria's banking crisis of May 1931. The BIS' incapacity to act as an emergency lender as the crisis erupted was directly related to the influence of governments in the decision to cooperate. Eleonor Dulles emphasised the diversity of the institutional design of central banks, some of which have been coopted by their governments.²⁸ As we show below, the outcome of governments' influence on central banks' capacity to cooperate was twofold. One was governments' vetoing of additional resources to be at the BIS disposal as the crisis unfolded. A second, indirect effect was the unpredictability that this scheme generated in other central banks' actions, thereby complicating the BIS' coordination potential. We describe these dynamics in the rest of the article.

II.

Contrary to the "failure" perspective on the BIS' management of the crisis, contemporary views on the BIS' interventions were rather positive, in particular regarding its first crisis-time intervention in Austria. During the weeks that followed the issue of the first BIS loan to the Austrian central bank, the verdict of international financial newspapers was generally positive. To quote but some of them, on June 18 1931 *The Times* commented that the BIS had acted with "foresight and capacity" and had lost "no time in supporting the Austrian National Bank."²⁹ The *Wall Street Journal* indeed praised the BIS for avoiding a financial disaster and for having "satisfactorily cleaned up" the Austrian banking crisis³⁰. By the beginning of August, when the crisis had already affected Hungary, Germany and other European countries, *The Economist* commented that the BIS had "undoubtedly done much" to tackle the turmoil and the Bank in Basel gave proof of its power to act "wholeheartedly and decisively in a major financial and economic emergency."³¹ Even by 1932, Eleonor Dulles' book about the first year of the BIS reckoned that "the quick and efficient arrangement of credits" to central banks of Austria, Hungary and Germany was an "outstanding contribution" of the Basel based bank³².

²⁷ See, for example, the BIS First Annual Report (1931, pp. 6-7).

²⁸ Dulles, *The Bank for International Settlements at Work*.

²⁹ "The Austrian Crisis", *The Times*, June 18, 1931.

³⁰ "Situation in Austria", *Wall Street Journal*, June 5 1931.

³¹ "The Exchange Crisis", *The Economist*, August 8 1931.

³² Dulles, *The Bank for International Settlements at Work*, p. 478.

It is difficult to reconcile these statements with the historical narrative prevailing in the historiography of the 1931 crisis. Clarke might be the only historian to have adopted a more benevolent stance, stressing the fact that the 1931 financial crack was completely different from previous crises so "authorities had no previous experience by which to guide themselves."³³ Other historians have also underscored the innovative character of the BIS' experience. The BIS was the first historical attempt to institutionalise the cooperation between central banks.³⁴ It was different from the kind of central bank cooperation that emerged in the 19th century which favored bilateral or ad hoc financial assistance aimed at handling monetary crises and sustaining the international monetary regime.³⁵ Borio and Toniolo (2005) described the BIS' experience as a proto IMF support scheme and a novelty. Toniolo and Clement (2005) suggest that the BIS materialised a long-term initiative (initially attributed to Luzzati) on the need to establish an international central bank that could provide emergency liquidity in times of crisis³⁶.

In this regard, we could also add that the role of an ILOLR inside a cooperation scheme was a pioneering one at the beginning of the 1930s and thus its institutional design needed to be finetuned.³⁷ A brief overview of the internal debates on the BIS' role as an ILOLR is illuminating. The first proposals raised during the middle of 1930 suggest that in general, the BIS' architects perceived that an international crisis would be an improbable event. Nevertheless, the introduction of precautionary measures was not entirely precluded. Pierre Quesnay, former Head of the Bank of France's economic research service and general manager of the BIS, proposed outlining the informal rules which would have guided the BIS' actions as an ILOLR as early as July 1930. According to Quesnay, in the case of economic seasonal fluctuations —a situation described as typical for European peripheral countries— the available resources at the disposal of the BIS would have been considered sufficient to deal with those kinds of economic slumps. The abnormal requirements of foreign exchange may have threatened the monetary stability of the country. Given that in the case of a structural crisis the sums involved might be so large as to 'exceed the normal

³³ Clarke, *Central Bank Cooperation, 1924-31*, p. 185.

³⁴ See Clement, 'Institutionalizing Central Bank Cooperation: The Norman-Schacht Vision and Early Experience of the Bank for International Settlements, 1929-1933'. for an overview.

³⁵ See Kindleberger, *Manias, Panics and Crashes*; Eichengreen, *Golden Fetters*; Flandreau, 'Central Bank Cooperation in Historical Perspective'.

³⁶ Italian economist and former Ministry of Treasury Luigi Luzzati, in 1907 was the first to envisage how a formal cooperation between central banks may have fulfilled the role of an ILOLR. See Luzzati, 'Une conférence internationale pour la paix monétaire'.

³⁷ According to Grossman, Richard and Rockoff (2016) the ILOLR idea grew up and spread amongst central bankers and economist only after the publication of Ralph George Hawtrey's book "The Art of Central Banking" in 1932.

capacity of the BIS', a special cooperation agreement between the BIS, the associated central institutions and private banks would be of 'paramount importance'.¹³⁸

Across the channel, similar reflections on the BIS' role as an ILOLR were taking place. In January 1931 Harry Siepmann, a member of the Bank of England's Central Banking Department, agreed with Quesnay on the implausibility of a great financial crisis in Europe. However, Siepmann also struck a cautionary note, claiming that in case of necessity "it may still be worthwhile" to consider what the role of the BIS should be if it were approached by central banks in case of serious trouble with private credit institutions within their area.³⁹ According to Siepmann's memorandum, such a danger was limited to capital importing countries. In those places, the struggles of a single and more important credit institution might have been exacerbated by the bulk of foreign lenders withdrawing their short-term credits, hence causing a general spreading of distrust from one bank to others.

How would the BIS react in those kinds of situations? The memorandum clearly stated that "new short-term borrowing in order to replace withdrawn credits would be just as impossible as the sale of securities, public or private, to foreign investors."⁴⁰ Moreover, Siepmann emphasised that central banks within debtor countries might not have at their disposal sufficient foreign exchange to repay the short-term indebtedness of private banks. Siepmann concluded that a solution would have been to ask for support from the BIS.

While Quesnay's and Siepmann's proposals were different in terms of technical implementation as well as final goals, a precondition for the realisation of such central banks' networks—centred around the BIS—lay in the setting up of the appropriate machinery for this purpose. In both cases, the first step was the collection of information about the composition of central banks' reserves and the short-term indebtedness of banks and bankers in every country. Thereafter, it would be mandatory that the BIS would be backed up with a sufficient amount in financial resources to face future potential crises. As we show below, the BIS' institutional design became a dynamic process which accelerated with the onset of the 1931 crisis.

III.

³⁸ Pierre Quesnay "Memorandum on the discussion held the 18th July 1930 dealing with some questions of cooperation between central banks", BIS Archive (BISA), Leon Fraser and McGarrah Papers.

³⁹ Bank of England Archive (BoEA), Country Files: Austria OV28. File No. 3, Supplement 1: Note dated 22 January 1931 prepared by 'CB'. The note is unsigned, but it is likely that Harry Siepmann was the author. See also Cottrell, 'Norman, Strakosch and the Development of Central Banking: From Conception to Practice, 1919-1924'.

⁴⁰ Ibid.

This section reviews how the BIS' institutional framework was designed and details the main features under which the BIS was expected to operate. According to Article 3 of its statutes, the Bank for International Settlements (BIS), aimed to "promote the cooperation of central banks and provide additional facilities for international financial operations".⁴¹ However, in 1930 these concepts were vaguely delineated at best. The famous British financial journalist Paul Einzig gave a harsh verdict on the kind of cooperation the BIS was eager to implement. In particular, he criticised the BIS for being "at once too informal and too vague in character" and for offering a casual, "clumsy" and "too vague an interpretation" of the goals and instruments of cooperation.⁴²

This set of discretionary agreements underlying the first of the BIS' activities did not entirely hamper more ambitious steps towards the establishment of an institutional framework supporting central bank cooperation. Member central bankers agreed on the common standards of the time (i.e. gold standard adherence) and concurred that the next level of cooperation involved the gathering and sharing of member banks' data. The foundation of the Central Banking Department at the BIS followed this target.⁴³ This unit oversaw the collection of member central banks' statistical information, a duty which was highly prioritised. By January 1931, the BIS' general manager, Leon Fraser, claimed with some self-complacency that "the array of statistics which the Banking Department is gathering is considerable."⁴⁴

Nevertheless, the next step involved the definition and implementation of a common line of action, a slower and more complex process. Many BIS members conceived central bank cooperation solely in terms of financial assistance. In this regard, it could be argued that the BIS promoted a continuity to the practices already in place during the nineteenth century when central bank cooperation mainly took the form of financial support to a given country with the aim of tackling a monetary crisis and sustain the international monetary regime.⁴⁵ However, the novelty of central bank cooperation, as compared to the pre-World War I period, was the handing out of several central banks' stabilisation loans whose main goal was to establish a new international monetary order rather than maintaining an old one. The main tasks targeted by central banks

⁴¹ The statutes of the BIS are reproduced in Bank for International Settlements, 'Charter and Statutes of the Bank for International Settlements; Committee Organizing Bank for International Settlements Completes Labors; Charter Signed by Delegates; Basle, Switzerland, Chosen as Site for the Bank'.

⁴² Einzig, *The Bank for International Settlements*, p. 22. Baffi, *The Origins of Central Bank Cooperation*. provides a thorough description of the negotiations leading to the foundation of the BIS, revealing how each central bank had its own idea of cooperation

⁴³ The Central Banking Department of the BIS was in charge of collecting member central banks data on: gold policy (reserves, sale and purchase of gold, gold points); foreign exchange policy; discount policy; advances against collateral and open market policy. See "Suggested Program for Central Banking Department", February 23, 1931. BISA, Fraser and McGarrah Papers.

⁴⁴ "Leon Fraser. Note for Mr. Rodd", January 14, 1931. BISA, Fraser and McGarrah Papers.

⁴⁵ See Kindleberger, *Manias, Panics and Crashes*; Eichengreen, *Golden Fetters*; Flandreau, 'Central Bank Cooperation in Historical Perspective'.

included the regeneration of currency parities under a gold exchange standard scheme, achieving price stability and fostering the mobility of international capital.⁴⁶

While the BIS actively took part in the stabilisation loans scheme, its institutional capacity to consolidate its creditor role was directly conditioned by the financial resources at its disposal.⁴⁷ Figure 1 shows the sources from which the BIS could enlarge its funds. It depicts the liabilities' side of the BIS' balance sheet. The four main categories were the BIS' own capital, the long-term deposits left in its custody under the Hague Agreements, the 'Treasuries' funds left as BIS deposits through their central banks (central banks for accounts of others), and the money deposited at the BIS by member central banks for their own account.⁴⁸ Since the money related to the debt agreements was not subject to any notable variation unless a new reparation schedule had been made, the great bulk of the BIS' financial resources hinged on the will of central banks to share part of their reserves with the new institution. In short, the BIS' capacity to expand its powers and its resources became conditional on central banks' eagerness to allocate part of their reserves to the new institution.

<Figure 1 around here>

During the BIS' early days, the institution required central banks to deposit an unspecified portion of their reserves to complement the capital which was made up by the shares. While the amounts that each central bank effectively transferred to the BIS depended upon several factors, one way to interpret them is as a rough indicator of each central bank's willingness to cooperate through this multilateral framework. Archival evidence confirms that this interpretation was also the one prevailing among BIS staff members. So, for instance, as early as November 15, 1930, McGarrah pointed out to Vincenzo Azzolini, the Governor of the Bank of Italy, that "if public and other central banks" observed a steady increase of central banks deposits in Basel, they "must realize that the bank is really and instrumentally for work in the field of cooperation other than those of the debt payments."⁴⁹

⁴⁶ See Clarke, *Central Bank Cooperation, 1924-31*; Meyer, *Banker's Diplomacy*; Eichengreen, 'Central Bank Cooperation under the Interwar Gold Standard'; Eichengreen, 'Central Bank Co-Operation and Exchange Rate Commitments'; De Cecco, 'Central Bank Cooperation in the Inter-War Period: A View from the Periphery'; Cottrell, 'Central Bank Co-Operation and Romanian Stabilisation, 1926-1929'; Mouré, 'French Money Doctors, Central Banks, and Politics in the 1920s'. and Schuker, 'Money Doctors between the Wars'; Toniolo and Clement, *Central Bank Cooperation at the Bank for International Settlements, 1930-1973*.

⁴⁷ The BIS participated in the stabilisation loans granted to Yugoslavia, Portugal and Latvia. For details see BISA, "Stabilization of Various Currencies", Box 6.11, 1930-1935.

⁴⁸ BISA, Monthly Balance Sheet.

⁴⁹ "McGarrah to Azzolini", Basle November 10, 1930, BISA, Leon Fraser and McGarrah Paper. On this point see also Toniolo and Clement (2005, p. 73).

Table 1 displays the amounts of the deposits that member central banks maintained at the BIS in three different months between December 1930 and June 1931. These amounts are represented as ratios to the foreign exchange reserves held by central banks. Table 1 is divided between creditor and borrowing countries as defined by the BIS.⁵⁰ Within each group, the countries are ordered according to the respective ratio values in June 1931. The last column specifies whether foreign exchange reserves were legally required for covering the money supply. Certain central banks, such as France's and Great Britain's, did not require holdings of foreign exchange (gold was therefore the main reserve asset), but opted to keep them as "extra reserves". In this regard, those central banks had a wider margin to transfer their extra reserves to the BIS than others.

<Table 1 around here>

Table 1 shows that the willingness to cooperate was extremely variable. Among creditor countries, France was the country least prone to cooperate, while Sweden stands as the only country which transferred a significant part of its reserves to the BIS (about 28%). All others maintained their ratios between 1 and 8%. Among borrowing countries, these figures were even more diverse, even if the majority of them kept deposits at the BIS that exceeded 10% of their foreign exchange holdings. Greece maintained its high cooperative status in June 1931, followed by Hungary, Poland and Austria. The fact that some central banks utilised foreign exchange as legal cover to its monetary supply does not emerge as a differentiating element in the amounts of BIS deposits.

Even if most central banks gradually increased their deposits at the BIS, Table 1 also proves that these amounts were not stable over time and were affected by different factors. A first factor was the central banks' reserve positions. Central banks facing economic crises or balance of payments disequilibrium and reserve losses could decide to withdraw their deposits. This might have been a reason why there were severe drops among these figures, particularly in countries experiencing serious banking crises (i.e. Hungary, Yugoslavia and Germany). We delve into this question in the next section. Here we present a preliminary piece of evidence on the relationship between each central bank's level of reserves and the amounts of its BIS deposits. We correlated the ratio of BIS deposits to central banks' foreign exchange holdings and the central bank's reserve ratio, computed as the ratio between total reserves and central banks' notes. In principle, central banks with higher reserve ratios should have been those with higher BIS deposits. Figure 2 shows that this was not the case, suggesting that willingness rather than capacity to cooperate lay behind central banks' attitudes. Most central banks whose reserve ratios were above 80% transferred less

⁵⁰ Creditor countries were defined as those with the highest volumes of central bank reserves, and which were net exporters of capital (both short and long term). See BISA 3/12 "Opening by B.I.S. of Special Account for maintenance of Gold Standard of various currencies", June 1931- August 1931.

foreign exchange to the BIS, the sole exception being Sweden. On the contrary, most of the central banks with the lowest ratios, such as those from Czechoslovakia and Greece, largely exceeded their uncooperative counterparts.⁵¹

<Figure 2 around here>

Another relevant factor were the incentives offered to central banks to transfer a portion of their foreign exchange to the BIS. Central banks were active managers of their own reserves and their decisions were dependent upon risk and profitability criteria, thereby triggering the BIS' debates on its own deposit strategy. Quesnay recognised, for instance, that central banks throughout Europe had acquired a "taste for profit yielding reserves" since the general adoption of the gold exchange standard.⁵² Consequently, several European central credit institutions left part of their funds in commercial banks based abroad for the sole reason of obtaining higher interest rates.⁵³ In February 1931, Fraser confessed to the Italian central bank governor Beneduce, that the BIS was working towards "encouraging central banks to keep a substantial portion of their reserves with us."⁵⁴

The determination of the interest rates to be offered by the BIS was a major issue given their impact on the amount and choice of currencies that central banks would decide to deposit. Furthermore, the BIS' interest rate policy also attempted to encourage the movement of funds from high-liquidity markets (with lower interest rates) to other, low-liquidity markets.⁵⁵ Therefore, the BIS introduced a uniform interest rate for all deposits irrespective of the currency, even if they varied according to the deposits' maturity.⁵⁶ The BIS recognised that even if such a policy created certain exchange risks for the institution, they were limited as long as participating countries remained on the gold standard.⁵⁷ Nevertheless, staff members challenging such a one-rate policy

⁵¹ An illustrative case was the Bank of Netherlands, when McGarrah directly asked for an increase in deposits. He proposed directly to Dr Bruins, governor of the Bank, to increase their funds in Basel since even central banks of small countries like Greece and Yugoslavia had "more deposits than your Bank". See BISA, McGarrah to Dr. Bruins, 6 February 1931, Leon Fraser and McGarrah Paper.

⁵² "Note of M. Quesnay's Conversation in London on 27 to 29 of January 1931", BISA Leon Fraser and McGarrah Paper, 6 February 1931.

⁵³ Idem. It will be useful to bear in mind that the BIS offered a uniform rate of interest (*taux unique*) for all currencies on a gold basis.

⁵⁴ Leon Fraser to Beneduce, 23 February 1931, Bank of Italy Archive (AIBIT), Carte Beneduce.

⁵⁵ On this aspect see "Remobilization of time deposits" and "Remobilizing of fixed term deposits" both written by BIS official Marcel Von Zeeland in September 1930, in BISA Leon Fraser and McGarrah Papers, September 1930.

⁵⁶ Differences in deposits' maturities were not accompanied by high variations in interest rates. In October 1930, for instance, the range laid between 2% for sight deposits and 2 ¾% for fixed-term deposits exceeding 3 months. This range declined thereafter, established at 1 ¼% and 1 ¾% respectively in June 1931. See BIS "Rates paid on deposits by the B.I.S.", BISA Leon Fraser and McGarrah Papers, 24 July 1931.

⁵⁷ "Uniform rate", November 2, 1933. BISA George Rayot Papers 79-78. This rate was determined according to the average yields obtained on the BIS' own investments. "Les dépôts à la BRI et la question des taux d'intérêt, Annexe XI/H", 18 May 1931. BISA George Rayot Papers.

were concerned that rate uniformity might have reduced the possibility of obtaining deposits in the currencies from countries that were paying higher interests.⁵⁸

While we can only speculate on the impact of interest rates on deposits at the BIS, we can provide evidence of the arbitrage activities of central banks, suggesting that central banks could have increased the amounts of deposits denominated in currencies where interest rates were considerably lower than those offered by the BIS. However, information on the currency composition of central banks' deposits is difficult to obtain. We could find the complete figures for two specific months (August and November 1930), and partially retrieve them for a third one (April 1931). We used this information to link them with interest rate movements in New York and London occurring between those benchmark months, given the reserve status of the dollar and the pound sterling.⁵⁹ Increases in the spreads between the rates in New York (or London) and those offered by the BIS should be accompanied by a decline in the relative weight of the dollar (or pound) in total deposits.

In the interval between the first two months reported, rate movements were minimal. The BIS maintained its rate at 2.75% for 3 months deposits. In August, New York's market rate stood at 1.75% (spread with the BIS was thus 1%) while in London the same rate was reported at 2.25% (spread with the BIS was 0.5%). In November, market rates slightly increased to 1.875 in New York (spread with the BIS decreased to 0.875%) and fell to 2.18 in London (spread with the BIS rose to 0.57%).⁶⁰ These movements should have been accompanied by a decline in dollar deposits and an increase in sterling deposits.

Table 2 suggests that arbitrage was taking place. It displays the currency composition of the BIS' deposits and their total amounts in both months. As expected, central banks mostly made their deposits in US dollars, followed by pounds sterling and, far behind, French francs and other currencies. These figures corresponded to the aim of the BIS' policy, as rates in New York were lower than those offered by the BIS —central banks could profit from arbitrage— while the difference with those prevailing in London was minimal (the arbitrage profit was not as appealing as the one obtained through US dollar deposits). Deposits in most other currencies were difficult to attract, as market rates in their respective countries were higher than those offered by the BIS, thereby imposing a cost on central banks.⁶¹

⁵⁸ See "Deposits with the BIS and the question of interest rates. Confidential", May 15, 1931 in BISA 1/19 a. Banking Policy of the BIS. Granting by BIS a single rate of interest on Deposits in Various Currencies, 1.5.1931-31.05.1931.

⁵⁹ See "Deposits received from central banks and others position as on August 30th 1930" in BISA, McGarrah and Fraser Papers and "Deposits received from central banks and others position as on November 30th 1931" in BISA, McGarrah and Fraser Papers.

⁶⁰ Data from the Federal Reserve Bulletin.

⁶¹ For instance, the Federal Reserve Bulletin (December 1930) reported a private discount rate of 5.5% in Italy, 3.24% in Germany and 4-4.25% in Austria.

<Table 2 around here>

Table 2 includes the total amounts of each central bank's deposits in both months (all figures converted to US dollars). The upward trend observed in these amounts was accompanied by a corresponding decline in the dollar shares in most cases —as rates in New York increased— suggesting that rates could have had an impact on currency composition even if total deposits seem to have been less affected. Not surprisingly, central banks increasingly favoured deposits in pounds sterling —market rates in London having declined— as demonstrated by the higher proportion of sterling deposits in November. However, we do not observe similar trends for French francs and other currencies.

Interest rate movements are more relevant when we compare November 1930 and April 1931. Between both months, market rates fell in New York to 1.5% and increased to 2.58% in London. Most importantly, the BIS decreased its rate to 2.25%. The spread between the BIS rate and the one in New York declined to 0.75%.⁶² In contrast, the corresponding figure for London led to a spread of -0.33% (the rate in London being higher than the BIS' rate). In principle therefore, we should have observed a general move to dollar deposits at the BIS in between both months.⁶³ This, in fact, is what we observe. Figure 3 reveals the absolute increase in US dollar deposits at the BIS. Apart from Poland, other countries raised their deposits.

<Figure 3 around here>

This overall picture suggests that central banks were more concerned with arbitrage opportunities than with cooperative behaviour. A final argument could be made about whether the deposits' currency composition merely reflected the composition of central banks' own reserves. To verify whether this was the case, we compared data on the currency composition of central banks' reserves which we have for the first half of September 1931 on the eve of the sterling crisis, with the deposits sent to the BIS in November 1930 — the last month for which we have complete information— assuming that the currency composition should have been roughly the same. Figure

⁶² The BIS reported that on April 1931, rates were Reichsmark 4.69% Florins 0.94% Swiss Franc 0.24% Lire 3.59% "Banking Policy of the BIS. Granting by BIS of a single rate of interest on Deposits in Various Currencies, 1.5.1931-31.05.1931". Confidential. BISA 1/19a, May 1931.

⁶³ As BIS officials underscored in May 1931, when "the effective rate for sterling rose above the rate offered by the BIS, an appreciable decline in the deposits denominated in sterling was immediately observed". See "Banking Policy of the BIS. Granting by the BIS of a single rate of interest on Deposits in Various Currencies, 1.5.1931-31.05.1931". Confidential. BISA 1/19a, May 1931.

4 presents this comparison. The US dollar proportion of BIS deposits in November 1930 was higher than its proportion in the reserves in September 1931, suggesting that central banks were conducting arbitrage, albeit acknowledging that the reserves' composition might have changed in 1931. Nevertheless, certain countries behaved differently, including Germany, Hungary, Sweden and Yugoslavia. This last country did not transfer any US dollars to the BIS.

<Figure 4 around here>

IV.

A major argument made by scholars on the BIS' failure was its incapacity to increase the financial resources at its disposal.⁶⁴ This section analyses the reasons behind central banks' refusals to grant the BIS more ammunition. It is noteworthy that before the onset of the 1931 crisis, the BIS' policy about the amount of foreign reserves to be deposited by central banks remained completely discretionary. Some preliminary efforts were undertaken by the BIS' governors to build a cooperative framework based on rules with different initiatives being attempted before the Credit-Anstalt crisis. An illustrative example is the one raised by Dr. Huelse of the BIS' Banking Department in March 1931. He drafted a new plan according to which the BIS might have accepted foreign exchange not only from central banks but also from private banks.⁶⁵ In May, Pierre Quesnay suggested that the participating central banks should agree to hold a predetermined minimum proportion of their foreign exchange reserves at the BIS (a ten per cent figure was suggested). Even if the goal of Quesnay's plan was to end up transforming the BIS into an international clearing organisation, the plan for centralising reserves and facilitating transferability became of paramount importance during the Austrian crisis.⁶⁶

As the effects of the Credit-Anstalt crisis were fully underway, a second project was presented by Harry Siepmann at the beginning of June 1931. Its main goal was to increase the BIS' intervention capacity. Recapitulating the main events leading to the crisis in May, Siepmann placed a particular emphasis on the role of central bank cooperation. While he acknowledged that the role played by the BIS as crisis manager was "overall beneficial", Siepmann emphasised how current circumstances forced the BIS to elaborate a different framework for central banks' cooperation. In doing so, Siepmann suggested that cooperation in times of crisis should be completely different

⁶⁴ Kindleberger, *The World in Depression, 1929-1939*, p. 196; Toniolo and Clement, *Central Bank Cooperation at the Bank for International Settlements, 1930-1973*.

⁶⁵ See "The BIS and the Market. Huelse Report", 30 March 1931, BISA, George Rayot Papers.

⁶⁶ "The BIS and International Payments", by Quesnay, P. in BISA, Box 9.1 File 003, Meeting of the Representatives of Central Banks participating in the BIS. 1st Committee- Currency II Reports, Basle, 19 and 20 May 1931.

from the framework used by central bankers during the 1920s. The "old" form of cooperation that emerged after World War I was based on stabilisation loans and aimed at ensuring the legal stability of the central bank, prompting the adoption of the gold exchange standard. The Austrian crisis became the first case where the main struggle was in defending stability in times of financial crises. In such episodes, central banks needed to receive a rapid and appropriate credit injection to increase their foreign exchange reserves. By doing so, central banks could be able to minimise the impact of sudden withdrawals of foreign credits, thus meeting the demands of home depositors whilst reassuring the public.

To speed up the BIS' actions, Siepmann advised central banks to increase the sum deposited on their own accounts at Basel and to be prepared to assist all the central banks struggling with internal problems. To reach this goal, he proposed drafting an arrangement under which central banks would agree to deposit a part of their foreign exchange at the BIS. Such amounts should have been proportional to the aggregate short-term foreign indebtedness of the commercial banks situated within the same country.⁶⁷ Siepmann was advocating a new institutional role of international lender of last resort for the BIS.

This initiative took place on 13 June 1931. BIS directors sent letters to all member central banks claiming that the financial turmoil that had originated in Austria was spreading to other central European countries. Since the crisis was potentially damaging for the 'less powerful central banks', it was indeed necessary to strengthen cooperation in order to enable the BIS to support them.⁶⁸ The BIS asked central banks to raise their deposits in order to set up a new fund called "Special Account" to be used in emergency situations.⁶⁹ The creation of this new account was intended to allow the BIS to speed up its interventions and avoid any delays related to coordination problems. As Vincenzo Azzolini, the governor of the Bank of Italy, directly communicated to McGarrah, the new scheme envisaged by the BIS' management was a great idea in order to "apply the principle of solidarity in the various practical cases which have arisen or may arise."⁷⁰

⁶⁷ The memorandum suggested other ways to help central bank in distress. One was to abandon the practice of extending three-month loans and prolonging them indefinitely, or rather "make the continuation of credits contingent upon the debtor central bank making a sound currency policy and following the advice being given by a special advisor through the intermediary of the BIS". The second was to allow central banks to reduce their legal reserve ratio in order to use their reserve more freely without "unduly frightening the public". "Lesson of the Austrian crisis" 3 July 1931, BoEA, OV 28/3.

⁶⁸ BIS to FED, Banca d'Italia, Reichsbank, Nederland, Belgium; France, England, 14 June 1931. See BISA 3/12 "Opening by B.I.S. of Special Account for maintenance of Gold Standard of various currencies, June 1931- August 1931.

⁶⁹ BIS to Central Banks, 13 June 1931 in BISA 3/12 "Opening by B.I.S. of Special Account for maintenance of Gold Standard of various currencies", June 1931- August 1931.

⁷⁰ "Azzolini to McGarrah," 16 June 1931. ASBIT, Banca d'Italia, Direttorio - Introna, "Corrispondenza relativa ad aiuti economici concessi all Austria e all' Ungheria", Giugno 1931.

While the governor of the Bank of Italy felt "sure that [the plan would] meet with the approval of my colleagues of other central banks," not all of the BIS' members responded in the same way.⁷¹ In the previous section we showed that, with the exception of Sweden, creditor countries were among those with the lowest value of reserves transferred to the BIS as compared to their foreign exchange holdings. Moreover, with the exception of the Netherlands, none of them increased those reserves in June. On the contrary, borrowing countries were those that most increased their reserve ratios deposited at the BIS, while the opposite holds for most lending countries. In fact, all Scandinavian countries (Denmark, Sweden and Norway) were sceptical about the new solution and declined the BIS' invitation, while other central banks openly rejected the plan.⁷² Alberto Beneduce, an Italian member of the BIS Board, astonishingly communicated to Italian Secretary of Finance Antonio Mosconi that some of the most powerful central banks in Europe, such as Belgium and the Netherlands, refused to be associated with the proposal.⁷³

Most importantly, two of the three major central banks agreed only reluctantly to participate in the initiative. George Harrison of the Federal Reserve Bank of New York had been supportive of the plan since the beginning. By the end of June 1931, this institution had deposited more than 50 million CHF (about 9.7 million US dollars) in the Special Account. The Bank of England's reaction was constructive but still sceptical. Even though Siepmann was promoting the virtue of the plan amongst central banks, Montagu Norman, the governor of the Bank of England, was more careful and made British participation contingent on the acceptance by "other powerful central banks."⁷⁴ He was bothered both by the internal financial problems of England as well as by the attitude of the Bank of France. Norman expressed his concerns in a confidential letter to George Harrison. He reckoned that the Special Account plan was a good idea and would allow the BIS to "anticipate a possible crisis" by accelerating its interventions instead of "asking from time to time to participate in individual arrangements for individual countries as emergencies arise."⁷⁵ Nonetheless, Norman confessed that the "Bank of England had already lent quite as much in central Europe" and it was problematic for him to give further financial help.⁷⁶ Finally, the Bank of France decided to participate with two million dollars under two conditions. One was related to the quality of the guarantees attached to each credit granted by the BIS' Special Account, which were to be approved by the BIS' directors, and a second one related to the Bank of France's own

⁷¹ Ibid.

⁷² See Hansen (2012) for details about the reaction of the Scandinavian country to the BIS plan.

⁷³ "Beneduce to Antonio Mosconi" Rome 20 June 1931. ASBIT, Banca d'Italia, Direttorio - Intronza, "Corrispondenza relativa ad aiuti economici concessi all Austria e all' Ungheria", Giugno 1931

⁷⁴ "Beneduce to Antonio Mosconi" Rome 20 June 1931. ASBIT, Banca d'Italia, Direttorio - Intronza, "Corrispondenza relativa ad aiuti economici concessi all Austria e all'Ungheria", Giugno 1931

⁷⁵ "Norman telegram to Harrison. Confidential", 4 July 1931. BISA, Fraser MC Garrah Papers.

⁷⁶ "Norman telegram to Harrison. Confidential", 3 July 1931. BISA, Fraser MC Garrah Papers.

approval of each of the credits granted through this fund.⁷⁷ France ended up contributing 30.4% of total central banks' deposits at the BIS in June 1931. For comparative purposes, the figure for the Federal Reserve was 33%, while the one for the Bank of England was 7.7%.⁷⁸

We traced the correspondence between the BIS and all the member banks that were asked to participate. Table 3 summarises the responses. For those central banks that accepted, Table 3 shows the conditions under which they would participate. For countries that declined, it classifies each refusal into economic, political, and institutional reasons. Most of the central banks that refused raised issues related to economic conditions affecting their countries. In certain cases, the impediments referred to concern the banks' statutes or to conditions which the BIS refused to accept. The *Sveriges Riksbank*, for example, underscored the fact that its internal statutes did not allow the bank to deposit foreign currencies in other institutions without previously knowing " the form and conditions of the credit as well as the security offered in each case."⁷⁹

<Table 3 around here>

Nevertheless, we have reasons to remain sceptical and can only speculate about whether these institutional obstacles were truly insurmountable. This was also the attitude of Leon Fraser who remained highly suspicious about the use of real or alleged reasons for financial and economic distress to justify uncooperative behaviours. While he frankly reckoned that, at least for debtor countries, the general crisis situation was a key factor that hindered central banks' cooperation, the same could not be said for some more prosperous central banks of creditor countries.⁸⁰ The uncooperativeness shown by the Netherlands and Switzerland was indeed strongly criticised in Basel. McGarragh, in a private letter to George Harrison, laconically confessed how those two central banks were " growing wealthier thanks to the miseries of others".⁸¹

In the case of the Netherlands, its central bank first raised the problem of the bank's statutes when declining to participate in the Special Account. However, it changed its argument two months later to an economic one, when the BIS insisted on the importance of its new initiative. In fact, the reference to the economic difficulties raised by the Dutch and other creditor countries' central banks is difficult to reconcile when we compare their reserves' position with the correspondence with the BIS. Figure 5 compares the levels of reserves to the legal ratio defined by the statutes of each central bank. Central banks are grouped between accepting and declining banks. As Figure 5

⁷⁷ "Procès-verbal de la séance du jeudi 18 juin 1931", BdF Digital collection.

⁷⁸ Own estimates drawn from "Depositi delle Banche Centrali per proprio conto presso la Banca dei Regolamenti Internazionali", September 1931 in ASBI, Direttorio - Azzolini, Prat n. 102, Fasc. 1 and BIS Central Banking Department, " Situation of Central Banks", 31 October 1931, in BISA, McGarragh and Fraser Papers.

⁷⁹ "Sveriges Riksbank to McGarragh", Stockholm, 19 June 1931., BISA 3/12 "Opening by B.I.S. of Special Account for maintenance of Gold Standard of various currencies, June 1931- August 1931

⁸⁰ "Fraser to McGarragh", June 20, 1931. BISA. Fraser and McGarragh Papers.

⁸¹ "Mc Garrah to George Harrison", July 23, 1931. BISA, Fraser and McGarragh Papers.

shows, there were no major differences between both groups. Not only the *Nederlandsche Bank*, but also the central banks of Albania, Switzerland and Belgium had declined the BIS' proposal even though their reserve levels were largely above the legal ratio. On the contrary, in countries such as Lithuania and Greece, reserves were declining rapidly and just barely remained above the legal ratio, suggesting that willingness to cooperate was not entirely conditional on reserves.

<Figure 5 around here>

A common attitude among most central banks was their desire to retain some control of the destinies of the BIS' credits. Furthermore, even central banks that agreed to participate did so with the proviso that they would be consulted regarding the conditions and destination of each operation proposed. Furthermore, in the cases of England and France, they conditioned their participation on that of other, "principal" central banks. The Federal Reserve only conditioned its participation by establishing a limit on the amount to which it would engage.

Further evidence suggests that the willingness to maintain a certain control upon the BIS' credits stemmed from central banks' subservience to their own government's attitudes. The Bank of Italy's Board of Directors, for instance, subordinated every decision to Mussolini's approval. Italy's central bank joined the Special Account scheme primarily to increase the fascist government's "international prestige" rather than from a true spirit of cooperation.⁸² In the case of the Bank of Lithuania, the bank clearly stated that its first duty was to "stay always loyal to our government" and agreed to help only central banks from countries which had "normal political relations" with it.⁸³

While BIS officers publicly praised the efforts made by central banks to enhance cooperation by extending loans to countries in trouble, privately there arose some doubts about the attitude of some of its members.⁸⁴ The close correlation between central banks' actions and political motivation did not surprise BIS representatives. In this regard, only Montagu Norman, a long-time defender of central bank autonomy, suggested that true central bank cooperation could only be achieved when BIS funds stemmed solely from central banks without their being conditioned by [on] political reasons.⁸⁵

⁸² "Alberto Beneduce to Benito Mussolini", 18 June 1931, ASBIT, Directorio Introna, Corrispondenza relativa ad aiuti economici concessi all' Austria e all'Ungheria.

⁸³ "Lietuovous Bank to the BIS", Kaunas, 19 June 1931, see BISA 3/12 "Opening by B.I.S. of Special Account for maintenance of Gold Standard of various currencies, June 1931- August 1931. Other cases include Poland, Czechoslovakia and Albania.

⁸⁴ The BIS Second Annual Report published in May 1932 underlined the "mutual effort" made by central banks to help countries under financial distress. See BIS, Second Annual Report (1932, p. 21).

⁸⁵ "Norman for Harrison. Confidential", 3 July 1931. BISA, Fraser and McGarrah Papers.

V.

In this paper, we have argued that the creation of the Bank for International Settlement represents the first attempt in history to institutionalise central bank cooperation. Its institutional design was pioneering for the time, where the set of principles, norms and rules which characterised the BIS' design were implemented not as the outcome of legally binding agreements (“hard law”), but rather through voluntary adoption. Yet the BIS was created and controlled by central bankers and not by government representatives. It captured the idea—as popular in the 1920s as it is today—in which central bankers were the guardians of monetary expertise and therefore shared the same values and code of conduct. While this implied that a common theoretical framework would suffice to achieve the targets that the BIS initially adopted—namely, monetary stability—it also left a large opening for discretionary behaviour and government interference, something that the BIS' managers had attempted to avoid.

Since the literature always draws parallels between the BIS and the IMF, some scholars assumed that the BIS was charged with the double task of being an international lender of last resort as well as a transnational crisis manager. As we show in this article, this view is somewhat misleading. The BIS' first year of existence largely surpassed the activities of the IMF's first five years, the time required before rules were defined and the first loans were granted. The BIS was obliged to adopt a learning-by-doing stance despite its original design which did not foresee having the institution act as an international lender of last resort as we would understand it today. Rather, central bank cooperation, according to the BIS' founders, was limited to the soft kind, including monthly meetings, exchange of information, clearing agreements and stabilisation loans. Once the problem of reparation transfers had been solved, the main goal of the BIS was to bind the current international monetary system by preventing its participants from scrambling for gold, and simultaneously establishing a closer business relationship between central banks. In short, the BIS' founders had entirely overlooked the ILOLR role.

After the spread of the financial crisis across central European countries, the BIS attempted to institutionalise its newly adopted ILOLR role. It proceeded with the creation of a Special Account which allowed it to intervene promptly in case of emergency. The basic premise behind the BIS' activities was to increase the ammunition at its disposal without involving governments in the process. In acting as a lender of last resort, subtlety and art are core skills. Yet persuading central banks to cooperate proved more difficult than expected. As our paper shows, central banks behaviour was dictated by domestic interests and profit-seeking through arbitrage opportunities rather than by a disposition to enter into an institutionalised process of reciprocal assistance. Each

central bank's willingness to cooperate was indeed directly linked both by the potentiality and degree to which the crisis could affect the country but also by the political affinity of its government. This dynamic severely impacted the capacity of the BIS to mitigate the effects of the banking and currency crises of 1931.

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Tables and Figures

Table 1. Ratios of reserves at the BIS to foreign exchange holdings at central banks in percentages and in different months.

Country	December 1930	February 1931	June 1931	If foreign exchange is considered legal cover
Creditor countries				
Sweden	10.06	28.54	28.29	No
Netherlands	2.46	2.43	6.37	No
Switzerland	5.13	7.61	6.01	No
France	1.95	1.96	2.03	No
United Kingdom	NA	NA	NA	No
United States	NM	NM	NM	No
Borrowing countries				
Greece	4.99	29.36	66.05	Yes
Hungary	13.70	0	62.01	Yes
Poland	18.26	18.85	37.66	Yes
Austria	16.67	11.76	29.66	Yes
Lithuania	4.39	6.03	28.44	No
Czechoslovakia	15.39	20.09	21.22	Yes
Norway	NS	NS	16.93	No
Albania	NS	NS	16.04	Yes
Italy	7.90	9.65	11.49	Yes
Romania	11.63	0	11.28	Yes
Belgium	8.55	11.59	10.37	Yes
Finland	3.46	4.29	3.73	Yes
Danzig	3.89	3.55	2.33	Yes
Denmark	0	0	1.32	Yes
Yugoslavia	6.02	14.5	0.73	Yes
Germany	5.38	4.95	0.5	Yes
Bulgaria	4.23	0	0.15	Yes
Latvia	0	0	0.11	Yes

NA= Data not available; NM= Not a member of the BIS ; NS= Not shareholders of the BIS. Central banks of Norway and Albania had become shareholders by 31st May 1931 and 30th April 1930 respectively. *Sources:* Own computations from "Central Banking Division", 31 December 1930 and 18 February 1931 in BISA, Fraser and McGarrah Papers. The June 1931 data are retrieved from "Depositi delle Banche Centrali per proprio conto presso la Banca dei Regolamenti Internazionali", September 1931 in ASBI, Direttorio - Azzolini, Prat n. 102, Fasc. 1.

Table 2. Composition of currencies of central banks' deposits at the BIS.

	August 1930					November 1930				
	(Currency composition in percentages and totals in US dollars)					(Currency composition in percentages and totals in US dollars)				
	USD	Sterling	French Franc	Others	Totals (US\$)	USD	Sterling	French Franc	Others	Totals (US\$)
England	96.8	0.0	3.2	0.0	10,3	96.8	0.0	3.2	0.0	10,3
France	100.0	0.0	0.0	0.0	10,0	100.0	0.0	0.0	0.0	10,1
Reichsbank	74.7	25.3	0.0	0.0	9,6	35.3	64.7	0.0	0.0	8,2
Italy	92.3	3.6	0.0	4.0	10,0	88.6	3.8	0.0	7.6	12,7
Belgium	68.2	24.9	0.0	6.9	5,9	51.0	44.0	0.0	5.1	7,9
Austria	88.2	0.0	0.5	11.3	19,8	85.9	0.0	0.0	14.1	19,8
Sweden	0.0	100.0	0.0	0.0	0,5	34.0	66.0	0.0	0.0	17,7
Poland	100.0	0.0	0.0	0.0	6,0	68.2	31.8	0.0	0.0	9,2
Czechoslovakia	90.9	0.0	0.0	9.1	1,1	46.9	38.0	0.0	15.2	6,4
Greece	100.0	0.0	0.0	0.0	1,0	75.3	24.7	0.0	0.0	2,2
Switzerland	75.3	0.0	15.0	9.7	2,7	79.2	0.0	12.6	8.3	2,5
Bulgaria	100.0	0.0	0.0	0.0	0,3	100.0	0.0	0.0	0.0	0,3
Roumania	100.0	0.0	0.0	0.0	0,2	100.0	0.0	0.0	0.0	0,3
Finland	100.0	0.0	0.0	0.0	1,0	100.0	0.0	0.0	0.0	1,0
Netherlands	0.0	0.0	0.0	0.0	0,0	0.0	100.0	0.0	0.0	2,4
Yugoslavia	0.0	0.0	0.0	100.0	3,4	0.0	18.3	0.0	81.7	2,4
Japan	80.5	19.5	0.0	0.0	2,6	0.0	100.0	0.0	0.0	0,5
Hungary	0.0	0.0	0.0	0.0	0,0	45.2	0.0	0.0	0.0	2,2
Danzig	0.0	0.0	0.0	100.0	0,0	0.0	0.0	0.0	100.0	0,2
Latvia	0.0	0.0	0.0	100.0	0,4	0.0	0.0	0.0	100.0	0,4

Source: "Deposits received from central banks and others position as on August 30th 1930 " in BISA, McGarrah and Fraser Papers and " Deposits received from central banks and others position as on November 30th 1931 " in BISA, McGarrah and Fraser Papers.

Table 3. Central Banks responses to BIS "Special Account Project"

Bank	Date (1931)		Response	Amount (US\$)	Motivation/ Conditionality		
	Request	Reply			Economic and Financial	Political	Institutional
Bank of England	June 13	June 16	Yes	2,000,000	Always to be consulted as to the destination, the terms, the period, and the conditions of the operation proposed	All the other "principal" central banks must take part	
Bank of France	June 13	June 18	Yes	2,000,000	Always to be consulted as to the destination, the terms, the period, and the conditions of the operation proposed	All the other "principal" central banks must take part	
Reichsbank	June 13	-	No		-	-	-
Bank of Italy	June 13	June 16	Yes	1,000,000	Always to be consulted as to the destination, the terms, the period, and the conditions of the operation proposed	Every central bank's participation must be proportional to the total central banks' reserves	
Bank of Belgium	June 13	June 16	No				Not allowed by bank's statute
Bank of Switzerland	June 13	June 19	No				Not allowed by bank's statute
Bank of Sweden	June 13	June 19	No				Not allowed by bank's statute
Bank of Netherlands	June 13	June 17	No				Not allowed by bank's statute
	August 8	August 10	No				

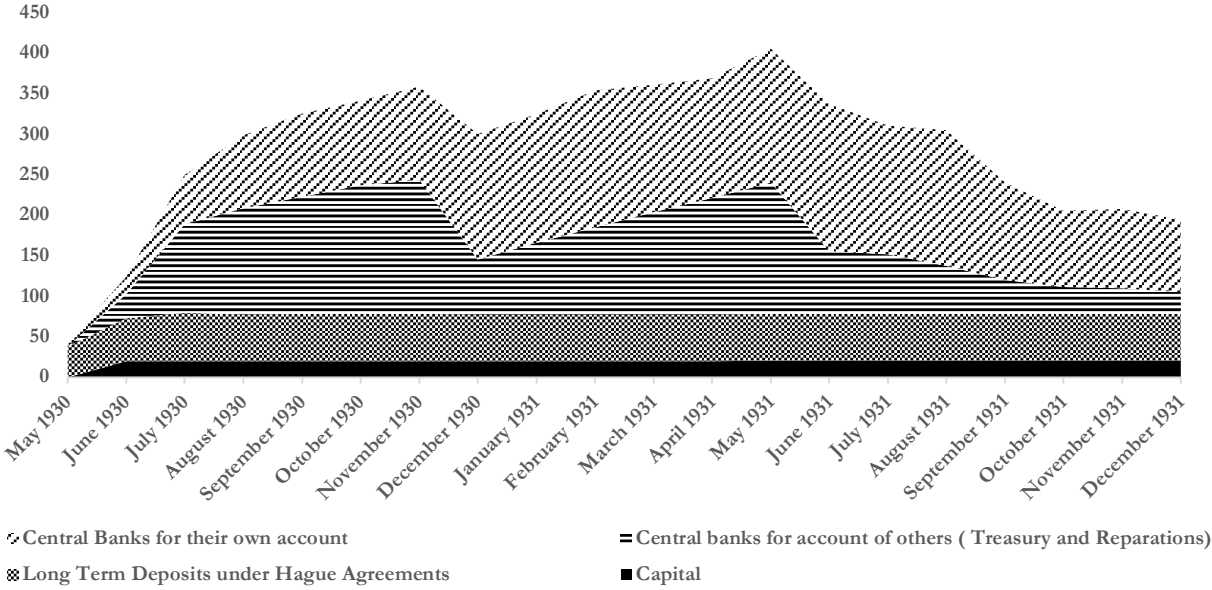
					Economic crisis and lack of liquidity	
Bank of Poland	June 13	June 19	No		Economic and financial crisis of the country obliged the central bank to be prudent and defend the cover ratio	Need to talk with the Government before any operation
Bank of Czechoslovakia	June 13	June 18	Yes	300,000	Always to be consulted as to the destination, the terms, the period, and the conditions of the operation proposed	Need to talk with the Government before any operation
Bank of Greece	June 13	June 23	Yes	500,000	Always to be consulted as to the destination, the terms, the period, and the conditions of the operation proposed	
Bank of Romania	June 13	July 3	Yes	500,000	Always to be consulted as to the destination, the terms, the period, and the conditions of the operation proposed	
Bank of Lithuania	June 13	June 19	Yes	300,000	Always to be consulted as to the destination, the terms, the period, and the conditions of the operation proposed	Need to talk with the Government before any operation
Bank of Bulgaria	June 13	June 18	Yes	200,000	Always to be consulted as to the destination, the terms, the period, and the conditions of the operation proposed	
Bank of Yugoslavia	June 13	June 29	No		Economic and financial crisis of the country obliged the central bank to be prudent and defend the cover ratio	Mechanism of the special account is not clear

Bank of Albania	June 13	June 17	No		Participation to the special account scheme is conditional upon the withdrawals of Bank of Albania's deposits with the Credit Anstalt
Bank of Finland	June 13	June 30	No		Economic and financial crisis of the country obliged the central bank to be prudent and defend the cover ratio
Bank of Norway	June 13	June 28	No		Economic, social and financial crisis of the country obliged the central bank to be prudent and defend the cover ratio
Bank of Latvia	June 13	July 2	No		Economic and financial crisis of the country obliged the central bank to be prudent and defend the cover ratio
Bank of Denmark	June 13	July 2	No		Economic and financial crisis of the country obliged the central bank to be prudent and defend the cover ratio
Bank of Japan	June 13	-	No		- - -
Bank Von Danzig	June 13	June 20	No		Economic and financial crisis of the country obliged the central bank to be prudent and defend the cover ratio
Bank of Estonia	June 13	July 6	No		Economic and financial crisis of the country obliged the central bank to be prudent and defend the cover ratio

Federal Reserve Bank	June 13	June 17	Yes	From 2,000,000 up to a maximum of 10,000,000	Always to be consulted as to the destination, the terms, the period and the conditions of the operation proposed
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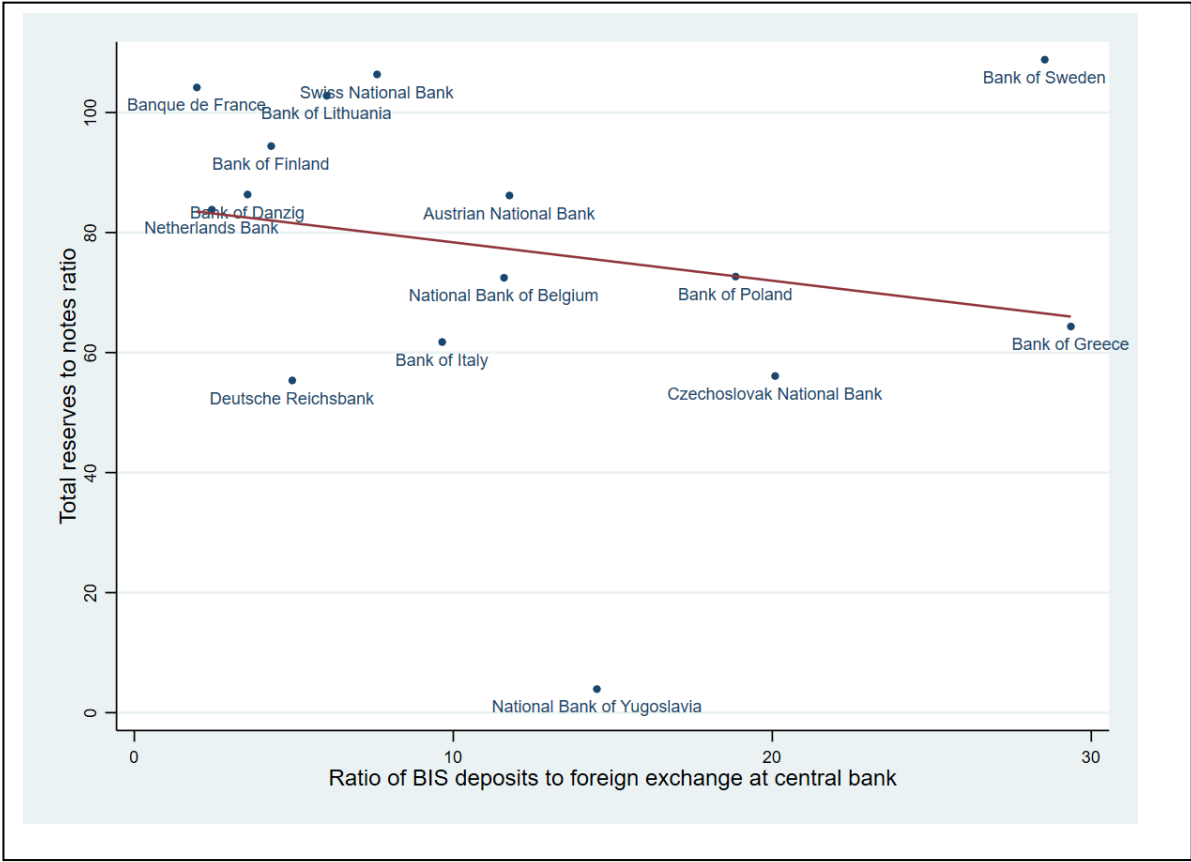
Source: BISA 3/12 "Opening by B.I.S. of Special Account for maintenance of Gold Standard of various currencies", June 1931- August 1931.

Figure 1. Sources from which funds at the disposal of the BIS were derived (US\$ million)



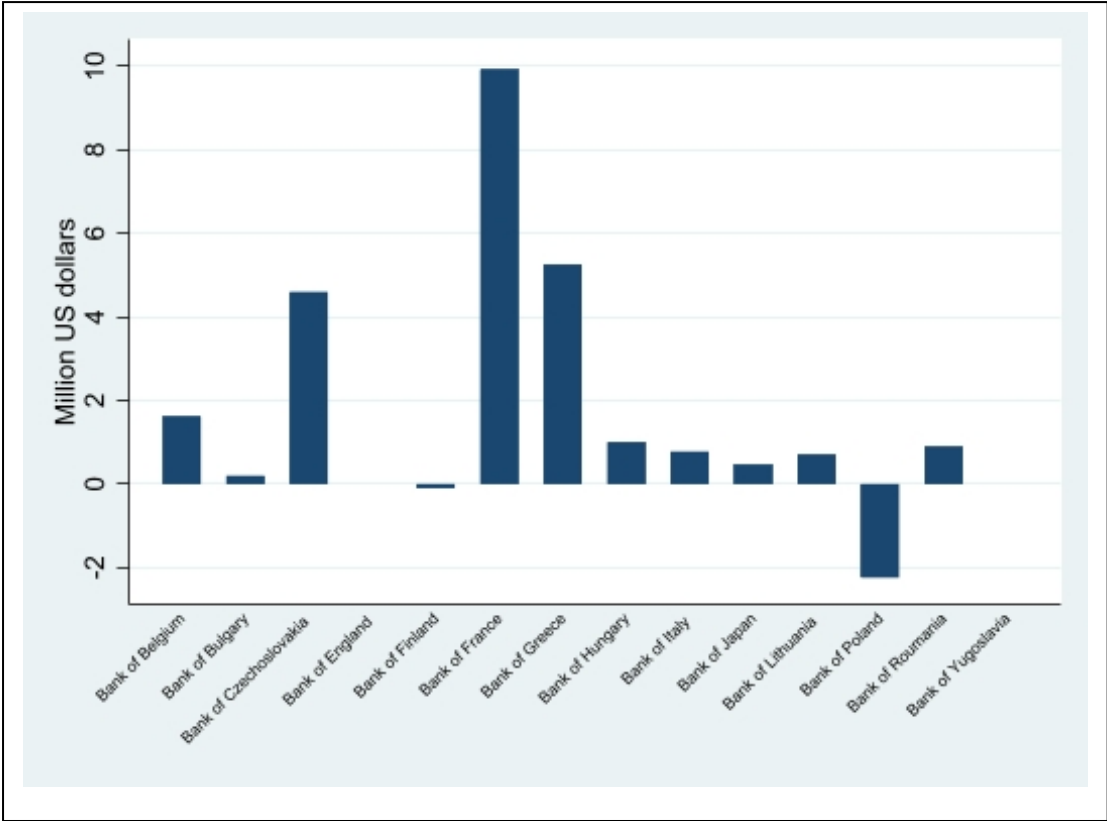
Source: BIS, Monthly Balance Sheet

Figure 2. Ratio of BIS deposits to foreign exchange and total reserves ratios, in percentages.



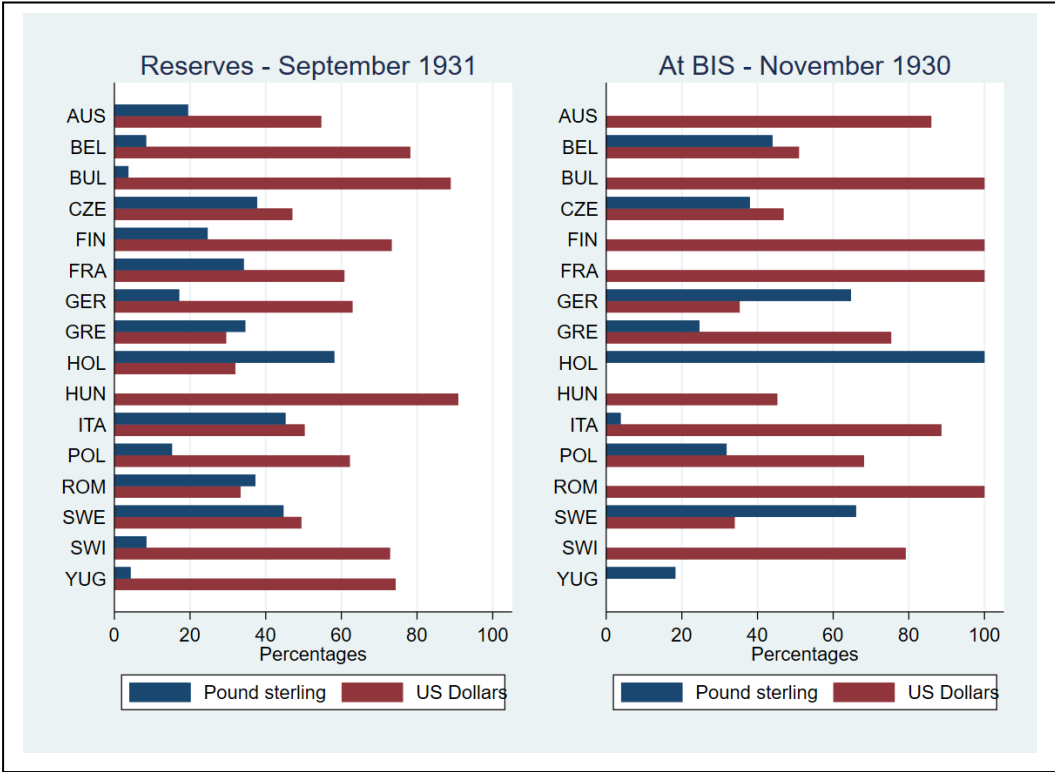
Source: Own computations based on BIS Central Banking Department, " Situation of Central Banks", 31 October 1931, BISA, Fraser and McGarrah Papers and Federal Reserve Bulletin, various issues.

Figure 3. Absolute increases in US dollar deposits between November 1930 and April 1931.



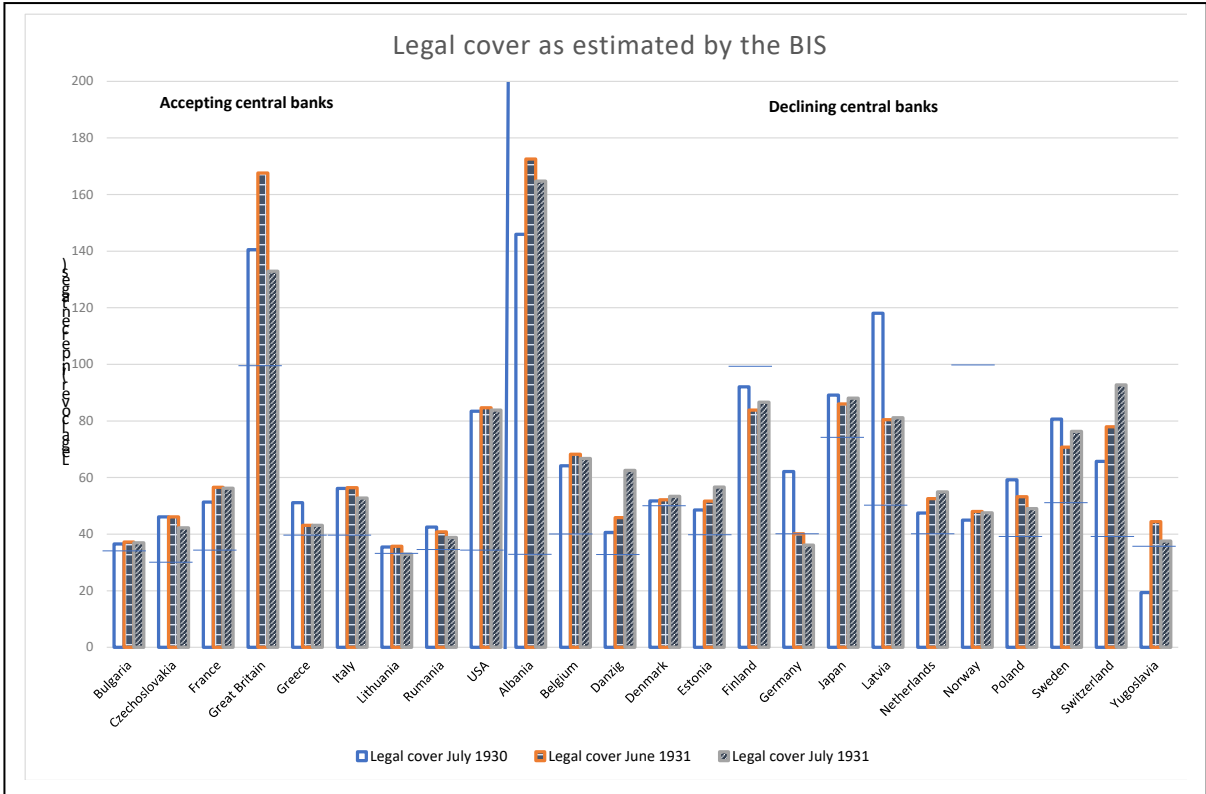
Source: Own computations based on "Deposits received from central banks and others position as on November 30th 1930 " in BISA, McGarrah and Fraser Papers and "Deposits received from central banks and others position as on April 30th 1931 " in BISA, McGarrah and Fraser Papers

Figure 4. Proportions of US dollar and sterling pound in foreign exchange reserves and their respective transfers to the BIS.



Source: Own computations from "Deposits received from central banks and others position as on November 30th 1930" in BISA, McGarrah and Fraser Papers and "Corrected list of central banks' foreign exchange holdings around the middle of September 1931", October 10, 1931 in BoE, OV 4 /25.

Figure 5. Reserve losses around Special account.



Source: BIS Central Banking Department, " Situation of Central Banks", 31 October 1931, in BISA, McGarrah and Fraser Papers.