

CENTRAL BANK COOPERATION 1930-1932. A REAPPRAISAL

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Introduction

- Why do central banks cooperate? (and why not?)
 - Institutional/multilateral vs bilateral cooperation
 - Rules vs discretionary behavior
 - Crises periods - Need for an international lender of last resort
- We analyze the emergence of institutional cooperation during the 1931 crisis in Central and Eastern Europe through the BIS

Emergence and consolidation of a new institution: the Bank for International Settlements



The unofficial first board meeting of the Bank for International Settlements (April 1930)

Central bank cooperation and the establishment of the BIS

- Central bank cooperation before 1914 – key to maintain the gold standard
 - (Eichengreen 1992 vs Flandreau 1997)
- What changed in the 1920s?
 - James (2013 and 2016) - A new and more systematic pattern of central bank cooperation emerged (central bank cooperation became " increasingly frequent and systematic")
 - 1927 - Apex of central bank cooperation (Chandler 1958; Clarke 1967; Cooper 2008 and Eichengreen 1992)
- Main problem: "ad hoc and bilateral cooperation" vs "Institutionalization of cooperation".
- 1930: Bank for International Settlements was established

International cooperation during the 1931 crisis

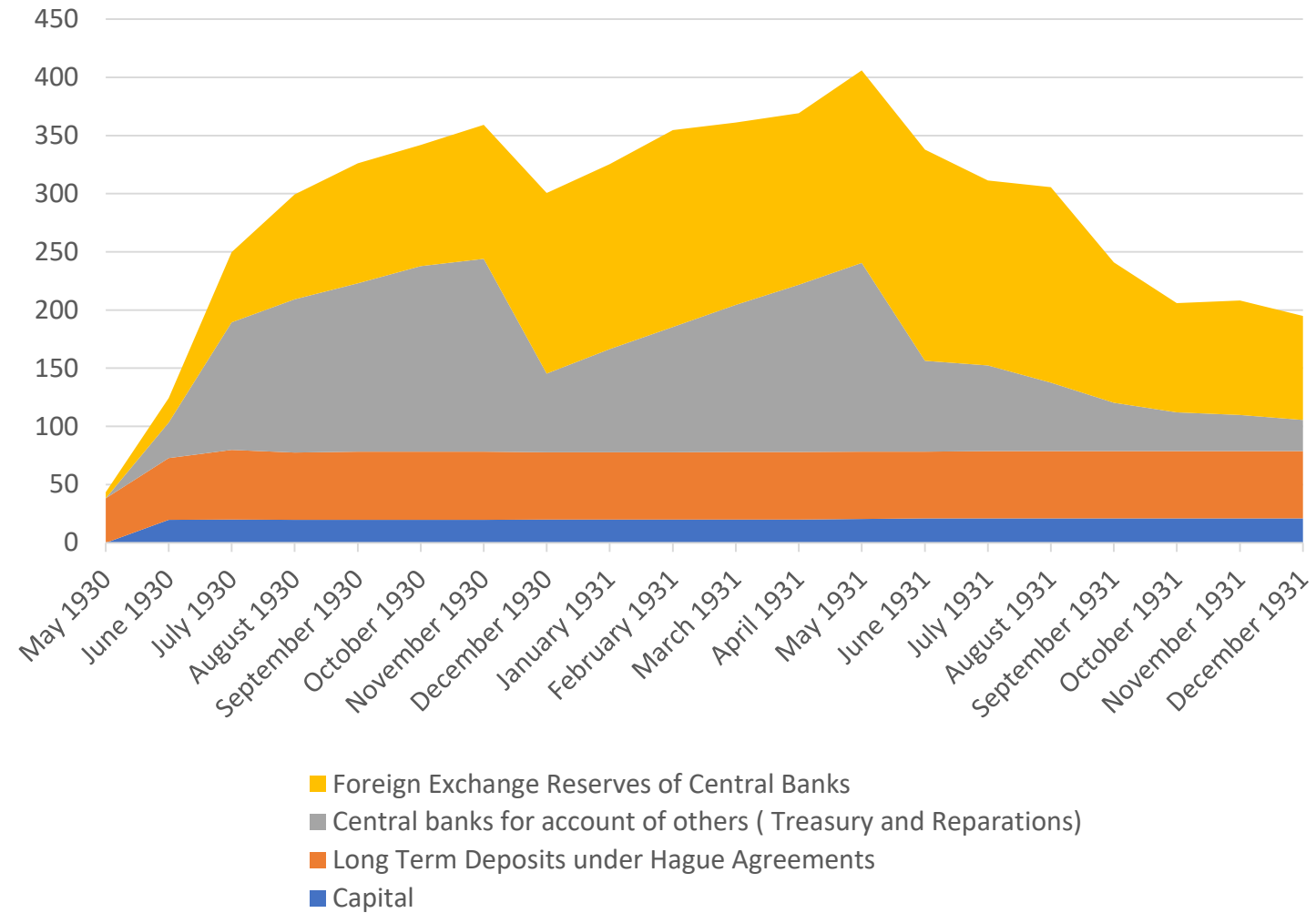
- Literature so far has been quite negative on the BIS experience:
 - Charles Kindleberger (1973, p. 131) on the Austrian crisis of May 1931, " the niggardliness of the sum [of the BIS credit] and the delay together proved disastrous"
 - Barry Eichengreen (1992, p. 295) define BIS action as "singularly ineffectual"
 - Harold James (2002, p. 65) " the major failure of the BIS was the mishandling of the Austrian Crisis"
 - Toniolo (2005) "too late too little" and political problems
 - Nevertheless: Clarke (1967, 185) 1931 financial crack was completely different from previous crises so that "authorities had no previous experience by which to guide themselves".

Revisiting this (rather pessimistic) perspective:

- Contemporary views differ from the dominant perspective on the role of the BIS:
 - *The Times* (June 18 1931) commented that the BIS had acted with " foresight and capacity" and had lost "no time in supporting the Austrian National Bank".
 - *The Wall Street Journal* (June 5 1931) praised the BIS for avoiding a financial disaster and for having "satisfactory cleaned up" the Austrian banking crisis.
 - *The Economist* (8 August) commented that the BIS had "undoubtedly done much" to tackle the turmoil and gave proof of its power to act "wholeheartedly and decisively in a major financial and economic emergency".
 - Dulles (1932, p. 478) : the quick and efficient arrangement of credits" to central banks of Austria, Hungary and Germany was an "outstanding contribution" of the BIS.

BIS – funding sources

Sources from which the BIS derived its funds at disposal (US\$ million)



"Willingness to cooperate"

- We look at the evolution of Central Bank Foreign Exchange Deposits and interpret it as a proxy of each central bank's willingness to cooperate through the BIS multilateral framework
- November 15, 1930, McGarrah to Vincenzo Azzolini, (Governor of the Bank of Italy): **"if public and other central banks observed a steady increase of central banks deposits in Basel, they must realize that the bank is instrumentally working in the field of cooperation other than those of the debt payments only"**

• Source: "McGarrah to Azzolini", Basle November 10, 1930, BISA, Leon Fraser and McGarrah Paper

Austria's crisis and efforts to change the BIS institutional setting

- Before the onset of the 1931 crisis, the BIS policy about the amounts of foreign reserves to be deposited by central banks remained completely discretionary

- **3 June 1931:** Harry Siepmann, "Lesson of the Austrian crisis":

- 1) Cooperation in time of crisis vs. stabilization loans of the 1920s
- 2) Creation of the "Goose Club": an arrangement for which central banks would have agreed to deposit at the BIS a part of their foreign exchange (the 10 percent of total amount was suggested)

Source: "Lesson of the Austrian crisis" 3 June 1931, BoE, OV 28/3

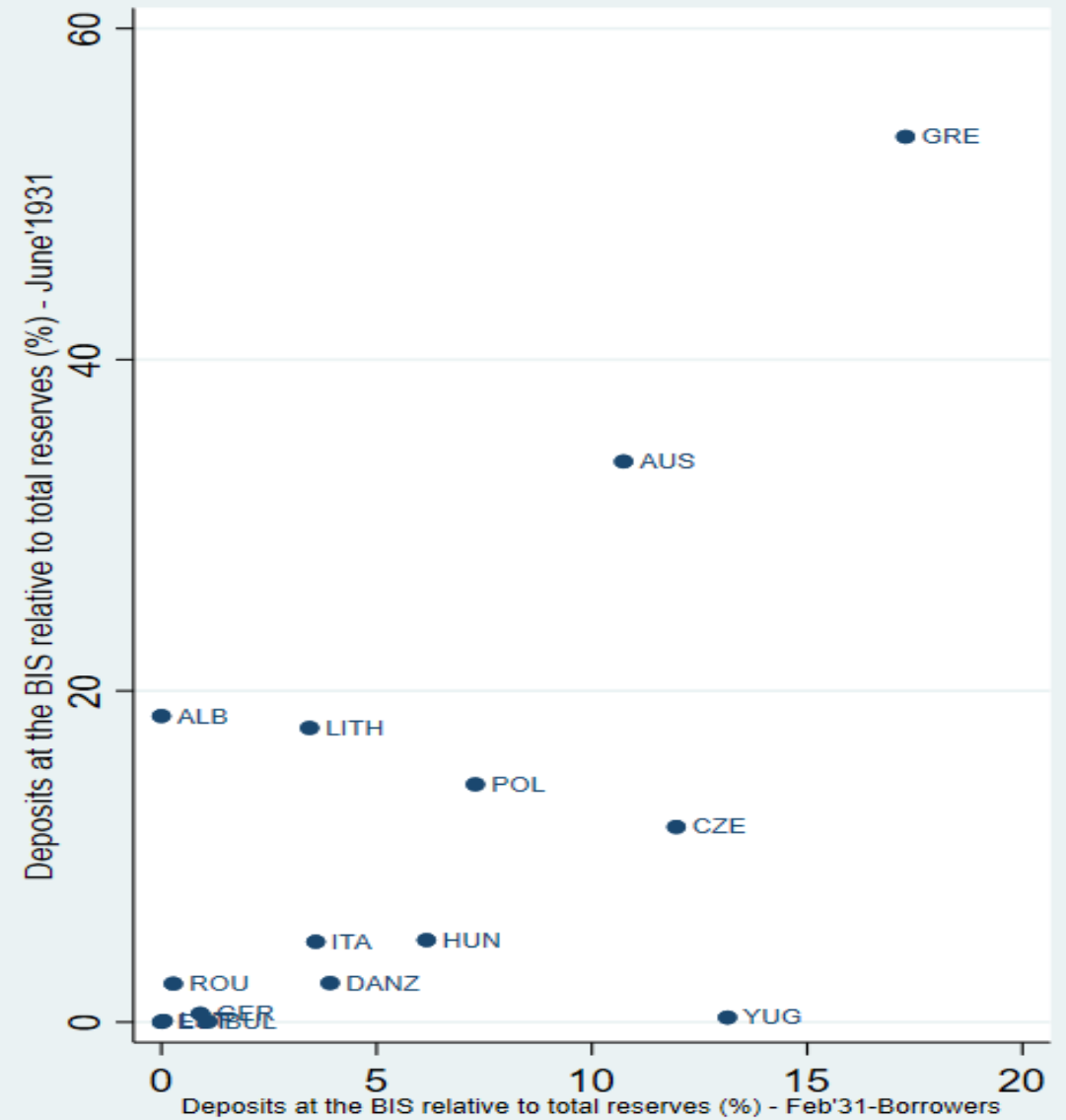
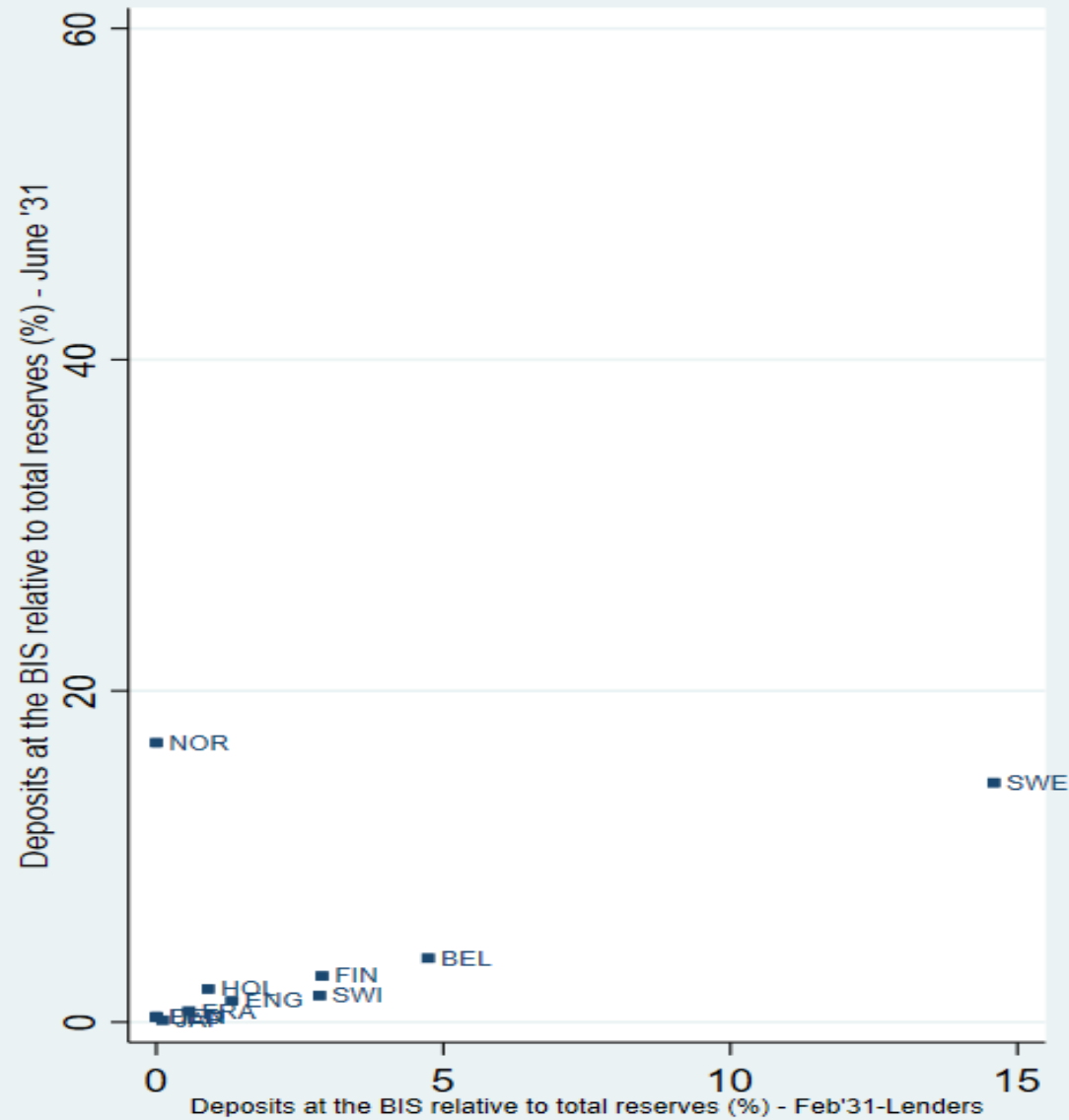
13 June 1931: BIS asked central banks to raise their deposits in order to set up a new fund, called "special account" to be used in emergency situations. The creation of this new account intended to allow the BIS to speed up its interventions and avoid any delays related to coordination's problems

Source: McGarrah BIS to Central Banks, 13 June 1931 BISA, Fraser and McGarrah Papers.

Reserves deposited at the BIS, February 1931 (in Swiss Francs, 000 omitted)

Countries	Foreign exchange holdings of Central Banks (2)	Deposited with the BIS (3)	Ratio of 3 to 2 (%)	Reserve required for cover
France	5,343,416	104,769	1,96	No
Italy	1,110,452	107,182	9,65	Yes
Belgium	643, 863	74,452	11,59	Yes
Austria	626,698	73,512	11,76	Yes
England	Not reported	54,255	NA	No
Germany	537,669	26,549	4,95	Yes
Netherlands	522,197	12,700	2,43	No
Sweden	416,537	118,646	28,54	No
Switzerland	384,053	29,242	7,61	No
Czechoslovakia	350,452	70,244	20,09	Yes
Poland	225,768	42,251	18,85	Yes
Greece	192,844	40,267	29,36	Yes
Finland	119,544	5,112	4,29	Yes
Yugoslavia	102,711	14,970	14,5	Yes
Lithuania	39,522	2,387	6,03	No
Danzig	29,094	1,033	3,55	Yes
Total	10,644,820	777,771	7,3	

Increases in deposits at the BIS between February and June 1931



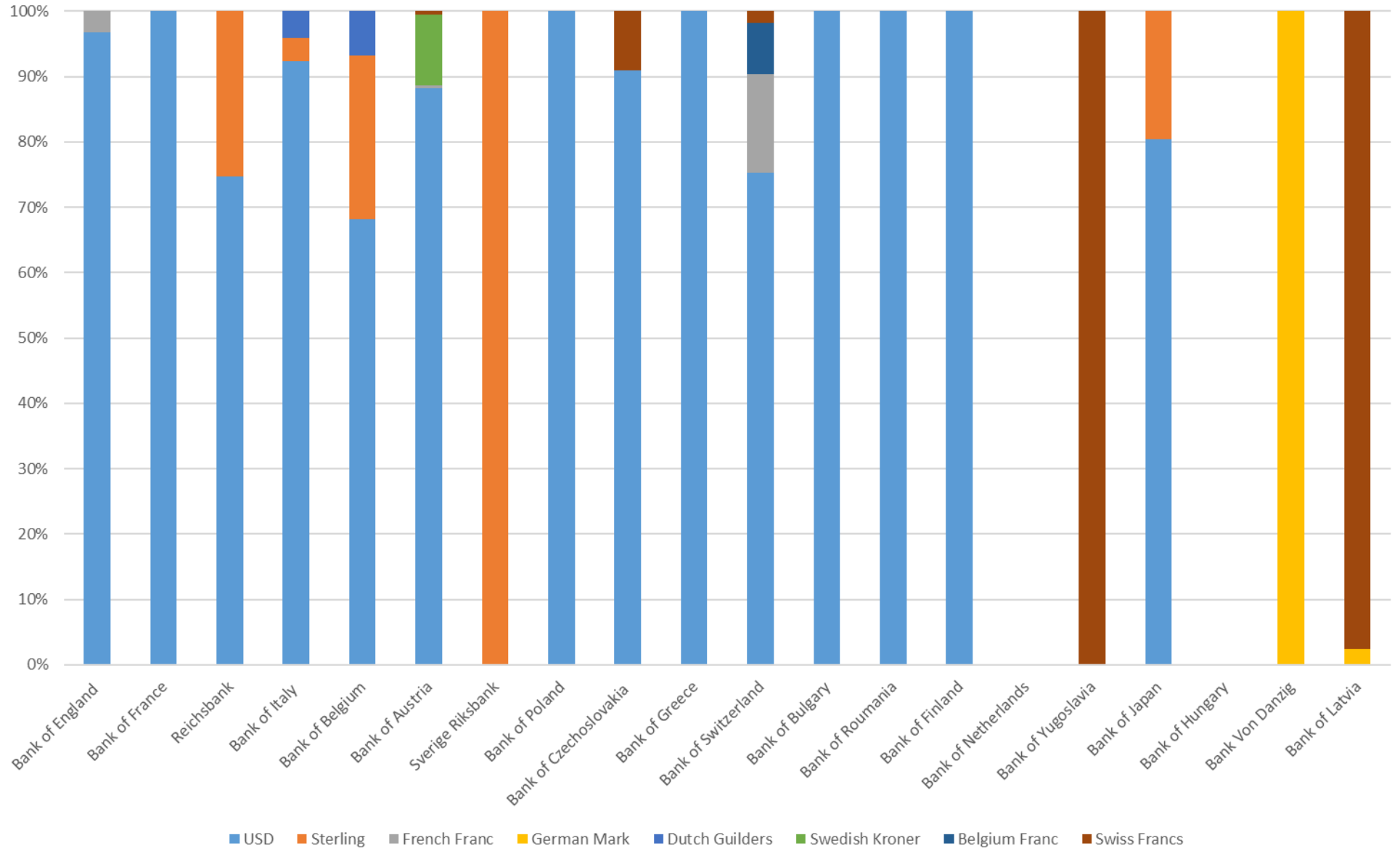
Willingness to cooperate or something else?

- Reactivity to interest rates
 - Quesnay suggested that CBs all over Europe had acquired a "taste for profit yielding reserves" since the general adoption of the gold exchange standard.
- Limits on reserves' availability
 - CBs in countries with balance of payments disequilibrium and facing reserves' losses less likely to increase their deposits at the BIS
- Other?

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 banks' 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		
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		

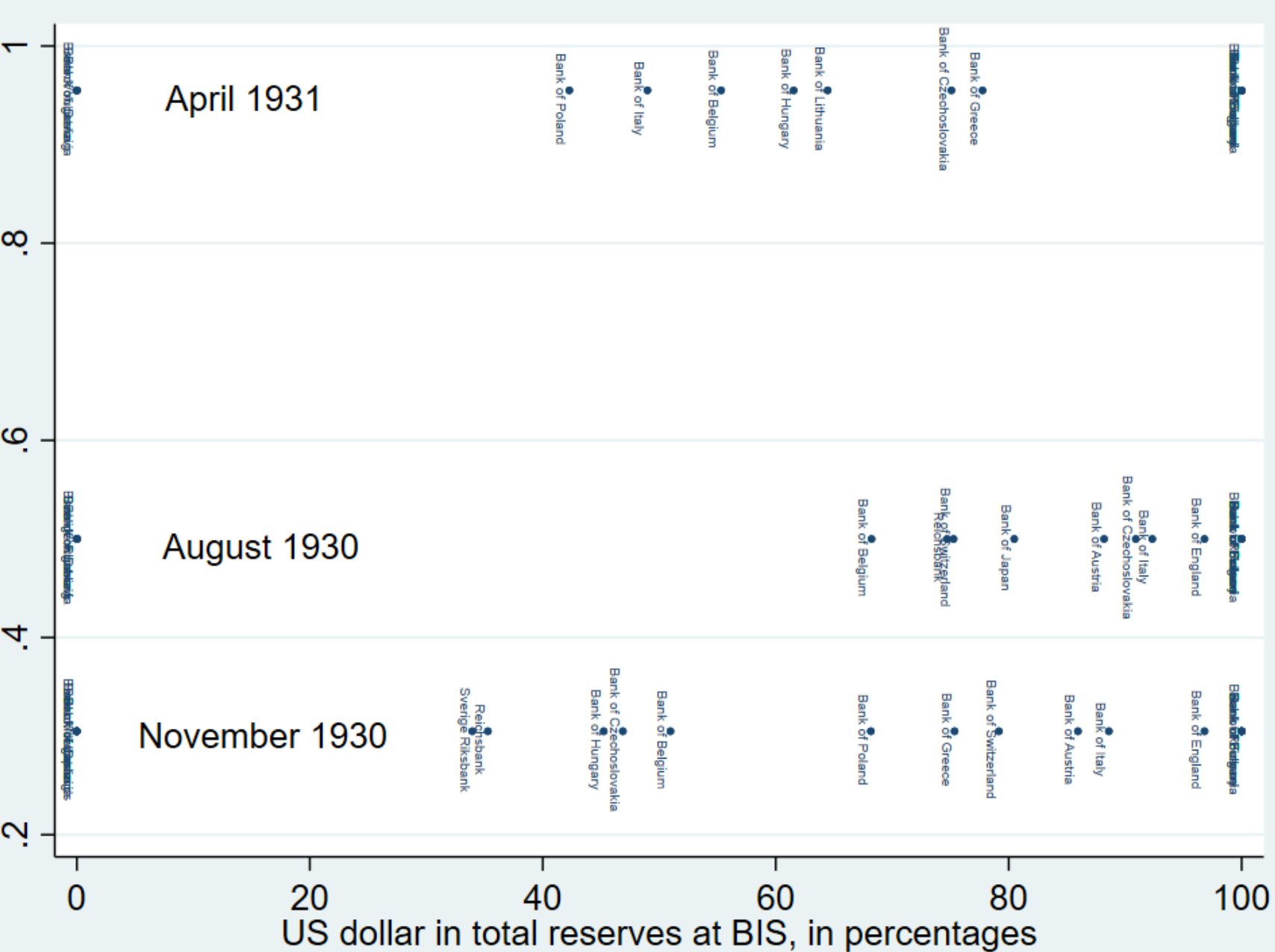
Currency composition - reserves (forex) at the BIS, August 1930



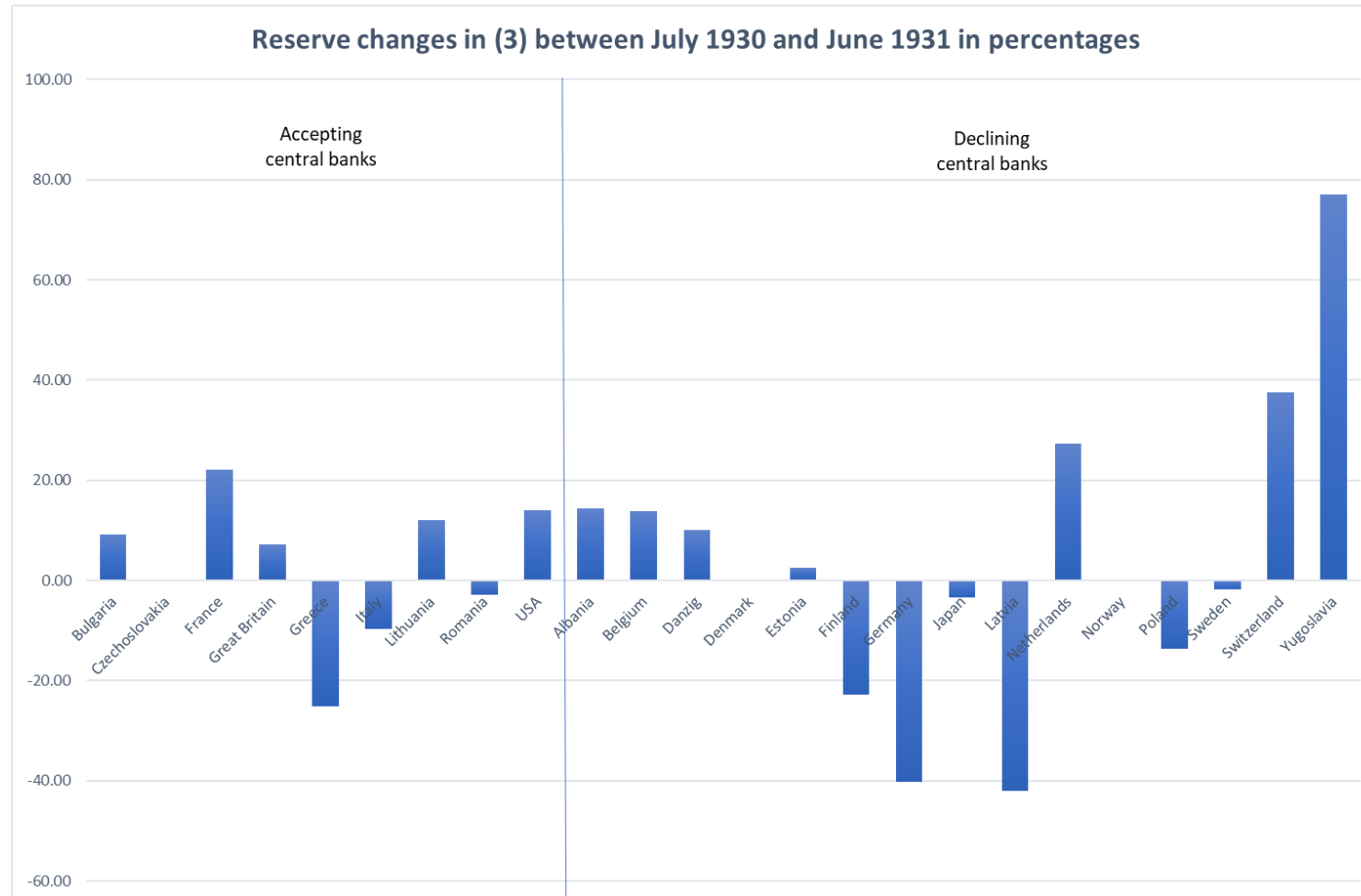
Deposits received from central banks

	August 1930 (currency composition in percentages and totals in US dollars)						November 1930 (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	
Bulgary	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	

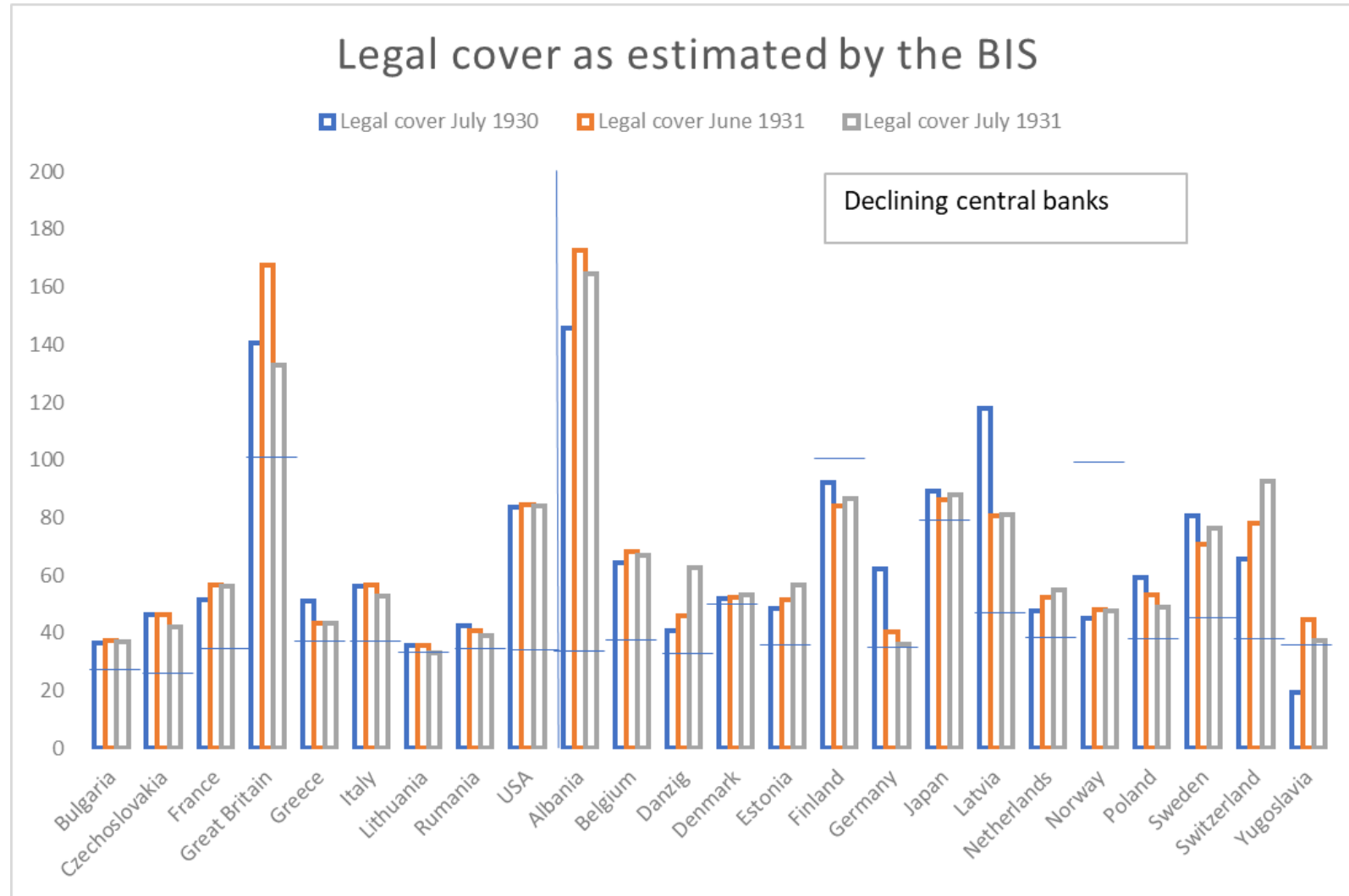
Absolute differences in market rates London - New York



Dis reserve losses refrain CB from increase their deposits at the BIS?



Not really...



Conclusions

- The BIS faced a trade-off as it attempted to consolidate its intervention tools
 - The set of principles, norms, rules which characterized BIS design were implemented not as the outcome of legally binding agreements (“hard law”), but rather through voluntary adoption
- Lack of central bank independence (maybe was a problem that BIS architects did not fully consider)
 - Sacerdotal view about central bank cooperation (no government to be involved)
 - Nevertheless, governments were involved in central banks' decisions to cooperate.
 - Ex. Italy's central bank joined the special account scheme primarily to increase its fascist government's "international prestige;" (rather than for a true spirit of cooperation) ; Bank of Lithuania stated that its first duty was to "stay always loyal to our government" and accepted to help only central bank of countries with "normal political relations" with them.