One Bank to Rule Them All: The Bank for International Settlements

By Devon Douglas-Bowers
Global Research, October 09, 2015
Theme: Global Economy

Please note that this article is being published as a three-part series on Occupy.com.

The Bank for International Settlements (BIS) is an organization that is shrouded in mystery, mainly due to the fact that the majority of people don't even know of its existence. According to the BIS itself, the main purpose of the Bank is to "to promote the cooperation of central banks and to provide additional facilities for international financial operations" and "act as trustee or agent in regard to international financial settlements entrusted to it under agreements of the parties concern."[1] This means that the BIS is to have the central banks work with one another to facilitate international operations and to oversee any international financial settlements.

The Bank has a Board of Directors, which "may have up to 21 members, including six ex officio directors, comprising the central bank Governors of Belgium, France, Germany, Italy, the United Kingdom and the United States. Each ex officio member may appoint another member of the same nationality. Nine Governors of other member central banks may be elected to the Board."[2] BIS also has a management wing in the form of a General and Deputy General Manager, both of whom are responsible to the board and supported by Executive, Finance, and Compliance and Operational Risk Committees.[3]

However, its purpose has changed and evolved over the decades, however, it has always been a club for central bankers, yet in many ways it can aid some countries more than others.

The origins of the BIS lie in the United States, specifically New York City. The individuals involved were international bankers who, despite past differences, "worked together to establish a world financial order that would incorporate the federal principle of the American central banking system."[4] Specifically among them were people such as "Owen D. Young, J. Pierpont Morgan, Thomas W. Lamont, S. Parker Gilbert, Gates W. McGarrah, and Jackson Reynolds, who, in conjunction with the Federal Reserve Bank of New York, sought to extend the principle of central bank cooperation to the international sphere."[5]Before delving any further into the creation of the Bank, it is necessary to examine some of the more notable of these individuals to better understand why they would be involved in the creation of an international bank.

Owen D. Young was already in good with the US government as he, “with the cooperation of the American government and the support of GE, organized and became chairman of the board of the Radio Corporation of America” and “in subsequent years he engineered a series of agreements with foreign companies that divided the world into radio zones and facilitated worldwide wireless communication”[6] Young had a strong belief that global radio service and broadcasting were important for the advancement of civilization. In 1922, Young became chairman of General Electric, and along with GE President Gerard Swope, “urged closer business-government cooperation and corporate self-regulation under government supervision.”[7]

During the 1920s, Young became involved in international diplomacy as the foreign affairs spokesman for the Democratic Party. At the behest of then-Secretary of State, Charles Evan Hughes, Young and Charles Dawes, a banker, were recommended to the Allied Reparations Commission in order to deal with the breakdown in Germany’s reparations payments following the First World War.The Commission resulted in the Dawes Plan which allowed for “Germany’s annual reparation payments would be reduced, increasing over time as its economy improved; the full amount to be paid, however, was left undetermined. Economic policy making in Berlin would be reorganized under foreign supervision and a new currency, the Reichsmark, adopted.”[8] Young viewed improving the world financial structure as important to “the very survival of capitalism” and furthermore he “sought rather the ‘economic integration’ of the world which would prepare the way for ‘political integration’ and lasting peace.”[9]

John Piermont Morgan, Jr. was already ensconced in the world of international banking, having inherited the JP Morgan Company from his father. During World War One, the House of Morgan worked hand-in-hand with the British and French governments, engaging in a number of tasks such as floating loans for the two countries, handling foreign exchange operations, and advising officials of each respective country.[10]

Both these individuals were heavily involved in politics and banking therefore had a personal interest in the creation of a global bank. It should be noted, this fits into the US government’s own policies as they wanted to “[keep] aloof from the political entanglements in Europe while safeguarding vital American interests by means of unofficial observers or participants.”[11] The Federal Reserve also was interested in the creation of the BIS as it would “[promote] both the ascendancy of New York City in world banking and the reconstruction of a stable and prosperous Europe able to absorb American exports.”[12]

This idea of an international bank didn’t occur in a vacuum. The creation of the bank “was inextricably tied to the problem of German reparations in the context of Germany’s overall debt burden during the 1920s.”[13] A slowdown in international lending to Germany began in 1928 as markets became extremely worried about the internal politics of the Weimar Republic. Due to the breakup of a center coalition government and the Social Democrats needing support from right-wing parties, the political situation began to fall apart with "government stability [being] threatened whenever budget debates exposed the basic social divide of unemployment insurance and increased industrial taxation on the one hand versus spending austerity and tax cuts on the other."[14] The budget problems came on the heels of the Reparations Committee having determined that Germany's total reparations came to $33 billion, which was twice the size of the country's total economy in 1925. As long as foreign capital kept coming into Germany, things were fine, however as was aforementioned, that situation changed in 1928.

Between February 1929 and January 1930, negotiations were made to reschedule Germany's reparations payments. "These negotiations were initiated by central bankers and private actors, who were the first to link problems in the capital market with the need to reorganize Germany's financial obligations."[15] Thus, it should be no surprise that many of the main individuals involved in the creation of the BIS were central bankers or engaged in international affairs/finance to some extent.

The idea for an international bank had already been explored to some extent by people such as John Mayard Keynes[16], however the idea truly took off during the Young Conference in 1929 when the Allies were attempting to deal with Germany's reparations debts for World War One. Belgian delegate Emile Franqui bought up the possibility of having a settlement organization to administer the reparations agreement and the very next day, Hjalmar Schacht, president of the Reichsbank and chief German representative at the conference, presented a proposal to establish such an organization to as a direct financier of global economic development and trade. The bank would act as a lender to the German central bank in case the Germany currency weakened and the government found itself unable to make the reparations payment. In addition, it would give steps for how to proceed in the case of German default as if "Germany did not resume payments within two years, the BIS would propose revisions collectively for the creditor governments (which would only go into effect with their approval)" and "the bank was responsible for surveillance and informing the creditor countries about economic and financial conditions in Germany."[17]

While the US State Department was concerned with having a settlement as State Department "economic adviser Arthur N. Young observed, 'a final reparations settlement' would 'promote both political and economic stability in Europe, and thus tend to be of advantage to the United States," the US government as a whole didn't want any type of linkage between reparations and war debts due to the fact that because each of the Allied nations was demanding reparations from Germany large enough to cover the debts it owed to the US, having such a linkage would mean that "Germany's refusal or inability to pay that amount would put Washington in the position of having to agree to a debt reduction or bear the opprobrium and suffer the consequences of opening the door to financial chaos."[18] However, several other countries had their own interests as well in the creation of the BIS.The French Prime Minister, Raymond Poincare, promised the French public that the reparations would cover the country's debts to both the US and Britain as well as cover the war damages. France was also interested in reaching an agreement on German debts as they were developing trade interdependence with the Germans and stability was needed.[19]

The British wanted to use the BIS as a means to ensure that the Germans would pay on their debts as scheduled. The Bank of England itself supported the creation of the BIS "because of its potential role in stabilizing the position of the pound in the international monetary system. Britain's relatively small gold reserves made it difficult to defend the pound without international monetary cooperation and the willingness of smaller powers to hold foreign exchange as reserves instead of gold."[20]At the meeting in Baden, Germany in October 1929 to draw up the final plans for the BIS saw the heavy presence of US finance in the form of Melvin Traylor of the First National Bank of Chicago and Federick Reynolds of the First National Bank of New York. There, the two nominated Gates W. McGarrah, chairman of the board of the New York Reserve Bank for the officer of President. Later, his assistant, "Leon Fraser, a legal counselor at Gilbert's reparations office, the Young conference, and Baden,"[21] would become president of the Bank in 1935. When the Bank of England expressed anger and that the European public wouldn't find American domination of the Bank acceptable, they were effectively told that if they wanted American participation in the BIS it would have to be on American terms. However, they did agree to appoint Pierre Quesnay of the Bank of France as the general manager of the BIS. The Bank was officially founded on May 17, 1930.

The role of the BIS quickly changed as with the onset of the Great Depression, it was unable to "play the role of lender of last resort, notwithstanding noteworthy attempts at organizing support credits for both the Austrian and German central banks in 1931" and due to the Depression, the issue of reparations was off the table due to Germany's inability to pay. The problem was further compounded when countries such as Britain and the US began to devalue their currencies (i.e. print more money) and the BIS attempted numerous times to end the exchange rate instability by restoring the gold standard, "the BIS had little choice but to limit itself to undertaking banking transactions for the account of central banks and providing a forum for central bank governors to help them maintain contact."[22] During the Second World War, all operations were suspended for the duration of the conflict, yet the situation became rather dicey for the Bank once the guns stopped firing.

Immediately after World War Two, the global economic landscape had massively changed and thus a new system was needed, In July 1944 over 700 delegates from the Allied nation met in Mount Washington Hotel in Bretton Woods, NH for the United Nations Monetary and Financial Conference which "agreed on the creation of the International Monetary Fund (IMF) and an International Bank for Reconstruction and Development (BRD), which became part of the World Bank,"[23] where the IMF would pay attention to exchange rates and lend reserve currencies to nations in debt. A new global currency exchange system was created in where all currencies were linked to the US dollar and in exchange the US agreed to fix the price of gold at $35/ounce.

All of this meant that there would be no need for currency warfare or manipulation. This proved a threat to the BIS as if the IMF was to be the center of this new global financial order, what need would there be for the BIS? Wilhelm Keilhau, a member of the Norwegian delegation, even went so far as to propose a notion to eliminate the BIS. However, the Bank was to continue as several other European nations noted its importance to the financial matters of the European continent and soon the move to eliminate the Bank was rescinded.Matters were stable until the 1960s and '70s as while the Bretton Woods system of "free currency convertibility at fixed exchange rates" coincided with a massive increase of international trade and economic growth, cracks began to show as the British currency was weak and, more importantly, the gold parity on the US dollar was straining due to "an insufficient supply of gold and from the weakening of the US balance of payments."[24] However, the Bretton Woods system collapsed on August 1971; however the system of 'managed floating' was created in its place which allowed for flexibility of exchange rates within certain parameters.

Later in the 1970s, the situation became all the more dire due to the creation of OPEC and the subsequent rise in oil prices and the Herstatt Bank failure.The Herstatt Bank was central in processing foreign exchange orders (people exchange currencies, such as trading in dollars for yen) and when German regulators withdrew the bank's license forcing the bank to close up shop on June 26, 1974. Meanwhile, "it was still morning in New York, where Herstatt's counterparties were expecting to receive dollars in exchange for Deutsche marks they had delivered"[25] and when Hersttat's clearing bank Chase Manhattan refused to fulfill the orders by freezing the Herstatt account, it caused a chain of defaults. It was this problem that led to the creation, in conjunction with the G-10 countries and Switzerland, of the Basel Committee on Banking Supervision in which the goal was to set the global standard for bank regulation and to provide a forum for bank supervisory matters.

Yet, this newly created stability was short-lived as in the 1980s and '90s saw serious economic problems involving Latin America and Asia.

Oil prices quadrupled in November 1973, leading to stagflation, an increase in balance of payment imbalances, and major shocks in international banking. The Euro-currency markets were growing as they began to be utilized by OPEC countries more and more as the oil-producing nations invested in European money markets, greatly increasing the money European banks had and thus could lend. Thus, the European Coal and Steel Community began loaning money to developing nations at a faster and faster peace and while this was largely beneficial to the world economy at the start, "it also implied that the international banking system was faced with an increase in country risk,"[26] as many of the countries that were being loaned to were getting more and more into debt. This concerned then-BIS Economic Advisor Alexandre Lamfalussy who warned of a threat of a crisis and was specifically focused on credit, saying in a 1976 speech that from" '[looking at]... the continuous growth of credits, the spread of risks to a large number of countries, and the change in the nature of credits – I draw the conclusion that the problem of risks has become a very urgent one."[27]

While real interest rates (the difference between yearly interest rates on savings and inflation rates) were negative in the 1970s, meaning that borrowers lost a percentage of every dollar they loaned, allowed for an increase in credit, it quickly came to a halt in 1979 as the US Federal Reserve tightened US monetary policy which led to an increase in debts which many Latin American countries were unable to pay off.

The BIS was worried about debt that matured in less than a year as by early 1982, such debt would amount to half of Mexico's and Argentina's debt respectively. On August 12, 1982, Mexico alerted the US that its financial reserves were exhausted. This prompted the BIS to work to get financial assistance to Mexico in the form of loans, as the Mexican government negotiated with the IMF. Specifically, the BIS "offered a US$ 925 million loan, backed by the G10 central banks and the Bank of Spain" and both the US Federal Reserve and Treasury "matched this with an equal amount, so that a total of US$ 1.85 billion was made available for an initial period of three months."[28] While there were some last-minute problems, Mexico eventually accepted the loan and made a promise to pay it back, "[consisting] of a gold pledge by the Bank of Mexico and advance claims on future revenues of the Mexican state oil company Pemex."[29] The first loan was paid out on August 30, 1982.

However, the loans were tied to the Mexican government enacting austerity measures.[30] This had serious effects as the cutback in public spending "set back many development programs, including poverty alleviation programs"[31] and the overall economic effects harmed “especially the lower and middle classes. For Mexican workers, real wages in 1986 were at virtually the same level they had been at in 1967; for many, a generation of economic progress had been wiped out by the ‘lost decade’ of the 1980s.”[32]

In the late 1990s in Asia, a new crisis would emerge. There were extremely robust GDP rates in the Asian markets, ranging from “more than 5 percent in Thailand to 8 percent in Indonesia. This achievement continued a pattern existing since the early 1980s. Rapid growth was fueled by high rates.”[33] However, the growth began to slow down in 1996, which “[reflected] slower growth of demand in the region’s principal export markets, a slowdown in the global electronics industry, and competition from Mainland China.”[34] This slowdown led to an increase in deficit rates, especially with Thailand, whose deficits grew eight percent of GDP. In an attempt to prevent fluctuations in the Thai currency, the baht, the government tied the value of the baht to a basket of foreign currencies, heavily leaning on the US dollar. However, because the dollar was gaining strength, the strength of the baht also grew, making the export of goods more difficult.

Thailand, as well as Indonesia, the Philippines, and Malaysia devalued their currencies 25 to 33 percent in the middle of 1997 and when Taiwan began to devalue its currency, it led to a speculative currency attack on Hong Kong the in which people sold off their Hong Kong dollars, expecting them to fall in value. This caused the Hong Kong stock market to crash in October 1997 while at the same time the South Korean won was weakening in value. From there the crisis grew to global proportions and spread to a number of countries such as Russia and Jakarta.

Thailand as well as South Korea and Indonesia went so far as to request assistance from the IMF, which the IMF granted of course, but only in exchange for brutal austerity measures. Much of this led to violence and even deaths in Indonesia and protests in South Korea.[35]

What is most interesting about the crisis is how the leaders of some of the affected countries spoke about it. Dr. Mahathir Bin Mohamad, the former Prime Minister of Malaysia, said in a speech on September 26, 2008 that “in 1997-98 American hedge funds destroyed the economies of poor countries by manipulating their national currencies.” It should be noted that this isn’t a simply ‘blame America’ attitude as Dr. Mohamad is “recognized as an authority on the role of hedge funds in financial crises, given his experience managing the Asian currency crisis as it engulfed his nation.”[36] The Reserve Bank of Australia “produced two reports in 1999 on the potentially destructive role of highly leveraged institutions such as hedge funds.” The reports claimed that “hedge funds contributed to the instability of its exchange rate in 1998, and it describe how hedge funds can have a destabilizing impact on not only the currencies of emerging economies but also on currencies such as the Australian dollar which has the eighth largest global trading volume.”[37]

In a paper written in early 1999 after the crisis ended, William R. White, then-Economic Adviser and Head of the Monetary and Economic Department at the Bank for International Settlements, wrote that “Many Asian-Pacific authorities (including representatives from Australia, Hong Kong and Malaysia) feel strongly that hedge funds set out systematically to destabilize their currencies and their financial markets. However, other evidence is less compelling in support of this hypothesis and, even if accepted, would not necessarily lead to the conclusion that such funds should be regulated.”[38]

So he is not only denying the evidence that not only have Dr. Mohamad produced, but also the Reserve Bank of Australia produced, but effectively saying that even if he did accept the information, so what?However, years later, in a turn of the ironic, White had warned of the global crisis as he and his team had been paying attention to the growing US real estate bubble and they "criticized the increasingly impenetrable securitization business, vehemently pointed out the perils of risky loans and provided evidence of the lack of credibility of the rating agencies."[39] He started warning people back in 2003, "[imploring] central bankers to rethink their strategies, noting that instability in the financial markets had triggered inflation, the 'villain' in the global economy."[40] White retired from the BIS on June 30, 2008 with his advice having been ignored.

This was due to the fact that the Federal Reserve was attempting to "artificially prop up those markets [of bad debt and worthless assets] and keep those assets trading at prices far in excess of their actual market value"[41] which led to them providing "$16 trillion to domestic and foreign banks in the form of secret loans and bought mortgage-backed securities that were in reality, completely and totally worthless"[42] as well as the fact that many of the people on the board of directors at the Federal Reserve also had connections to corporations that received bailout money.

Even still, after the financial crisis seemed to be over, the BIS was sounding the alarm about debt, in June 2010 the organization "delivered a stern message to central banks and governments that keeping interest rates low for too long, or failing to act quickly to cut budget deficits, could sow the seeds for the next crisis."[43] Earlier that year, the organization was warning of a sovereign debt crisis and noted that "Drastic austerity measures will be needed to head off a compound interest spiral, if it is not already too late for some."[44] It seems that from the austerity measures that have been enacted in Europe and the US, the call has been heeded. The question is this: how much devastation will this have and will it result in a 'lost generation' such as in 1980s Mexico?

Devon DB *is a 23 year old independent writer and researcher and is the Politics/Government Department Chair of the Hampton Institute. He can be contacted at devondb[at]mail[dot]com.*

Notes

1: Roger Auboin, *The Bank for International Settlements, 1930-1955*, Princeton University, https://www.princeton.edu/~ies/IES_Essays/E22.pdf2: Bank for International Settlements, *Board of Directors*,http://www.bis.org/about/board.htm3: Bank for International Settlements, *Management of the BIS*,http://w
ww.bis.org/about/officials.htm4: Frank Costigliola, "The Other Side of Isolationism: The Establishment of the First World Bank, 1929-1930," *The Journal of American History* 59:3 (1972), pg 602

5: Ibid, pg 603

6: Steven Schoenherr Home Page, *Owen D. Young*,http://www.sunnycv.com/steve/-ar/dd5/young.html7: Ibid

8: US State Department, *The Dawes Plan, the Young Plan, German Reparations, and Inter-allied War Debts*, https://history.state.gov/milestones/1921-1936/dawes9: Costigliola, pg 605

10: Martin Horn, "A Private Bank At War: J.P. Morgan & Co. and France, 1914-1918," *Business History Review* 74:1 (2000), pg 86

11: Costigliola, pg 603

12: Ibid

13: Beth A. Simmons, “Why Innovate? Founding the Bank for International Settlements,” *World Politics* 45:3 (1993), pg 370

14: Simmons, pg 375

15: Simmons, pg 377

16: J. Keith Horsefield, *International Monetary Fund 1945-1965 Twenty Years of International Monetary Cooperation, vol. 1 Chronicle* (Washington D.C.: International Monetary Fund, 1986)

17: Simmons, pg 383

18: Costigliola, pg 610

19: Simmons, pgs 384-385

20: Simmons, pg 389

21: Costigliola, pg 616

22: Bank for International Settlements, *BIS Archive Guide*,http://www.bis.org/about/arch_guide.pdf

23: Adam Lebor, *Tower of Basel* (New York: Public Affairs, 2013) pg 87

24: Bank for International Settlements, *BIS Archive Guide*,http://www.bis.org/about/arch_guide.pdf

25: Gregana Koleva, “Icon of Systemic Risk Haunts Industry Decades After Demise,” *American Banker*, http://www.americanbanker.com/bankthink/bankhaus-herstatt--icon-of-systemic-risk-1039312-1.html (June 23, 2011)

26: Piet Clement, Ivo Maes, “The BIS and the Latin American Debt Crisis of the 1980s,” *National Bank of Belgium*, Working Paper 247, December 2013, pg 3

27: Ibid, pg 4

28: Ibid, pg 17

29: Ibid

30: Paul Lewis, “Mexico to Receive $1.85 Billion In Loans,” *New York Times*, August 31, 1982 (http://www.nytimes.com/1982/08/31/business/mexico-to-receive-1.85-billion-in-loans.html)

31: Bhuvan Bhatnagar, Aubrey C. Williams, eds. *Participatory Development and the World Bank: Potential Directions for Change*, http://www-wds.worldbank.org/external/default/-WDSContentServer/WDSP/IB/1999/10/21/000178830_98101903552081/Rendered/PDF/-multi_page.pdf (October 31, 1992), pg 103

32: Robert M. Buffington, Don M. Coerver, Suzanne B. Pasztor, *Mexico Today: An Encyclopedia of Contemporary History and Culture* (Santa Barbara, CA: ABC-CLIO, 2004), pg 137

33: Barry Eichengreen, *Understanding Asia’s Financial Crisis*, Saint John’s University,

https://www.csbsju.edu/Documents/Clemens%20Lecture/lecture/Book98.pdf (November 2, 1998)34: Ibid

35: PBS, *Timeline of the Crash*, http://www.pbs.org/wgbh/pages/frontline/shows/crash/etc/-cron.html36: Stephen J. Brown, "The Role of Hedge Funds in Financial Crisis," *The EconoMonitor*, October 20, 2008 (http://www.economonitor.com/blog/2008/10/the-role-of-hedge-funds-in-financial--crisis/)

37: Hedge Funds, *Hedge Funds Studies*, http://www.fundshedge.co.uk/hedgefundsreports.htm

38: Bank For International Settlements, *Mr. White discusses the Asian crisis and the Bank for International Settlements*, http://www.bis.org/review/r990331a.pdf

39: Beat Balzi, Michaela Schiessl, "The Man Nobody Wanted To Hear: Global Banking Economist Warned Of Coming Crisis," *Der Spiegel*, July 8, 2009 (http://www.spiegel.de/-international/business/the-man-nobody-wanted-to-hear-global-banking-economist-warned-of-coming-crisis-a-635051.html)

40: Ibid

41: John Wallace, "The Financial Crisis and the Federal Reserve," *News Blaze*, September 27, 2008 (http://newsblaze.com/story/20080927140845tsop.nb/topstory.html)

42: Bernie Sanders, *The Fed Audit*, http://www.sanders.senate.gov/newsroom/press-releases/the--fed-audit (July 21, 2011)

43: Brian Blackstone, "International Finance: BIS Warns Countries About Risks of Debt," *Wall Street Journal*, June 29, 2010

44: Ambrose Evans-Pritchard, "Sovereign Debt Crisis At 'Boiling Point,' Warns Bank for International Settlements," *The Telegraph*, April 8, 2010 (http://www.telegraph.co.uk/finance/economics/7564748/-Sovereign-debt-crisis-at-boiling-point-warns-Bank-for-International-Settlements.html)

Articles by: **Devon Douglas-Bowers**