BIS Birthday *Blues*

Uneasy times as the Bank for International Settlements turns 75.

B Y K L A U S C. E N G E L E N

Central bankers—in contrast with finance ministers and finance officials—have a reputation for working behind a veil of secrecy. Therefore it is not surprising that for decades the Bank for International Settlements in Basel—"a central bankers' bank" and reclusive meeting place for those who pull the levers of global finance—has been shrouded in mystery. Such reclusiveness no longer works in a world where the BIS stands center stage in the efforts to reform the global financial architecture and where increasing transparency and disclosure is required as an alternative to more regulation of largely deregulated markets.

The seventy-fifth anniversary of the Bank—officially celebrated at the Bank's annual general meeting in Basel in June of this year—is a case in point.

Looking back at three-quarters of a century in central bank cooperation provided a fitting opportunity for the BIS leaders to demonstrate that central bankers are learning to open up and be more responsive to a skeptical public and to the financial community at large.

As host of this summer's birthday party, BIS General Manager Malcolm D. Knight and his chairman of the Board of Governors, Dutch central bank Governor Nout Wellink, not only acted to please the delegates from central banks, financial institutions, and guests from the international banking and financial communities. By allowing the first-ever public exhibition on the premises of the BIS Tower, they also gave a broader public—more than six thousand visitors—a chance to get a first-hand look at the inner workings of the central banker's bank and its his-

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torical roots. Presented in the exhibition were the glorious and also the not-so-glorious phases of the institution, including the darker sides of the bank's despicable dealings with the Nazis during World War II. The role and history of the BIS is presented in a fifty-page booklet called "this is the biz."

Half a century of the activities of the BIS are covered in a 729-page volume by Gianni Toniolo, a professor from Italy, and Piet Clement, the BIS archivist, on *Central Bank Cooperation at the Bank for International Settlements, 1930–1973* (Cambridge University Press, 2005). And as part of the seventy-fifth birthday agenda, an academic conference on the "Past and future of central bank cooperation" was held in July, attended by central banker legends such as Paul Volcker, Alexandre Lamfalussy, and Jacques de Larosière, and top academics such as Barry Eichengreen, Richard Cooper, Harold James, and Charles Goodhart.

Some BIS staffers had different reasons for not spreading the welcome mat for Malcolm Knight, a twenty-four-year International Monetary Fund veteran who—in his short stint at the Bank of Canada—made a name for himself in one area especially: reducing staff and cutting costs. However, what Knight presented to the BIS anniversary gathering was a further gradual expansion—not the cost-cutting drive some had feared. By keeping the staff of the BIS—from some fifty different countries—at about 550, Knight didn't shake up the Basel towers as predicted. By appointing German economist Peter Dittus to the job of Secretary General—a position vacated by another German, Gunter D. Baer—and by placing Günter Pleines, a former Bundesbanker, to head the banking department, Knight helped to improve the strained relations with Germany and the Deutsche Bundesbank.

—K. Engelen

BIS General Manager
Malcolm D. Knight

For Knight, organizing the historic birthday events in the middle of his first term and presenting further impressive progress in the transformation "from a predominantly European organization into a truly global institution servicing central banks around the world" was a welcome occasion to heal bad feelings originating from an election process that some saw as an Anglo-Saxon takeover of a European bastion.

A GOOD START FOR THE NEW BIS GENERAL MANAGER

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Without a doubt, since its founding as a predominantly European organization in 1930, the BIS has developed into a truly global central banker's bank in ways that have made it into an important pillar of today's world financial system. In the financial crises of

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Old Unease at The Tower of Basel


Big Unease at the Tower of Basel

By Klaus C. Engelen

Once a European fortress, the BIS is about to experience a Canadian takeover. Is this an emerging Anglo-Saxon Trojan horse? TIE's Klaus Engelen goes behind the scenes.

The Big-Time Players

Two years ago *TIE* wrote about the "Big Unease at the Tower of Basel"—a high-level reshuffling underway at the BIS and the threat that this European fortress was about to experience a "Canadian takeover" via an Anglo-Saxon Trojan horse (Spring 2003). At the time, some European financial officials accused key European central bankers of having committed a major strategic blunder in a world of escalating transatlantic rivalry and tension by selecting as general manager a Canadian central banker who had spent most of his professional career at the IMF.

Yet on April 1, 2003, a bit more than two years ago, Malcolm D. Knight, 58, senior deputy governor of the Bank of Canada since 1999, succeeded Andrew Crockett, who in almost a decade transformed the BIS from an exclusive forum for major central bank governors into a global service institution for central banks. Then and now the bank's high-caliber team of economists is headed by William White, also a Canadian. Another Canadian, Nick LePan, superintendent of financial institutions, took the newly established position of vice chairman of the Committee on Banking Supervision.


Bank for International Settlements building, Basel, Switzerland.

The reshuffling at the BIS concerned European finance officials and regulators for another reason. A second key international position held by Crockett was at stake: the chairmanship of the Financial Stability Forum, the global platform for cooperation among financial policymakers. Worries about a creeping Anglo-Saxon takeover in Basel were confirmed when Roger W. Ferguson, Vice Chairman of Board of Governors of the U.S. Federal Reserve System—who had already assumed leadership of the Committee on the Global Financial System in Basel—was put at the helm of the Financial Stability Forum. There was fear that the combination of an IMF veteran heading the BIS and a key aide to Alan Greenspan heading the FSF would make it much easier for the Americans to steer discussion of such sensitive topics as high U.S. current account deficits and their risky external financing, the concentration of derivative risks, the regulation of hedge funds, and the risks of government-sponsored enterprises like Fannie Mae and Freddie Mac.

Karel Lannoo, who heads the Brussels CEPS Research Institute, said, "Europe shouldn't lose what the BIS has been providing until now, namely independent, high-quality economic and monetary analysis from a European angle." In his view, the BIS and its various committees such as the CGFS have a reputation for delivering "a second opinion" in a world of analysis dominated by Anglo-Saxon experts.

But other BIS watchers saw the choice of someone wired into the Washington-IMF establishment as an asset. Said Robert Pringle, publisher of the London magazine *Central Banking*: "The BIS has always shown a remarkable ability to adjust to changing circumstances and has in the past narrowly survived potential threats to its existence. It is now showing an admirable degree of Darwinian survival instinct. The appointment of Malcolm Knight is another stage in the evolutionary struggle."

—*K. Engelen*

"BIS Not Fallen Under the Influence of U.S. Authorities"

William R. White, who for more than ten years has served as chief economist of the BIS, admits to "complete puzzlement" about suggestions "that the BIS has suddenly begun to pull its punches about needed policy changes in the United States because we have somehow fallen under the influence of the U.S. authorities."

He argues that "There must always be a certain amount of reading between the lines to get the full BIS message." And he points out, "In reality, nothing material has changed in terms of the independent expression of my views since my arrival at the BIS; neither under Andrew [Crockett] and Malcolm [Knight]…"

As to the absence of controversial policy suggestions in the BIS Annual Report, White recommends "a number of them that should attract attention." For instance, "proposing a new framework for conducting both macroeconomic and regulatory policies to resist the costly fall-out from financial imbalances." This "attests to our belief that the framework that has led to past policies must be improved upon." Part of the new framework would be "a more 'symmetric' monetary policy; this is sharply at odds with the idea of only leaning against the aftermath of bubbles."

White, who worked more than two decades with the Bank of Canada before coming to Basel, draws attention to the praise the latest BIS Annual Report received from *The Economist* in its July 2, 2005, issue for its "willingness to question the common complacency of policymakers," its warning to central banks that "targeting inflation is not enough," and for its worries about "the rapid growth in debt and asset prices" in a world of deregulated financial systems where inflation has been defeated.

The problem with White's suggestion to "read between the lines to get the full BIS message" and with his diplomatic way of presenting controversial issues in the BIS Annual Report might be subject to selective perception. Many readers don't know where the "central bankers' bank" stands.

—K. Engelen

the past two decades, the BIS emerged as an important short-term lender in multilateral emergency assistance operations in cooperation with the IMF and other central banks and national monetary authorities. This happened in 1982 (under the BIS leadership of Fritz Leutwiler as president and Günther Schleiminger as director general), when major debtor countries including Mexico and Brazil defaulted and the survival of the global banking and financial system was threatened. After the financial and banking crises of the 1990s, the G7 finance ministers and central bank governors embarked on a major effort to reform and strengthen the international financial architecture. As it turned out, this meant more mandates for the BIS—to serve as a global forum for training and for cooperation between financial market supervisors and regulators, and as a place where new international banking rules such as Basel II could be negotiated.

Thus, at a time of globalization and dramatic change, this venerable financial institution offers some lessons. One is that central bankers are able to change while sticking together to preserve their independence from governments and finance ministers. The other is that sometimes this change comes at a high price in terms of traditions, credibility, and shifts in influence and power.

A GLOBAL BIS FOLLOWING ITS NEW MASTERS

This explains why not all of the central bankers celebrating BIS's seventy-fifth birthday this summer were happy. Among some European central bankers, there was a feeling of resignation and loss in watching what used to be a European power center in economic and monetary research gliding into the American-dominated mainstream, where an almighty U.S. Federal Reserve Board in close collaboration with the U.S. Treasury pulls the strings. For them, the fact that the "Basel Tower" is no longer using its traditional independence from governments to take firm and critical positions in its Annual Report, but instead is hedging most of its bets, is a worrisome indication that the new BIS managers don't want to take on the policy failings of the big global economic powers. Only listing "Yes" and "No" answers in the Annual Report when exploring the most controversial issues in today's international economic and financial debate is not what the central banking and financial world traditionally expects from

Founding Fathers

The Basel exhibition includes a historic photo showing four leading central bankers meeting in New York prior to the establishment of the BIS in July 1927: **Hjalmar Schacht** (Germany), **Benjamin Strong** (United States), **Montagu Norman** (United Kingdom) and **Charles Rist** (France).

Norman and Schacht in particular had the common vision to use the mandate of the governments of Belgium, France, Germany, Italy, Japan, the United Kingdom, and the United States, of the Second Hague Conference on January 20, 1930, to establish a trustee bank to better administer German reparation payments as a much-needed forum for closer central bank cooperation.

—K. Engelen

Hjalmar Schacht (Germany), Benjamin Strong (United States), Montagu Norman (United Kingdom) and Charles Rist (France).

the BIS flagship publication in times of global disorientation. Also, investors acting in both mature and emerging markets need orientation at a time when other experts from the official and private sector are coming up with a wide range of often confusing and completely contrarian answers on current economic issues.

Mitigating the feeling of loss among some Europeans is the hope that the European Central Bank is now assuming more of the critical counter-position in the global economic and monetary debate that the BIS seems to be relinquishing. It is now the annual and monthly reports of the ECB where U.S. policymakers are criticized most sharply for such policy failures as allowing ever-larger current account deficits, inaction on the breakdown of private savings, and risking more financial instability by not reining in megaspeculators who are using hedge funds to take advantage of historically low interests and an oversupply of liquidity.

AN OLD INSTITUTION WITH MANY DIFFERENT LIVES

At seventy-five, the oldest financial organization can be considered to have led several different lives. As a central bankers' bank, the BIS survived by reinventing itself and adjusting to ever-changing times and challenges.

The Bank for International Settlements was established in 1930 by western governments to administer reparations payments required from Germany under the Treaty of Versailles following the First World War. While at the time governments were thinking in the

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context of the Young Plan of establishing a trustee institution to process and settle Germany's reparation payments, key western central bankers advising their governments had a second agenda.

Even before Hitler took power in Germany and repudiated reparations, the BIS had lost the trustee business it was created for due to the financial and budgetary crises of the Weimar Republic. Although the breakdown of the monetary order, the Great Depression, and the growing political turmoil didn't leave much room for central bank cooperation, central bank governors continued to meet in Basel each month until the beginning of the Second World War.

In spite of adopting a "neutrality declaration" at the outbreak of the war, investigations afterward revealed that the German Reichsbank had used large quantities of gold stolen from central banks in the occupied countries to make wartime payments to a number of institutions including the Swiss National Bank and BIS. As the BIS notes in its exhibition booklet, "During the war, the BIS received 3.7 tonnes of such gold which, it later emerged, had been taken from the central banks of Belgium and the Netherlands. The BIS cooperated fully with the investigations and returned all this gold by 1948."

Its despicable dealings with the Nazis in receiving and laundering the shipments of plunder explain why the 1944 Bretton Woods Agreement establishing the IMF and the World Bank also called for the abolition of the BIS. But central banks, particularly in Europe, came to the rescue of what they saw as "their institution," an institution not under the control of governments. As East-West relations deteriorated into the Cold War, the BIS provided a valuable contact forum for central bankers from both sides of the "Iron Curtain." After the United States launched the Marshall Plan and set up the European Payments Union in the framework of the Organization for European Economic Cooperation, the BIS—as EPU agent—assumed a key technical role in helping European countries make their currencies fully convertible.

This meant that after 1950, the BIS became an important vehicle in gradually doing away with

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Don't mix up the BIS Committees

Regular meetings among the Governors of BIS member central banks are at the center of what some call "the BIS process." These bimonthly meetings comprise four regular meetings of governors: the Global Economy Meeting, the meeting of Governors of the G10 countries, the All Governors Meeting, and the Review Meeting for Governors. In addition, governors of key emerging market countries also meet separately. On average, about forty central banks are represented. In a recent initiative, senior representatives of the financial sector are invited to Basel to exchange views with governors and other central bankers.

The central bank governor of Spain, Jaime Caruana, is presently chairing the Basel Committee on Banking Supervision that last year got the green light from the G10 governors for the new capital standard known as Basel II.

Federal Reserve Vice Chairman Roger Ferguson chairs the Committee on the Global Financial System that, in addition to monitoring of financial market activities over the year, is investigating structural changes that affect how the financial system worldwide rally works. Another U.S. central banker, Tim Geithner, president of the Federal Reserve Bank of New York, is in charge of the Committee on Payment and Settlement Systems that just recently published the "General guidance for payment system development." In addition, the BIS Towers host the secretariats of the International Association of Insurance Supervisors, the International Association of Deposit Insurers, and the Financial Stability Forum.

—K. Engelen

exchange restrictions and making European currencies convertible on international markets. Full convertibility was restored at the end of 1958. The BIS also served as a platform where central banks could implement and defend the Bretton Woods international monetary system which was based on freely convertible currencies at fixed but adjustable exchange rates. During the "silver fifties" and the "golden sixties" the BIS started to play an important part in crisis management among central banks whenever the gold price, the position of the reserve currencies (the dollar and the pound sterling), or other monetary imbalances threatened to undermine the international monetary system.

Even before the Bretton Woods system of fixed exchange rates gave way to the era of floating currencies in 1973, the BIS had become an important platform for ever-closer cooperation and integration of monetary policy at the European Economic Community level. In 1964, the Committee of Governors of the Central Banks of the Member States of the EEC began to meet regularly at the BIS to put limits on exchange rate fluctuations between participating European currencies as a step to towards closer integration (the so-called currency "snake"). In the run-up to European Monetary Union under the Maastricht Treaty of 1992—with the introduction of the European Monetary System (EMS) in 1979, the work of the Delors Committee Report of 1989, and the establishment of the European Monetary Institute, precursor of the European Central Bank—the BIS served as a sort of launching platform for the most ambitious European integration project.

ADJUSTING TO EMU BY GOING GLOBAL

Coming to the BIS in January 1994 after stints at the IMF and the Bank of England, Andrew Crockett reacted promptly to the formation of the European Central Bank by setting his institution on a new course to become a global service center for central banks and a global platform for setting standards and modernizing financial market supervision. Crockett also won backing from the seventeen-member Board to invite central banks from emerging markets and important financial centers such as Hong Kong into the BIS, which substantially broadened its field of activities. Representative offices in Hong Kong and Mexico City were established.

G7 finance ministers recognized the outstanding role of the BIS in reforming and strengthening the international financial architecture by asking Crockett to head the newly formed Financial Stability Forum. Begun in April 1999 with the blessing of the G7 finance ministers and following the recommendation of Hans Tietmeyer, former president of the Deutsche Bundesbank, the Financial Stability Forum has since done much to bring together on a regular basis, with a small secretariat at the BIS, the national authorities responsible for financial stability in international financial markets. By placing the distinguished former governor of the Czech central bank, Josef Tosovsky, as director of the newly established Financial Stability Institute, Crockett was also able to strengthen the BIS' role as a global training center for central bankers, financial supervisors, and regulators. The Financial Stability Institute has organized numerous seminars and high-level meetings with central bankers and other supervisors from around the world. In addition, last year, it saw the launch of "FSI Connect," an online information and learning resource tool for banking supervisors.

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In its three main areas—central bank assistance, banking supervision, and financial stability—the BIS has played a crucial role in the evolution of today's global financial system. "From its very first days, the BIS has acted as an agent for the central banking community in providing short-term emergency support, helping to address financial crises threatening the stability of the international financial system as a whole," says the bank in its official history. Early on, during the financial crisis of 1931–33, the BIS organized support credits for both the Austrian and German central banks. Later, in the 1960s, the BIS arranged special support credits for the French franc and two so-called Group Arrangements to support the sterling. More recently, the BIS has provided emergency finance for IMF-led stabilization programs for Mexico in 1982 and Brazil in 1998. As the growth of international financial markets and cross-border money flows in the 1970s highlighted the lack of efficient banking supervision on an international scale—with the collapse in 1974 of Bankhaus Herstatt in Germany and of the Franklin National Bank in the United States going beyond the realm of national financial supervisors—the G10 central bank governors set up the Basel Committee on Banking Supervision. In December 1975, the Committee adopted the "Basel Concordat," calling on host- and home-country authorities to share supervisory responsibility for banks' foreign activities. In 1988 this Committee issued the Basel Capital Accord, introducing a credit risk measurement framework for internationally active banks that became a globally accepted standard. The revision—known as Basel II—is to be implemented worldwide after 2006.

LOWERING ITS CRITICAL VOICE IN THE GLOBAL ECONOMIC DEBATES

One role the BIS has used very effectively—until recently—is as an independent authoritative voice in the economic and monetary debates of the times.

Right from the start the BIS staff used its independence from governments to become a "leading authority" in its economic and monetary research.

Since most supranational or multilateral organizations—the International Monetary Fund, the World Bank, the Organization for Economic Cooperation and Development, and the European Commission—operate more or less under the influence of governments, the BIS has been in the privileged position of being accountable only to independent shareholder central banks.

Here things are changing—and not for the better. In the view of some Basel watchers, the central bankers' bank is now "so much hedging its position on the major politically sensitive economic issues that nobody, reading this year's annual report, will find out where the BIS really stands." With the backing of major European central banks, the BIS took firm positions in the economic and monetary debates of recent decades, not shying away from getting into fights with governments—not only in Washington and Tokyo but also in Europe.

When the United States was using the old Bretton Woods system of fixed exchange rates to finance the Vietnam War by causing an inflationary dollar glut in Europe and other surplus areas, the BIS was the first to sound appropriate warnings. It was also the BIS in its Annual Reports that warned emerging market countries and private sector banks about risking their solvency in the reckless recycling of petro-dollar surpluses of oil-producing countries without due consideration of a possible rise of U.S. dollar interests.

When key European politicians decided to bring integration a step further and form a European Monetary Union, it was the BIS staff that spelled out in great detail the risks and costs of such a project, such as the loss of the trusted deutschemark and Bundesbank for Germany. Even in recent years the BIS has been very clear in sending out early warnings to governments, supervisors, and market actors on the recurrence of credit, asset price, and investment booms and busts. The BIS had been taking on U.S. policymakers much more firmly than other multilateral institutions for running ever-larger current account deficits and financing them by absorbing most of the world's savings.

When some European governments, faced with criticism from the BIS economists over the prospect of a single European currency, put their central banks under pressure to get a handle on the drafting process of the BIS Annual Report, they met with stiff resolve from the BIS to protect the independence and integrity of the institution's economic research.

TO REMAIN CREDIBLE MORE COURAGE IS REQUIRED

For the great economist John Maynard Keynes, the BIS annual reports had a special place due to their quality of research and statistical foundations. "Between 1934 and 1936, Keynes contributed three reviews to *The Economic Journal* on current international economic concerns, always using the current annual report of the Bank for International Settlements as the excuse," notes Donald Moggridge, who edited Keynes' economic articles and correspondence. Writing in response to the Fourth Annual Report of the new bank in Basel in 1934, Keynes explained that "this Report, which covers much interesting ground, is now the leading authority for certain statistics, not easily obtainable, relating to gold and exchanges." And he continued: "It is particularly useful because it goes beyond the published statistics and ventures on certain estimates and opinions which can be based on information not generally available. Whilst the central banks on the Board of the BIS cannot be presumed to take any responsibility for the facts and estimates in the Report, it is reasonable to suppose that the report will not contain any statement which the representatives of the central banks know to be wide of the mark."

This early praise for the Annual Report of the BIS—coming from the most influential economist of the time—was reflected in a tiny but enlightening exposé in the exhibition at BIS headquarters this summer. Lord Keynes' praise serves as a reminder to those who are responsible for drafting the Annual Report. They should continue providing the kind of authoritative orientation on the major global economic and financial issues that is called for in troubled times. More courage to use its institutional independence to take a firm stand on the major controversial international economic issues is what the BIS needs for the next seventy-five years. ◆