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THE BANK FOR INTERNATIONAL SETTLEMENTS: ITS PLACE IN THE GOLD MONETARY ORGANIZATION

THIS article aims to deal with the Bank for International Settlements, not in terms of its immediate past or current operations, but to interpret its significance in relation to the evolution of the gold standard monetary organization. In the latter respect this newly created institution seems to possess striking potentialities which will be of great future importance to the world of economic activity. The points under which the present status and future possibilities of the Bank for International Settlements will be discussed are as follows: (1) major stages in the evolution of the gold standard monetary organization; (2) pre- and post-war challenges to the gold standard system; (3) emergence of the Bank for International Settlements in the final stage as a keystone in the development of the gold standard order; (4) probable stages in the development of the Bank for International Settlements toward the fulfilment of the evolution of the gold money standard; (5) consequences to be expected after the completion of the final stage of development of the gold standard monetary organization through the service of the Bank for International Settlements.

1. *The three phases in the evolution of the gold standard organization.*—From a broad historical standpoint, the major stages through which the gold standard monetary organization has

evolved may be interpreted as follows: (1) the early formative period when gold was the chief circulating medium and in immediate direct or indirect relation with actual exchange processes; (2) the second stage, which witnesses the process of gold absorption by commercial banking institutions as reserves against bank notes and deposits—credit funds slowly appropriating the functions of medium of exchange and partly that of the standard of value at least over short periods and to some extent over long periods; (3) the third stage, now practically culminated, in which private banking institutions parted with gold holdings as reserves through the centralization of gold in central banks, permitting banks to count deposit credit with the central banks as their actual working reserve; and (4) the fourth probable stage, now seeming to be in the offing, when central banks will permit their gold holdings to become concentrated in the Bank for International Settlements as the supercentral bank and count deposit credit with the latter as their actual working reserve.

Now, of course this delineation of stages is not to convey the idea that the demarcation can be clearly drawn in point of time. For the industrially civilized world as a whole the stages are recognizable in their monetary history, although not simultaneously attained by these respective nations. That is to say, each nation exhibited within limits particular characteristics while passing through each of the three periods. For example, the United States passed through the initial stage from the time gold began to circulate as money to the period approximately set off by the last decade of the nineteenth century; the second stage overlapped with the first, during this last decade and reached its culminating phase about 1917 when, under war circumstances, gold in hands of banks was impounded in the Federal Reserve System; the third phase is clearly the one initiated after 1917, its form now practically consummated although still continuing. One must not overlook the fact that other moneys, such as silver for example served along with gold, and, although gold standard monetary legislation aided to shape the development, nevertheless the above-mentioned stages seemed to have been predicated more on other forces than those of legal origin.

Theories aiming to explain the relation between money, gold, credit, and prices also seem to have been born consonant with the periods above outlined. The difficulty with these theories has been that they have lagged in relation to the processes which changed with the development in the actual gold standard situation. Thus, it is still assumed, at one extreme, in many theoretical constructions of the relation between gold, credit, and prices, that gold is still in active immediate relation, as a circulating medium, with exchange processes. Therefore, it is alleged that gold value and goods value can be equated directly in terms of price. However, taking a long-time view of the evolution of the gold standard monetary organization, and conceiving the true position of gold in central banks as an administered reserve against credit operations, an alteration in theory becomes imperative. Such altered theory would conceive of gold as performing merely an indirect regulatory function in relation to the emission and remission of bank credit funds, i.e., gold as central banking reserve does not only function to some degree automatically but also administratively to limit the extent to which elastic credit funds may be created by banks and to influence their contraction in periods of business depressions. Obviously, what goes on among the price-making factors in realistic commodity markets is to a large extent predicated upon the evolutionary processes in the monetary organization itself. This is again over short periods conditioned by the various phases of the business cycle and by such non-monetary factors as operate therein. What is of significance in this connection is that in the third phase in the evolution of the gold monetary system—and this would be equally true of the fourth in the offing, an entirely different conception is required of the processes attached to the monetary factors for purposes of explaining price behavior over both short and long periods.

2. *Pre- and post-war challenges to the gold standard system.*—In the course of monetary history, the increasing incursion of credit operations in business and financial activities has resulted in a progressive separation of money functions from gold, especially in the third stage, when gold assumed its position as central banking reserves. The assembling of gold in central banks permitted a

powerful increase in the volume as well as in the scope of credit operations, for it aided the increase of primary expansion of bank credit and added to this the enormous actual and potential secondary expansion of bank credit based upon central banking operations. In the United States the belated concentration of gold reserves in the Federal Reserve banks witnessed a very rapid and voluminous expansion of credit operations, especially since 1917. The growth in consumers' credit, loans on real estate, agriculture credit, and in loans on securities as well as in bank investments since 1917, offers convincing evidence on this point. In addition, debts incident to the World War and to the subsequent rehabilitation of industries ravaged by war further augmented the increase of credit.

The huge superstructure of credit so created, and which it was possible to create, is particularly a phenomenon of the third phase in the evolution of the gold standard monetary organization under the hegemony of central banks. Centralization of reserves permitted an increase in primary bank credit expansion, as well as in the additional funds, through secondary expansion permitted on the basis of central bank operations. The effect on prices of this huge increase in credit funds since 1921 was held in abeyance on account of a remarkable increase in production efficiency. The inflationary effects, however, were chiefly spent in the security market with the concomitant and indirect optimistic revaluation of the fixed and other assets underlying common stocks. Nevertheless, it seems a safe conjecture that the increase in credit funds did exert an inflationary influence in keeping the commodity price level above the pre-war level and in serving to sustain the subsequent course of prices, thus preventing them from dropping as much as they might have otherwise in face of increasing production efficiency. In retrospect, the present liquidation period with its marked commodity price declines lends credence to this view.

The point of interest in this connection is that the huge volume of credits created and still currently in existence rests on a business world with large fixed assets, much overcapacity and heavy attendant overhead costs. In face of a probable long-time declining price level inaugurated (1) by deficient gold production, (2) by a reduced rate of credit expansion, and (3) by existing and continuing overcapacity under efficient production, not only may the liquedation of credits be jeopardized by inadequate reproduction and turnover on account of overlarge fixed assets but also by an obstreperous price level which may defy resuscitation. All of this is inevitable when, as a rule, business enterprises as well as governments committing themselves to obligations do so by holding a rosy vision of the future and hope to amortize with the vicarious aid of a long-time rising price level. In fact, some of the more civilized governments in Europe frankly avowed this position before the war, and after, with respect to their debts.

With the third phase of the evolution of the gold standard system climaxed by the credit conditions described above, the emergence of the idea of a supercentral bank offers auspicious implications. In a broad way, it is curious to note that in the United States the nature of panics and crises took its complexion from the stages in our monetary evolution. Up to the World War, panics and crises resulted from money-reserve difficulties because we lacked organization in our gold reserves. Also, we had outgrown automatic gold-reserve regulation and required an administered gold reserve; this became more and more evident before the war, since credit constituted a larger portion in our financial mechanism. In the first decade and a half of the twentieth century these financial difficulties appeared to become more and more of a credit nature, but still largely of a money-reserve origin on account of our unorganized gold standard system. Leaping to the crises of 1929–30 in order to avoid entanglements with immediate postwar factors, we witnessed and are witnessing for the first time in the United States a real credit crisis. That this seems true one may glean from the reserve ratios and gold holdings of the Federal Reserve System and from the harshness and character of the credit liquidation which has been under way since the latter months of 1929. The evolved stage of central banking must not be regarded as vitiating the importance of gold reserves, but attention is called to their growing significance as regulatory rather than as convertible reserves. One cannot avoid the suggestion that if the war had not occurred there would have appeared a need for a supercentral bank just the same. European countries, particularly England, France, and Germany, were already approaching saturation of their credit system and required the relief which the Bank for International Settlements now is to afford.

3. *The Bank for International Settlements as the keystone in the fourth and final stage of evolution of the gold monetary organization.*—The immediate occasion of originating the Bank for International Settlements was, of course, the attempt to meet the transfer problem connected with reparation payments by Germany—no better and more fertile occasion could have been desired. It provided a favorable setting for the creation of an institution which the world needed badly. It already had become an economic necessity through the evolution of the gold standard monetary organization long before payments of reparation became an issue. The origination of a supercentral bank must be interpreted as man's stroke to provide an instrument in which and through which the normal development of a credit system could find satisfactory expression. Further successful evolution of the capitalistic system is to a large extent dependent on the continuous growth and use of credit. *In short, the Bank for International Settlements is the keystone in the fourth and final stage in the evolution of the fagging gold standard system.*

There was much at stake in the development of the future credit and price situation on the basis of very immediate evidence. The increased volume and expanse of credit operations under the influence of the central banking régime in the third phase, the growing long-time character of these credits, the large efficient underlying production capacity with its continuing pressure on prices, the heavy overhead costs attending the enlarged fixed assets, declining gold production—all of these factors rendered uncertain the possibility of amortization through timely reproductivity and turnover. The desirability of staving off public clamor for managed currency systems or for extra-metallic monetary standards need not be questioned. The imminent political factors involved, possibly in a long-time decline of the price level on account of lower wages and personal incomes attendant thereon, held potential political dangers for the social and economic system. A rapidly rising standard of living with its necessary correlative, increasing production and consumption, could be insured more easily against jeopardy inherent in the crystallized credit structure reached in recent times provided a new means could be found promptly to retain at least the current price level if not to instigate a long-time climbing one. With these conditions and imperative factors so ominously challenging, the immediate creation of a supercentral bank attests to the genius of our financial leaders. It remains for us to interpret the significance of probable phases of development of the Bank for International Settlements in order that it may meet the requirements which the forces in the credit system have laid out for it in the final stage of our gold standard organization.

4. *Three probable stages in the development of the Bank for International Settlements.*—The general outline of the development of the supercentral bank may be forecast on the basis of giving more complete expression to the requirements of the existing gold standard organization: (1) the period of assimilation with national banking systems, particularly with existing central banks and national money markets, through operation chiefly with its own capital and deposits of central banks; (2) the second phase of adding clearing operations with permissible custodianship of a gold settlement fund and of partaking an increasing responsibility for regulating disparities arising between the respective national money and exchange markets, first, aiming to smooth them out and later to counteract impending changes by anticipating them; and (3) the final stage, culminating in its influence as an organ of tertiary credit expansion—the maturing of this somewhat predestined position will await the revisions of legal reserve requirements of central banks and the development of an active attitude on the part of the national banking systems toward using the supercentral bank.

The formative character of the initial stage is self-evident. No significant additions or changes in credit operations may be expected. The working capital of the Bank for International Settlements will be obtained from the stock subscriptions and deposits of central banks, as has already taken place. These operations merely changed the loci of the funds and the place from which they are handled in money markets, although an alteration of policy with respect to administering these funds might presumably exercise different effects than would have maintained had the funds remained in former hands. It seems that this stage is merely a preliminary one occupied with processes of initial assimilation of superbank operations with those of the national systems.

The second phase will witness a more positive set of credit operations. The development of clearings of an international character requiring the handling of a gold settlement fund will initiate far-reaching consequences. These will be (1) economizing gold by reducing international shipments, (2) moderating of variations in foreign exchange rates, (3) utilizing the mildly acquired power to create credit funds on the basis of the gold deposited or acquired in its own right, for purposes of synchronizing national money markets and of anticipating disparities therein by means of short-term credit operations. The effects of these will undoubtedly be to raise the total volume of credit operations over and above what would otherwise be possible had there been no supercentral bank. At first the superbank might conceivably operate in and out of national money markets, while later it might remain more or less in all markets similar to the practices of central banks which long ago found it necessary to be in the money market at all times if they wished to exercise influence in it.

The Bank for International Settlements will attain its matured position in the final phase in the evolution of the gold monetary system when it undertakes measures and responsibility for tertiary credit expansion. Concepts of "secondary" as well as of "tertiary" credit expansion imply that the underlying banking systems can expand credit funds to a greater extent when reserves are centralized, and in addition there is further expansion possible on the basis of credit operations permissible to central banks or to a supercentral bank. Funds resulting from the credit operations of central banks as well as the supercentral bank may be used to build up reserves at these banks by the underlying banking system. The exercise of tertiary credit expansion by the Bank for International Settlements will require a further development in the centralization of gold reserves. It seems a logical step in the light of historical experience with gold. First, gold passed, as we have already stated, from a circulating medium into coffers of banks, then from these private banks into the possession of central banks, and now comes the final shift from central banks to the supercentral bank. The nations' gold reserves may be divided into two parts: (1) that portion which experience has determined to be the approximate minimum national reserve which under normal conditions remains in a nation as a residual and (2) that portion which shifts or is shiftable between nations according to disharmonies arising in international balances of payments. The latter portion might again be subdivided into (*a*) that part which actually does shift over short intervals and (*b*) that part which is considered as a protective supply acting or conceived as a necessary buffer for emergency between the actually shifting supply and the national minimum. For example, the national minimum for the United States might be pointed to as being the amount calculated on the basis of the average Federal Reserve requirement against demand liabilities, deposit and circulating notes—given the 35 and 40 per cent legal ratios, plus the gold in the United States Treasury held against greenbacks, etc. The "free gold," now calculated by some authorities to be in the neighborhood of $800,000,000, would be equal to the second shiftable portion. However, no one would suggest under present conditions that all of this is a disposable portion. A certain portion of this is regarded as a buffer between the really disposable portion and the national minimum supply.

5. *Consequences which may be expected.*—Naturally, the various nations, through their central banks, in the future might be expected to place with the Bank for International Settlements, as experience is gained and confidence has been acquired with effective sentiment and measures for international peace, roughly first the portion of shiftable and disposable supply of gold, then the intermediate buffer part, and finally the entire supply of the now conceived necessary national minimum. While these deposits of gold are undertaken, central banks must be legally permitted to count deposit credit with the Bank for International

Settlements as reserve. When these conditions are fulfilled, the tertiary credit expansion can be undertaken with responsibility therefor lodged in an international body whose credit policies for the supercentral bank would be decisive. For how long the gold standard system in this final form of operation and administration would meet the requirements of the evolving credit and capital system can only be a wild guess at this time. Perhaps, even before it again reaches a stage of crystallization, some efficient and safe form of managed credit system will have been evolved through experience to supersede the gold standard organization whose service—or, as some would have it, disservice—to mankind will have come to an end. The experience gained in administering the passing gold standard through the instrumentality of a supercentral bank may well be productive of the seeds of knowledge useful in managing a pure credit system. The credit funds under such a system might then be administered so that their criteria as a standard of value may be developed on the basis of the inherent productive capacities of borrowers and in terms of what goods and services can be produced profitably without the aid of short-term credit inflation or a long-term climbing price level.

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