1

One Hundred and Thirty Years of Central Bank Cooperation: A BIS Perspective

CLAUDIO BORIO AND GIANNI TONIOLO[1]

INTRODUCTION[2]

The idea that an "international bank" would facilitate central bank cooperation dates back to the late nineteenth century (Toniolo 2005: 20–23). It was officially revived in the immediate postwar period, particularly at the 1922 Genoa economic conference. In keeping with the vision of Governor Montagu Norman of the Bank of England, the Bank for International Settlements (BIS), established in 1930 to facilitate the transfer of German reparations, was also given the mission of promoting central bank cooperation.[3] Since July 1931, when the Hoover moratorium put an

[1] Claudio Borio, Head of Research and Policy Analysis, Bank for International Settlements. Gianni Toniolo, Research Professor of Economics and History, Duke University, Durham, NC.

[2] The authors would like to thank Gunter Baer, Piet Clement, Andrew Crockett, Marc Flandreau, Charles Freeland, Ryozo Himino, Miles Kahler, Alexandre Lamfalussy, John Lowen, Robert McCauley, Paul Van den Bergh, and an anonymous referee for their helpful comments. The views expressed by Claudio Borio are his own and not necessarily those of the BIS.

[3] Article 3 of the BIS Statutes.

end to reparations, central bank cooperation has been the main objective of the BIS.[4]

The 1935 BIS *Annual Report* asked: "Cooperation on what? With what objectives in view? How?"[5] With the insight of 130 years of history, this chapter tries to answer three questions: How did changing international monetary and financial conditions shape the targets and tools of central bank cooperation? What conditions determined its intensity? Did a structured organization, such as the BIS, make a difference?

This chapter will not discuss the *desirability* of cooperation. We focus primarily on the *process*, rather than the ultimate *outcomes* of cooperation, and we do so from a *positive* rather than *normative* perspective. In other words, while we fully recognize that cooperation based on the wrong "model" of how the economy works or on the wrong analysis of current and future conditions can have perverse effects, we do not make such assessments in the scope of our analysis. We are only interested in understanding what factors shape cooperation and in its immediate results. Thus, we consider cooperation *effective* simply to the extent that its *proximate* goals are achieved (e.g., supporting an exchange rate arrangement, reaching agreement on a set of prudential standards) and do not address the trickier question of whether those actions promote the ultimate goals (e.g., economic welfare more generally).[6] We define cooperation broadly to include both purposeful exchanges of information ("low-key" cooperation) and joint decisions and implementation ("high-profile" cooperation).[7]

[4] Article 3 of the current BIS Statutes, including also the ancillary missions of providing additional facilities for international financial operations and [acting] as trustee or agent in regard to international financial settlements.

[5] BIS, *5th Annual Report*, Basel, 13 May 1935, pp. 41–44.

[6] For example, central bank cooperation may have been effective in delaying the collapse of the Bretton Woods system, but whether the achievement of this proximate goal was, on balance, positive or negative for the world economy is a separate question – a question, in fact, about which a heated debate exists.

[7] In practice, exchange of information is critical and accounts for the lion's share of international cooperative efforts. The exchange is aimed at (a) developing a better

The chapter is divided into several sections. The first section outlines the main targets, tools, and determinants of central bank cooperation and their evolution over time. Against this backdrop, each of the subsequent sections broadly reflects a given set of conditions in the international monetary and financial arena. The second section deals with cooperation in the context of the pre-1914 "classical" gold standard. The third section traces developments from the wartime regime to the creation of the BIS. The fourth section covers the most uncooperative period in the history of the twentieth century (1931–45), marked by autarky, beggar-thy-neighbor policies, and open conflict. The fifth section is devoted to cooperation under the Bretton Woods system. The sixth section considers the years from about 1973 to the present, when the balance of the targets of cooperation shifted from monetary to financial stability. A final section summarizes the chapter's main findings and draws some general conclusions.

CENTRAL BANK COOPERATION OVER TIME: CHANGING TARGETS, TOOLS, AND INTENSITY

Central bank cooperation throughout history has ultimately been directed to ensuring monetary and financial stability. However, the conception of these objectives, the relationship between the two, the balance in their pursuit, and the tools used have evolved over time, reflecting changes in the monetary and financial environment as well as in the

understanding of different points of view (e.g., concerning the "model" of the economy, other constraints on decisions, preferences, intentions, etc.) and/or (b) developing a convergence of viewpoints on the link between policy actions and outcomes (e.g., about the model of the economy, prevailing and prospective economic conditions, etc.). This definition is broader than the one typically used in the international relations literature, where what is envisaged is some form of coordination of actions in a game theoretic context (see, for instance, Keohane's [1984] notion of "mutual adjustment," which is more akin to the concept of policy coordination in the economic literature [e.g., Bryant 1987]). Our definition is closer to Truman's (2003) and Cooper's (2005).

political and intellectual climate. Accordingly, *depending on the circumstances and the intellectual perspective of the time*, we define "monetary stability" as either stability in an aggregate price level (index) or in the relative price of two units of account, that is, the exchange rate between national currencies or between a given currency and gold. We define "financial stability," in a narrow sense, as the avoidance of widespread defaults, typically associated with either banking or sovereign debt crises.

We shall see that changes in the operational conception of monetary and financial stability against the background of an evolving monetary and financial environment have deeply affected the targets and instruments of central bank cooperation (Table 1.1). Broadly speaking, the first 100-odd years covered in the chapter were characterized by the belief that a fixed exchange rate system was a desirable goal that underpinned the pursuit of domestic objectives, notably price stability. Cooperation therefore focused either on supporting or, when it broke down, on restoring that system. International liquidity packages were a prominent instrument in this context. During the gold standard period, international cooperation aimed at financial stability was not easy to disentangle from cooperation in pursuit of monetary stability as conceived at the time, as banking or external debt crises could threaten convertibility that was seen to underpin both. Without a prudential apparatus in place, international cooperation primarily took the form of liquidity assistance to support convertibility. By contrast, in the Bretton Woods period, financial repression tended to keep overt financial instability in check, obviating the need for international cooperation in this area. After 1973, with floating exchange rates and fully fiat money regimes, the pursuit of domestic price stability came to be increasingly regarded as a task that individual central banks could and should perform outside of international cooperation (except as far as the exchange of information was concerned). By contrast, as financial liberalization gathered momentum, cooperation was seen as crucial in promoting financial stability. In addition to international emergency liquidity packages aimed at emerging market

Table 1.1: *Regimes, targets, and tools of cooperation*

	Gold standard	Bretton Woods	Post-Bretton Woods
Regime Characteristics			
Monetary regime	– Gold convertibility as ultimate constraint (on countries and overall system)	– Fixed but adjustable exchange rates – Gold as (soft) constraint on overall system	– Unrestricted fiat money
Financial regime	– Liberalized financial markets – No (limited) prudential regulatory apparatus in place	– Financial repression (administrative controls)	– Progressive liberalization – Prudential regulation in plac
Conceptions and Experience			
Monetary stability	– Identified with gold convertibility – Approximate price stability (until Great Depression)	– Increasingly identified with price stability – Seen as consistent with fixed exchange rates until late 1960s	– Identified with price stability – After the Great Inflation, glol disinflation
Financial stability	– Financial instability can threaten convertibility – Financial instability not uncommon (especially at the periphery)	– Financial repression keeps overt financial instability in check	– Reemergence of financial instability
Targets of cooperation	– Maintaining gold convertibility	– Reestablishing conditions for current account convertibility – Sustaining fixed exchange rates	– Price stability seen as a domestic affair (except in Europe) – Financial stability gains grou
Tools of cooperation*	– Emergency liquidity lending	– Emergency liquidity lending – Gold Pool	– (Sporadic) foreign exchange intervention – Emergency liquidity lending (to EMEs**) – Developing codes and standards (banking, paymen and settlement systems) – Strengthening market information

* Other than exchanges of information ("low-key" cooperation).
** Emerging market economies.

countries in distress, the major innovation was the joint development and acceptance of codes and standards aimed at strengthening the global financial infrastructure through so-called "soft laws", especially in the prudential regulatory field.

Throughout the past 130-odd years, international financial cooperation was first and foremost the government's business. Central banks played a larger or smaller role according to their room for maneuver in the international arena. As the chapter focuses on cooperation among central banks rather than overall financial diplomacy, it is useful to try to pin down what factors influenced the degree of involvement of central banks in the overall game of financial cooperation (or lack thereof).

One can think of the intensity of central bank cooperation as varying over time according to three main factors: (1) the overall conditions in international relations; (2) the prestige enjoyed by central banks with the public at large, which also affects their institutional relationship with the political authorities (i.e., the allocation of tasks in monetary policymaking, including provisions for central bank independence); and (3) the technical nature of the problems requiring cooperation. Table 1.2 provides our subjective assessment of the varying strength of each of these three factors, resulting in an overall ranking by subperiods of the intensity of central bank cooperation, as described in the main sections of the chapter.

International Relations

Needless to say, international financial diplomacy was always dictated and largely run by governments as part of their foreign policy. Over the period covered in this chapter, the state of international relations varied enormously from war (1914–18 and 1939–45), to competitive nationalism (1873–1913), to confrontational unilateralism (1918–39), to various degrees of cooperative multilateralism within the so-called Western world

Table 1.2: *Intensity of Central Bank Cooperation*

Period	International relations	Prestige and independence of central banks	Technicality of issues requiring cooperation	Overall intensity of cooperation (total score/3)
	(1)	(2)	(3)	(4)
1870s–1913	2	2	3	2.33
1920s	1	3	4	2.67
1930s	0	1	1	0.67
1950s	4*	2	2	2.67
1959–73	3*	3	4	3.33
1973–mid-1980s	3*	2	4	3.00
Mid-1980s–2005	3	4	4	3.67

Note: All rankings on a scale of 0–4.
* "Western world" only.

(1945–2000). In most cases, central bank diplomacy closely mirrored governments' foreign policy, central bank governors being, after all, high-ranking civil servants. In the few instances when central bankers exercised a degree of autonomy in the international arena – as in the case of the European Economic Community (EEC) Governors in the 1960s – they were still strongly conditioned by the overall state of international relations. The notion, sometimes expressed at the BIS meetings, that the governors in Basel could be free from political "interference" was to a large extent an illusion.

Prestige and Independence of Central Banks

Central banks were never terribly popular with the public at large. Knowledge of their arcane tasks was limited even among the most educated members of the public. Similarly, "banks" have been quite unpopular with ordinary citizens ever since the Middle Ages. In this context, however, the

prestige of central bankers varied considerably over time, depending on how well they seemed to deliver monetary and financial stability. The overall standing of central banks with public opinion affected their relationship with governments and therefore the latter's willingness to allow central bankers discretional powers in financial diplomacy.

Technicalities Involved in Cooperation

Naturally, the more technical the issue calling for cooperation (and the more special the central bank expertise), the greater the scope for central bank cooperation. Other things equal, these conditions tend to channel international cooperation through central banks by leveraging their expertise. They can also provide central banks with a greater degree of discretion in pursuit of that cooperation. Accordingly, central banks played a larger role when cooperation required keeping the exchange rate within the gold points, engineering complex currency swaps, and agreeing on supervisory standards.

Table 1.2 contains our own subjective appreciation (on a 0–4 scale) of the weight of the three above-mentioned factors in explaining the overall intensity of central bank cooperation over seven relevant subperiods into which the time spans covered in the chapter can be conveniently divided.

Nationalism strongly affected international relations before 1914; the scars of the war and of the peace treaty strained them further in the 1920s. Tension was increased by the Great Depression, making the 1930s the most confrontational peacetime decade. By contrast, "consensual American hegemony" (Maier 1988) made the 1950s possibly the decade of smoother international relations within the Western world. As American leadership lost ground from the 1960s onward, international relations became less harmonious; nevertheless, cooperation remained at a much more intense level than at any time before 1939. The chapter also deals with the peculiar type of international cooperation that existed among

the allied powers during World War I and, in an implicit way, even among enemy central banks during the Second World War.

Before 1914, central banks were relatively little known to the public and quite strongly dependent on governments as far as their international operations were concerned (e.g., emergency lending to a foreign central bank was a highly sensitive political matter). In the 1920s, central banks gained power and prestige, as well as a higher degree of independence, owing to their role in the restoration of gold convertibility. With the Great Depression central banks everywhere lost prestige, as public opinion associated "bankers and financiers" at large with the debacle. Responsibility for monetary policy was shifted to the treasuries; in some cases, central banks became little more than dignified government departments (the German Reichsbank representing an extreme case in point). To be sure, in the 1930s many central banks were given new regulatory and supervisory responsibilities (Allen 1938). But these did not have a significant impact on international cooperation until half a century later. With their contribution to postwar reconstruction, in the 1950s European central banks slowly began to refurbish their public image. By the 1960s they had regained prestige and, in several cases, a degree of *de facto* autonomy from their respective governments. While key decisions in support of Bretton Woods required government direction and approval, the fact that central banks and governments generally agreed on the objective to be pursued – maintaining the system afloat – made the degree of independence less relevant. After the loss of prestige associated with the Great Inflation phase, starting in the mid-1980s central banks slowly regained a high standing, as their efforts to bring inflation under control bore fruit. From the 1990s, this was progressively enshrined in greater and more formal central bank independence. If, paradoxically, this autonomy and focus on domestic price stability at times proved inconsistent with efforts to implement international cooperation on exchange rates, it was valuable in the international cooperative efforts undertaken in the field of prudential regulation.

As for the degree of technicality involved in the matters requiring cooperation, Norman believed that central banks were the sole repository of the sophisticated techniques required to manage the international gold standard (Toniolo 2005: 163). Thus, contrary to textbook assumptions, at the day-to-day operational level, the actual running of the pre-1914 system did not rest on adherence to simple mechanical rules. The arcane subtleties of managing exchange rates within the gold points, nurturing market expectations, maintaining a high level of reserves as required by politicians and public opinion alike, and sterilizing gold inflows were all the exclusive domain of central bankers. International cooperation to keep the system viable could only rest on their technical expertise. An even higher degree of technical sophistication was probably required in the 1920s, when the reinstatement of the gold standard was the main task of cooperation. In the 1950s, cooperation for multilateral settlements called for a payments network and a clearinghouse technology developed at the BIS, but required little of the typical financial and monetary expertise of central banks. After 1958, with current account convertibility and the demand for financial engineering to prop up the dollar and the pound, the technical expertise of central banks again proved invaluable, for instance, in coordinating currency swaps and in the management of two separate gold markets. International cooperation in prudential regulation and the development of "soft laws" that marked the period from the mid-1970s onward was also characterized by a high degree of technical content, which central banks derived from their intimate knowledge of national banking systems, on which international convergence of prudential standards and rules could be based.

An unweighted average of the scores given to the three factors affecting central bank cooperation yields an overall ranking of the seven subperiods according to the intensity of cooperation, which reached its highest points in the years from 1958 onward and its lowest in the 1930s.

We next describe in some detail central bank cooperation from the mid-1870s to the present.

COOPERATION UNDER THE CLASSICAL GOLD STANDARD

With the Reichsbank's commitment to convert its notes into gold in 1876, the yellow metal became the unchallenged monetary standard of the developed "core" of the world economy. For the following forty-odd years, until the outbreak of World War I in 1914, the "classical gold standard" provided the background for a relatively efficient and stable system of international payments, in an epoch of rapidly expanding commodity trade, record-high labor migration, and free and growing capital mobility, often called the "first globalization."

Under the classical gold standard, convertibility was seen as the single anchor that underpinned both monetary and financial stability. On the one hand, gold convertibility was identified with monetary stability and thought to deliver stable prices, at last over medium- to long-term horizons.[8] On the other hand, the convertibility constraint would give way or threaten to do so at times of financial instability. Thus, in the context of liberalized financial markets with few or no prudential regulatory constraints, a single tool, the regulation of the supply of liquidity and of its price by central banks, was seen as underpinning the pursuit of both objectives.

Economic historians disagree on the extent of central bank emergency cooperation during the classical gold standard and on its usefulness for the viability of the system (e.g., Eichengreen 1992, 1995; Gallarotti 1995; Flandreau 1997). They do agree, however, that whatever cooperation did occur was carried out on a strict bilateral basis and was undoubtedly less intense than in the years following 1914.

The fact that central bank cooperation was limited and bilateral is partly explained by the strongly nationalist character of international

[8] The ultimate goal, however, was seen as convertibility rather price stability *per se*, itself subordinate to convertibility (e.g., Goodhart 1992). It was only subsequently, mainly following the Great Depression, that the objective of price stability came properly into its own in the policy world (e.g., De Kock 1974).

relations (which, for instance, made governments reluctant to lose gold reserves in favor of would-be enemy countries) and by the fact that international financial relations were more the domain of governments than of central banks, which were privately owned, if tightly supervised, institutions.

Managing the gold standard was a fairly complex technical matter, but international cooperation was not considered of paramount importance for the stability of the system.[9] If there was an understanding of the gold standard as an international public good, it underpinned emergency cooperation only: there was little grasp, except by some practitioners and non-mainstream economists, of the usefulness of day-to-day cooperation in technical matters such as payments technology. On the other hand, the economic environment made maintaining convertibility easier before 1914 than at later times. The balance of payments adjusted smoothly to domestic monetary policy thanks to labor and product market flexibility. Unrestricted international capital mobility produced the expected stabilizing flows and London's financial hegemony gave it some *de facto* coordinating powers. More important still, the perceived political costs of maintaining gold convertibility were relatively small for three main reasons. First, the system delivered (or was believed to deliver) price stability and growth. Second, given flexible markets, the output and employment trade-offs entailed by the commitment to the gold standard were relatively contained and therefore socially acceptable. Finally, suffrage limitations and the weakness of workers' organizations made it politically affordable for governments to guarantee gold convertibility, a priority for the upper and middle classes, even at the cost of some unemployment (Eichengreen 1992, 1996).

[9] There is, of course, considerable debate about what exactly those rules were and how closely they were followed. See, in particular, Bloomfield (1959) and, for a broader discussion, the articles in Eichengreen (1985).

Even among core countries, however, the classical gold standard did not assure continuous domestic financial stability and this in turn led to instances when cooperation did take place. Occasionally, contagious banking crises did occur (e.g., Kindleberger 1996). In the most severe instances – for example, in 1890 and 1907 – they resulted in emergency lending among banks of issue. In 1890, the drain on the reserves of the Bank of England seemed to be putting the gold standard at risk and the central banks of France and Russia stepped in by offering London a gold swap large enough to reverse market expectations about the adequacy of the Bank of England's gold reserves (Clapham 1944; De Cecco 1974). In 1906 the Bank of France purchased an extremely large amount of sterling-denominated bills to avoid a sharp increase in the London bank rate in response to a gold outflow from England to the United States. Again, in 1907, both the Bank of France and the Reichsbank allowed their reserves to decline, moving gold to London to finance England's transfer of gold to the United States (Eichengreen 1992). Even though their relevance is played down by some scholars (Flandreau 1997), these episodes indicate that some central bank cooperation took place when the survival of the fixed rate system was at stake.

This reluctance to cooperate except in circumstances when the gold standard was threatened also explains why cooperation to address instability at the periphery was even rarer. In contrast to the experience of core countries, at the periphery the gold standard did not deliver stability (Bordo and Flandreau 2001), and banking and exchange rate crises were not infrequent (Bordo et al. 2001).

To sum up: under the gold standard, cooperation took place only in emergencies and on a bilateral basis. The political and intellectual legitimacy of the gold standard, the relatively minor adjustment costs, and the character of nineteenth-century democracy all provided incentives for pursuing exchange rate stability by simple domestic adherence to the "rules of the game."

It must be added that international relations based on power politics stressed the need for a high level of metal reserves (except in London), inducing central banks of surplus countries to sterilize gold inflows – an uncooperative behavior that increased the adjustment cost of those in deficit. The observation that asymmetric adjustment was unnecessarily costly and a threat to international monetary stability drove proposals for more systematic forms of central bank cooperation.

In 1892 Julius Wolff, a professor at the University of Breslau, submitted a project at the Brussels international monetary conference for the creation of an international currency, to be used for emergency lending to central banks, backed by gold reserves contributed by the central banks themselves, and issued by a joint institution based in a neutral country. Similar suggestions, including the creation of an international central bank located in Berne, Switzerland, were made by several others. But it was Luigi Luzzatti who gave these ideas more precise shape and wider publicity. He observed that the US financial problems of 1907 had created an international liquidity crisis (a "monetary famine" as he called it) from which the main central banks had tried to protect their respective markets, scrambling for gold through competitive interest rate increases and other means. A "monetary war" of this kind was – according to Luzzatti – both detrimental and unnecessary: "peace" could be achieved through "cordial cooperation" in supplying gold to illiquid central banks. He argued that lending among monetary authorities should become the norm, rather than being occasional and emergency-driven. Central banks – Luzzatti argued – lent to each other out of their long-term self-interest, but politics could get in the way of a clear vision of economic self-interest. Hence the need for an international body, to be set up in normal circumstances, in order to provide for emergencies in a technical, apolitical way.[10] Among

[10] "There is no absolute remedy for financial crises – Luzzatti wrote – that are the consequence of human weakness, greed and imperfect forecasting. (. . .) What I simply ask for are agreements among experts capable of eliminating from inevitable crises

the several favorable reactions to Luzzatti's ideas was that of George B. Cortelyou, the US Treasury secretary, who announced his intention of convening a European conference of central banks to better specify and implement Luzzatti's proposals (Toniolo 2005: 20–22).

COOPERATION IN WAR, MONETARY STABILIZATIONS, AND THE CREATION OF THE BIS

The First World War led to the abandonment of the gold standard and the imposition of exchange controls. Once the war was over, countries sought at varying paces to reestablish the previous order, sometimes after having experienced traumatic bouts of inflation.

From the perspective of the broad objectives and instruments of cooperation, the period did not represent a major break with the past. True, the experience with high inflation in some countries and with large excess gold reserves in the United States helped to develop notions of monetary stability more closely identified with domestic price stability than with convertibility.[11] But the objective of convertibility remained paramount. And in the absence of a well-established regulatory framework, both monetary and financial stability were primarily pursued through a similar set of instruments, namely the provision of liquidity, domestically and internationally.

What did change, and markedly, was the global constellation of economic and political constraints. In particular, the German reparations problem loomed large throughout the period. In contrast to the classical

those elements that are due to poor organization of the banks of issue and treasuries or to the lack of agreements for mutual self-interested gold lending." See Luzzatti, L. (11 December 1907), article in the *Neue Freie Presse*. See also Istituto Veneto di Scienze, Lettere e Arti, Venice, Archivio Luigi Luzzatti, b. 154, fasc. III, sez. B.

[11] See, for instance, Laidler 1999 for an interesting discussion of the monetary policy debates in the United States at the time. See also De Kock (1974) for a discussion of the evolving notion of monetary stability.

gold standard phase, the prospect of a potential default in a core country profoundly shaped the evolution of events, the forms of cooperation, and their success or failure. It was also the factor that, surprisingly perhaps, would be at the root of the creation of an institutionalized vehicle of cooperation for central banks, the Bank for International Settlements (BIS).

In what follows, we consider sequentially the forms of central bank cooperation during the wartime period, those during the subsequent years, and the specific factors leading to the establishment of the BIS.

Wartime

One might think that World War I made central bank cooperation both unnecessary and infeasible. After all, in the summer of 1914 central banks all over Europe suspended gold payments, putting an end to the classical gold standard. A fiat money monetary regime was adopted by all belligerent countries and most neutrals. In financing military expenditure, each country found its own mix of tax, debt, and printing press. The more or less extensive use of the printing press depended on social and economic conditions specific to each country. Against this backdrop, one would think that no cooperation among central banks was necessary and that no incentive existed for it.

In fact, the opposite is true: total war made financial cooperation unavoidable. Cooperation largely took the form of interallied lending, but did not stop there. As public opinion – friendly, enemy, and neutral – took the rate of exchange as a good predictor of military success and failure, exchange rate pegging policies became part of the military effort. Thus, a strong incentive existed for interallied cooperation in the foreign exchange markets. It was during the war that central banks established standing bilateral agreements for the first time. The Governors of the central banks of England and France even set up a direct telegraph line between their respective offices to provide swift, regular communication.

Governor Benjamin Strong of the New York Fed spent a long time in Europe in order to promote formal links between his bank, London, and Paris, while the Bank of Italy sent a permanent representative to New York (Toniolo 2005: 16–17).

As soon as the wartime conditions ceased, however, so did the incentives to maintain allied financial solidarity and the cooperation that had gone with it.

Toward the New Gold Standard

There was a broad consensus after the war on the desirability of a return to gold convertibility. But its practical implementation was difficult. A return to the prewar gold parity would have spelled macroeconomic disaster for any continental European country, given the intervening inflation. At the same time, the distributional implications involved in choosing a new parity were politically explosive. Government assistance in the transition from a wartime to a peacetime economy was hardly consistent with the fiscal and monetary policies needed to convince the markets of a credible gold standard commitment. Internationally, the problems of debts and reparations had to be solved in order to recreate a stable system of international payments.

In principle, therefore, cooperation looked attractive in the postwar conditions; indeed, more lip service was paid to central bank cooperation than had been the case before 1914. In 1921, Norman issued a *manifesto* outlining four principles of central banking: independence from national governments; separation from commercial banks; banking supervision; and cooperation. He saw the latter as "confidential interchange of information and opinion," the conduct of foreign banking operations through the central bank of the country concerned, and the mutual extension of such facilities as "the custody of gold, monies and securities and the discount of approved bills of exchange" (Sayers 1976). At the 1922 Genoa conference, central banking was the subject of profound debates

by economic experts, academics, and central and private bankers. A resolution was passed containing the first official international recognition of the desirability of formal cooperation among central banks.

In spite of the obvious incentives to cooperate, strained international relations stood in the way. The war and its settlement had left in their wake a long list of unresolved issues, old and new conflicts of interest – not least among allies – incomprehension, new nationalisms and old ethnic rivalries, and deeply rooted desires for revenge. As observed by Eichengreen (1992), "so long as governments were at loggerheads, it was unlikely that national central banks could successfully collaborate."

Nevertheless, in the 1920s cooperation among central banks was more explicit than it had been before 1914 for three main reasons. First, in many countries, the central bank's prestige had been enhanced by the contribution made to the war effort, while at the same time the prospect of a return to gold convertibility gave back to central banks the aura of technical wizardry they had enjoyed before 1914. Second, the backing of the community of central banks, in the form of syndicated hard-currency loans, was the seal of approval, awaited by the markets, of the sustainability of a country's pledge to convertibility. Finally, contrary to pre-1914, cooperation was tirelessly preached and promoted (understandably primarily *pro domo sua*) by the heads of the two leading central banks: Montagu Norman of the Bank of England and Benjamin Strong of the Federal Reserve Bank of New York.

The Creation of the BIS

The BIS, as the organization for central bank cooperation, owes its existence to German reparations. In the late 1920s a short window of opportunity existed to try to provide a stable solution to a problem that had poisoned international relations since 1919. The conferences of Paris, The Hague, and Baden Baden, which gave birth to the BIS, are a good example of how economic cooperation may develop out of partly converging

interests when the international political environment is not poisoned by unbridgeable divisions.

The main driving force behind the creation of an "international bank," as part of a treaty on reparations, was the so-called commercialization of the reparation payments, whereby part of the German debt would be issued in the form of long-term bonds to be subscribed by international private banks and financial houses. Governments were keen on receiving lump sums up front rather than payments over a very long period of time, while private bankers saw a major business opportunity in underwriting and managing the operation. The German government, for its part, considered it essential that a mechanism be found for a good portion of the reparation payments to be reinvested in Germany.[12]

Given that obligations of sovereign states are notoriously difficult to enforce, the creation of an international organization such as the BIS was seen as potentially useful in improving the chances of future payments enforcement (Simmons 1993). It could do so, for instance, by overcoming information asymmetries about economic and policy conditions that might affect the regular flow of payments and by linking the fulfillment of the debtor's obligations to various incentives, such as the reinvestment in Germany of part of the proceeds from payments of interest and principal. At the same time, such an international institution, as the bondholder's trustee, could facilitate collective creditors' actions in case of default. More generally, central bank cooperation was also seen as conducive to a more stable international monetary environment, which would facilitate the fulfillment of both lenders' and borrowers' contractual obligations.

It is against this background of converging interests that central bankers, led by Montagu Norman, also made the BIS an instrument of their technical cooperation and independence.

[12] A large literature exists on the origins of the BIS; for recent contributions, see Simmons (1993), Baffi (2002), and Toniolo (2005: 33–60).

THE FAILURE OF COOPERATION (1931–45)

In the summer of 1930 when the BIS began to operate, the Great Depression was rapidly approaching. Soon afterward, a severe contraction in output and prices came to be intertwined with a succession of major banking crises, of which the failure of Creditanstalt in Austria was just the first, as well as sovereign defaults. The gold standard progressively disintegrated and countries retreated into autarky. In the meantime, international relations suffered continuous blows and became increasingly strained until the time when they would be consigned only to the language of arms during World War II.

Before central bank cooperation was to progressively atrophy, although never quite disappear, in the early 1930s, its main objectives and tools remained those developed during the gold standard era, that is, the provision of liquidity, domestically or internationally, in the attempt to prop up the system. Admittedly, the widespread banking crises led to the establishment of elaborate domestic regulatory and supervisory frameworks, with central banks often in charge (Allen 1938). But in contrast to what would occur later in the century, they did not give rise to international cooperative efforts, given the inimical conditions of the time. And with the final abandonment of the gold standard, monetary stability became more firmly identified with price stability. This meant that, for the first time, monetary and financial stability became clearly distinct goals, both conceptually and operationally.

For our purposes, when considering central bank cooperation in the new context of the BIS, the period can best be divided into three parts: the Great Depression, autarky, and war.

The Great Depression (1931–33)

The international lending to Austria, Germany, and Hungary in 1931 was the first multilateral international action undertaken in response to

a financial crisis. Fear of contagion and of a German default on public and private debt provided the rationale for the scheme, which, however, failed. Among the reasons for the failure, scholars cite poor understanding of the situation and political conditionality, as well as the inadequate timing and size of the loans (e.g., Kindleberger 1987). Central banks acted both individually and through the BIS, their recently created cooperative agent.

The creation of the BIS had somehow produced new expectations about collective action by central banks: when Spain contemplated the convertibility of the peseta, it approached Basel, rather than London and Paris individually, for advice and a possible loan. Likewise, as soon as Creditanstalt's predicaments became known, the BIS was involved in studying the Austrian situation and played a role of its own in the syndicated central bank loan that followed. It also advised on, and participated in, lending to Germany. Thus, the new multilateral player was drawn into the game in its own right.

Autarky (1933–39)

There are four main reasons why, in the 1930s, central bank cooperation at the BIS was reduced to research and exchange of information: strained political and economic international relations; a destructured international monetary system; diminished central bank power and prestige; and political (and intellectual) disagreement on how to reform the system of international payments.

In spite of their division between gold standard and non-gold standard countries and of the fact that what little cooperation existed took place on a strictly bilateral basis, central bankers continued to appreciate the services provided by the BIS. They kept meeting regularly in Basel, and taking advantage of the Bank for settling payments and making gold transfers. Besides providing those services, the BIS stepped up the collection of statistics, its monetary research, and the training of central

bank staff. Moreover, it elaborated and disseminated its own ideas about reforming the gold standard (it would not consider floating rates as a permanent option).

Can regular, personal intercourse and day-to-day technical cooperation be dismissed as irrelevant in the autarkic context of the 1930s? The answer depends on expectations. If one believes that international multilateral cooperation was hardly natural in the first part of the twentieth century, then even the minor exception to the rule provided by the BIS might be seen as a material development. This is particularly true if one takes a longer-term perspective. Effective institutions take time to develop. Had the BIS suffered the fate of other interwar international organizations, it would not have been available for central bankers after the war, when more favorable conditions for multilateral cooperation prevailed.

War (1939–45)

Oddly enough, one can plausibly speak of wartime low-key cooperation among BIS central banks of enemy countries. As they shared an interest in keeping the BIS alive, central banks cooperated, even against the wishes of their own governments, to create the conditions for the BIS to survive the war. Central banks believed that the expertise, networking, and assets of the BIS would turn out to be useful in the eventual reconstruction of the international monetary system, in which they hoped to play a substantial role. They all also tacitly agreed on the desirability, even in wartime, of an observation post on international monetary conditions, accessible to all, and of a place where informal, tenuous links might be maintained even among belligerents. This was, after all, the reason why both sides accepted the existence of neutral countries even in a context of total, unrestrained conflict.

In order to keep the BIS alive during the war, central banks maintained open communication lines among themselves through neutral

emissaries – a form of central bank diplomacy often frowned upon by their respective governments. As a result, the BIS was the only international organization to stay active during the war, trying to adhere to a self-imposed neutrality code. This, however, did not prevent it from making considerable blunders (Toniolo 2005).

ENHANCED CENTRAL BANK COOPERATION (1950–73)

The BIS emerged from the war a small institution with apparently no or only a meager future ahead. Owing to a mix of misinformation and truly objectionable aspects of its wartime conduct, the Basel institution was strongly opposed by the American Treasury and frowned upon in influential British circles (Toniolo 2005). The United States fought hard at Bretton Woods for the liquidation of the old "International Bank," which they saw as compromised with the past, too European in outlook and, in any event, made irrelevant by the creation of the new twin institutions, the International Monetary Fund (IMF) and the World Bank. Central banks, with the support of Lord John Maynard Keynes and thanks to the complex legal setting put in place in 1929–30, succeeded in fending off the assault on the BIS but were themselves too busy with reconstruction to make much use of their cooperative tool in the immediate postwar years. Moreover, economic (including monetary) policy was by then in the hands of governments, with central banks in many countries confined to the role of high-profile departments of the treasury. Little central bank cooperation, therefore, took place in the second half of the 1940s. Nevertheless, the body of international civil servants based in Basel took care of settling the problems inherited from the war (of paramount importance was the restitution of looted gold), reviving the BIS's banking activities and strengthening its balance sheet, thus preparing for future central bank cooperation.

The monetary and financial environment in which the BIS would thereafter support central bank cooperation was profoundly different

from anything seen since its inception. On the monetary side, Bretton Woods saw the establishment of a fixed but adjustable global exchange rate regime, with gold convertibility a tenuous constraint for a system that *de facto* evolved into a dollar standard. On the financial side, the system allowed for controls on foreign exchange transactions and on capital flows, so as to retain autonomy for domestic macroeconomic policies. Domestically, these controls were generally complemented by a complex web of regulations/constraints designed to reduce cost of funding for governments, to allocate credit, and to operate monetary policy. The overall objective was to combine progressive trade liberalization with stable exchange rates, so as to avoid the perceived "chaotic experience" of the interwar years, while at the same time allowing national policies to try to achieve full employment. Exchange rate parities were to be adjusted only in cases of fundamental disequilibrium.

In this environment, central bank cooperation largely focused, initially, on reestablishing the conditions for international convertibility of currencies and, subsequently, on supporting the system once it came under strain. Despite their loss of formal independence, thanks to their technical expertise and operational capabilities over time central banks regained a significant degree of influence, even though the ultimate policy decisions rested with treasuries. For the rest, in a context of domestic financial repression and constraints on external capital flows, financial stability concerns did not figure prominently on the policy agenda. The prudential framework put in place in the 1930s would continue to remain largely dormant for a while longer.

The discussion of the role of the BIS during this period is best conducted under three headings: its support for intra-European payments on the road to currency convertibility; the efforts to keep Bretton Woods afloat through coordinated international lending and the creation of a gold pool; and the initial steps taken to address emerging concerns about the rapid growth of the eurocurrency markets.

Technical Skills at the Service of Cooperation

It was to a large extent American aid, particularly the Marshall Plan, that created the incentives for postwar European cooperation. The Organisation for European Economic Co-operation (OEEC) was set up in Paris as a forum for discussion and coordination of the use of American grants and loans. Soon, however, its scope was broadened, as it became clear that one of the main postwar economic problems concerned the revival of Europe's international trade. Given the low level of European gold and dollar reserves, Europe's trade deficits with the United States could be financed only with American credit. This was the main economic purpose of the Marshall Plan. But intra-European trade also needed reviving. This meant the gradual dismantling of the myriad of barriers to trade erected from the early 1930s onward. As a precondition for freer trade, the intricate system of bilateral (basically barter) payment agreements had to be relaxed. Free convertibility of European currencies into each other and the dollar, while explicitly set as a policy target, was deemed to be premature.[13] A viable alternative seemed to be the creation of a managed system of intra-European settlements (basically an international clearinghouse).

The September 1949 devaluation of the pound and the realignment of the other main currencies were conducted in a coordinated fashion, reflecting the new postwar cooperative mood, and moved exchange rates closer to the purchasing power parity of European currencies. The stage was thus set for trade liberalization and a form of multilateral settlement. These were bold political moves for European governments to make, as long years of tight bureaucratic controls on trade and foreign exchange had created well-entrenched vested interests. The matter, therefore,

[13] Eichengreen (1993) believes that conditions for convertibility existed in the early 1950s – an opinion that was quietly shared in Basel at the time.

stood firmly in the hands of governments, whose representatives met at the OEEC. Central banks were required to provide the technical backing.

The European Payments Union (EPU), created in September 1950 by eighteen countries, was the cooperative tool for introducing intra-European multilateral settlements. Within the EPU, bilateral balances were automatically offset, so that each country had one single balance, debtor or creditor, toward the EPU rather than toward its individual trading partners. At the same time, the EPU extended credits to debtor countries, drawing from a fund created by surplus balances and by an initial allocation of dollars from the US Treasury.

The BIS was appointed agent for the EPU, in charge of managing multilateral settlements. The Bank had by then accumulated unrivaled experience in performing trustee and agent functions, a non-negligible part of its original mission. It had also established a system for cross-reporting by central banks of their own payment balances, which provided the technical basis for the EPU network. Thus, besides again acting as a well-established forum for confidential exchanges among central bankers from the EPU countries, the BIS made a significant technical contribution to the success of the scheme.

The EPU was one of the great success stories in international monetary cooperation. Its aim was fully realized with the introduction of current account convertibility for European currencies, at fixed dollar-gold parities, at the end of 1958. The reasons for this success reside mostly in the political climate of the decade, underpinned by the strong American stance in favor of multilateral Atlantic and European cooperation.

It is in this climate that, for the first time since 1930, the United States took a very positive view of the BIS. M. S. Szymczak, a Federal Reserve Board Governor, argued that the BIS was "likely to provide the most practicable way in which central bankers of the 'Atlantic community' could find regular occasions for informal discussions on matters that concern them as members of the community" (Toniolo 2005). The return of the

Americans to Basel considerably enhanced the prospects for cooperation at the institution.

Keeping Bretton Woods Afloat

With the introduction of current account currency convertibility at the beginning of 1959, the postwar international monetary system appeared to be set on a steady state based on fixed dollar exchange rates, a gold-dollar anchor, multilateral organizations intended both to regulate and to facilitate the operation of the system, and rules for parity adjustment.

Even before convertibility was formally introduced, experts believed that international monetary cooperation should be stepped up after its introduction. A report by the Federal Reserve Bank of New York argued that the "Paris set-up" (i.e., the OEEC) was created to deal with "an inconvertible world whereas Basel was an ideal set-up for a convertible world." In a letter to New York Fed President Allan Sproul, Szymczak wrote: "From the point of view of finance the arguments for its existence are not so cogent, but as a vehicle for providing monthly gatherings of central bank governors, and others, the arguments for it are overwhelming. The BIS is perhaps the most effective vehicle of cooperation amongst central banks in the world today."[14]

In the 1960s a large number of international monetary decisions originated at the "Basel Club." At the informal governors' meetings, matters were discussed and often decisions made (to be subsequently formalized at official meetings). The Gold Pool, the Sterling Group Arrangements, the IMF General Arrangements to Borrow (GAB), and the G10 multilateral surveillance exercise all originated at the Basel Club, which also played a role in helping to shape the reform of the international monetary system. The BIS supported an increasing number of official and

[14] Letter from Szymczak to Allan Sproul, 11 September 1950, quoted in Toniolo (2005: 320).

semiofficial "groups," sometimes made up of both government and central bank officials, through secretariat services and analytical background work. Since the matters addressed by these groups often overlapped, as did participation, Basel also provided informal coordination among them. Thus, the Basel Club came to be an active locus of financial diplomacy.

According to Bank of Italy Governor Guido Carli, in the 1960s the BIS played the dual role of decision-maker and executive organ. Decisions were made "by the group who met on the afternoon and evening of the day before the Board official meeting." The operative side consisted in executing those decisions, subject to government approval, for instance, in the case of the support to the pound and the Gold Pool (BIS 1980).

There are many reasons why the 1960s turned out to be years of intense central bank cooperation at the BIS. First, the very nature of the international monetary set-up (including the implicit political pact upon which it was based) required constant, almost day-by-day coordinated intervention on the currency and gold markets. Second, with the resumption of convertibility, the role and prestige of central banks was enhanced, not least because of the high skill content of monetary policymaking required by the new environment. Third, the decision-making processes at the larger multilateral institutions (the IMF and World Bank) were often more cumbersome. Finally, the BIS was host to the representatives of the countries that then mattered for international policymaking (soon nicknamed the G10), within a setting that provided confidentiality, technical support and, when needed, the backing of independent financial weaponry.

We now turn to a brief description of the main central bank cooperative efforts undertaken in the 1960s.

Support for the Dollar

Soon after the introduction of current account convertibility, the US government stepped up bilateral economic diplomacy aimed at persuading the governments of the European surplus countries to fulfill their

responsibilities in the adjustment process. In particular, the Europeans were urged to avoid sterilization of dollar inflows, to liberalize imports and, most of all, to show their confidence in the system by steering clear of gold conversion. It soon appeared, however, that there was a limit to what bilateral diplomacy could achieve. The September 1960 annual meeting of the IMF registered concern about the dollar's exchange rate. Kennedy's election as US President, two months later, did little to reassure markets. It is in this context that the United States "rediscovered" the BIS, thirty years after its short-lived enthusiasm about the "International Bank." In January 1961, Alfred Hayes, President of the Federal Reserve Bank of New York, attended the governors' meeting in Basel for the first time.

In the following months (and years), both sides of the Atlantic came to terms with the notion that no drastic measures for a structural adjustment of the US balance of payments would be politically acceptable. Ruling out a "permanent solution" to the dollar-gold convertibility problem, all parties concerned felt it imperative to gain time and allow the system to remain viable for as long as possible. Gaining time basically meant exercising imagination on how best to "recycle" European surpluses by various forms of lending to the United States. To this end, Basel became the focal point for operational international coordinated action in support of the stability of exchange rates. The Federal Reserve Bank of New York participated regularly in the BIS monthly meetings, highlighting, as Coombs put it, "a shift to a low-key, cooperative search for the right answers" that shaped "the course of international financial cooperation for the [following] decade" (Coombs 1976). From the BIS perspective, Gilbert saw a "spirit of trust and cooperation" being established through the "expertise, frankness and concern for the problems and opinions of other countries" of people like Roosa and Coombs (Gilbert 1980).

The Gold Pool

For dollar-gold convertibility to be credible, it was essential that gold traded at the London free market close to the official price at which the

United States was committed to convert dollars into gold on demand from central banks. When in late 1960 the free market price of gold shot up by over 15 percent above the official price, it was first suggested at the BIS governors' meetings that a scheme should be created by central banks to buy and sell gold in the market in order to keep the free and official prices close to each other. The suggestion was at first dismissed, but the BIS began to monitor the London gold market closely.

In the autumn of 1961, as concerns about the free market gold price increased, the US secretary of the Treasury revived with the UK chancellor the idea of joint central bank operations on the London gold market. Discussions on the Gold Pool scheme were first conducted between the two governments but when the continental Europeans had to be brought on board, the Americans were easily convinced by the British to turn to Basel's multilateral venue. The BIS governors agreed to give the Gold Pool a try. Europe's central banks together matched a US contribution to a pool of gold made available for sales on the London gold market. The Bank of England acted as the Gold Pool's operative branch, with its operations being reviewed on the occasion of the BIS Board meetings. It is perhaps noteworthy that the BIS commanded sufficient communality of purpose and mutual trust for the scheme to be agreed there and then, without a formal written agreement.

As the market calmed, interventions were discontinued. At the same time, central banks agreed to continue to abstain from buying gold in the free market on an individual basis; the task was left to the Gold Pool itself, which would thus act also as a purchasing syndicate. The running of the Gold Pool settled into a routine pattern. The Bank of England reported on a monthly basis to a group of experts from the participating central banks, who met at the BIS at regular intervals. The BIS also provided secretariat services to the Gold Pool, feeding the group of experts with more complete and reliable statistical data on world gold production and consumption than had been previously available.

The Gold Pool is a clear example of multilateral cooperation facilitated by the existence of the BIS, which played a crucial role in both creating and supervising it. Until about 1965 the very existence of the Gold Pool contributed to keeping the free price of gold close to the official one. In fact, the Pool bought considerable amounts of gold, which was allocated *pro quota* to participating central banks. After 1965, however, sales far outweighed purchases. Participating central banks accumulated losses on their joint gold operations that they eventually felt unwilling to sustain. In 1967 France withdrew from the Gold Pool. In March 1968 the Gold Pool central banks announced that they would no longer supply gold to the free market but would only buy and sell the metal at the official price among themselves (Toniolo 2005: 421).

The Sterling Group Arrangements

Throughout the 1960s, the weakness of the pound sterling, the junior reserve currency in the system, remained an almost constant threat to exchange rate stability. As Gilbert put it: "Whenever sterling might be devalued, confidence in the dollar price of gold could be expected to evaporate and a large rise in the market demand for gold, as well as in central-bank conversions of dollars for gold at the US Treasury, could be anticipated" (Gilbert 1980: 135).

In 1961, following the deutsche mark (DM) revaluation, and again in 1963, the pound was hit by heavy sales. On both occasions it was supported by international lending arranged on a bilateral basis. When the pound again came under fire in 1964, the Bank of England sounded out the BIS governors at a Basel meeting about a joint support package. Speed and absence of conditionality suggested looking to Basel for assistance rather than going to the IMF (Toniolo 2005: 390). A $3 billion facility was granted by eight central banks, under the auspices of the BIS.[15]

[15] As noted by Hirsch (1965: 103), quoted in James (1996), "In twenty-four hours the central banks created more international liquidity with fewer questions asked than the

In 1966, a first Sterling Group Arrangement was finalized. It consisted of a line of credit opened to London by nine central banks and the BIS. The latter acted as principal for the group. The novelty of the arrangement was that it was not made in response to an emergency but rather created a permanent stabilizing buffer for sterling, justified by its role as reserve currency. On this occasion, the coordinating role of the BIS was again particularly in evidence.

After the 1967 devaluation of the pound, the Bank of England worked directly with the BIS to prepare the blueprint for a second Sterling Group Arrangement aimed at keeping the pound at the new fixed parity. In June 1968, a $2 billion "safety net facility" was finalized between the Bank of England and the BIS acting on behalf of twelve central banks. The facility consisted of foreign-currency swaps made available by the BIS to the Bank of England for a three-year period.

These are just the most relevant cases of multilateral central bank cooperation arranged at or through the BIS in the 1960s and aimed at maintaining the system of fixed exchange rates envisaged at Bretton Woods for as long as possible. After 1968, however, these efforts looked increasingly doomed to failure; the United States began a policy of "benign neglect" of the dollar and multilateral cooperation to prop up the system lost momentum.

The Emergence of the Eurocurrency Market

During the 1960s, European central bankers began to be concerned about the rapid growth of the so-called eurocurrency markets – largely dollar-denominated deposits held by banks outside of the United States, not least in London. At this time, the concerns focused primarily on the monetary policy implications of these markets, including the possible loss of monetary control and the fueling of speculative pressures on exchange

most expansionist Triffinite would ever suggest for the IMF." The episode is described in detail in Coombs (1976).

rates. The market was the clearest sign of how increased mobility of capital flows could potentially add to strains on the Bretton Woods system. There were, however, also budding questions about its impact on banking stability, given its largely unregulated nature – an interest that would become much more important after the end of the Bretton Woods era.

Central banks thus began to improve the statistical information about this hitherto largely unknown phenomenon by pooling the information available to individual countries at the BIS. In 1964, central banks presented to the G10 deputies a first report on "The Eurocurrency Market and the International Monetary System." At the time, central banks felt satisfied that the eurodollar threatened neither macro nor banking stability and only required closer monitoring, as "anything that grows by 25–40 per-cent per annum" would call for (Toniolo 2005: 459). In the following years, they quietly also intervened in the market to try to keep interest rates paid on eurodollar and domestic-currency deposits within a limited range. From the early 1970s, however, concerns about the eurocurrency market were frequently voiced in the press. Central banks refocused their interest on the issue and in April 1971 established the Standing Committee on the Euro-Currency Market. At the time, they also announced an agreement not to deposit their reserves in the market (McCauley 2005).

POST-BRETTON WOODS (1973–2005): FROM MONETARY TO FINANCIAL STABILITY

The collapse of Bretton Woods deeply affected central bank cooperation and, therefore, the life of the BIS. Floating rates and rapidly increasing international capital mobility influenced the objectives of cooperation, its forms and instruments, as well as its functional and geographical scope.

The objectives of cooperation shifted away from monetary stability toward financial stability. To be sure, neither central banks nor the BIS abandoned their involvement in foreign exchange matters. In particular,

they played a significant role in the journey toward a single currency in Europe and a more peripheral one in the few instances of high-profile coordinated foreign exchange intervention. Exchanges of information on international and domestic monetary issues continued to take place and even intensified at the governors' meetings and other gatherings of experts in Basel. But the balance of BIS activities shifted toward safeguards against financial instability. This evolution gathered momentum with the passing of time, both reflecting and entailing a significant shift in the forms and instruments of cooperation. By the end of the century, the BIS had become one of the main players shaping the so-called new international financial architecture (Crockett 2002; White 2000).

The BIS continued to perform its core function of facilitator of low-key exchanges of information and views among central banks. But its decision-oriented activities shifted away from operational or "practical fire-fighting" (Baer 1999) to the design and implementation of policies. In this area, new high-level committees, notably the Basel Committee on Banking Supervision (BCBS) and the Committee on Payment and Settlement Systems (CPSS), played a major role. The process through which these codes and standards were developed and implemented represented an innovation on the previous instruments of international cooperation in the financial field. This is because these codes and standards were not the outcome of internationally legally binding agreements ("hard law") but were voluntarily implemented in national law and regulation, through a mixture of peer pressure and market forces, following informal international agreements among participants ("soft law")[16] (Giovanoli 2000; Crockett 2002; Giannini 2002).

[16] The definition of "soft law" used here is close to, but somewhat more specific than, the one sometimes used in international law. There, "soft law" sometimes has the general connotation of recommendations, guidelines, or principles that are not sufficiently specific to have legally binding force. Those recommendations, however, can be and often are issued as part of legally binding international agreements, such as treaties. The term here highlights the fact that the international agreement itself is not legally binding on the parties reaching it. On this, see, in particular, Hillgenberg (1999). An example of a "hard law" approach would, for instance, be the creation of a World Financial Authority, as advocated by Eatwell and Taylor (2000).

These developments also inevitably led the BIS to broaden its functional and geographical scope. Functionally, while owned by and working for central banks, the BIS gradually began to provide services for supervisory and regulatory authorities more generally. Geographically, the codes and standards elaborated by the Committees were adopted well beyond their member countries. And beginning in the early 1990s, the institution embarked on a major "outreach" effort designed to involve in its activities an increasing number of countries, implying significant changes in its governance structure. This marked the transformation of the BIS from what had generally been regarded as a European institution into a global one.

Why the Shift? The Evolving Backdrop to Cooperation

As in previous periods, the origins of the evolution in central bank cooperation can be traced back to the changes that took place in the international monetary and financial environment.

Bretton Woods had been a system designed from first principles by governments and largely run by governments. It was governments that ultimately sanctioned exchange rate parities and decided on the broad contours of adjustment processes. For their part, central banks were entrusted with the day-by-day management of international liquidity and acted as the main government consultants on international monetary issues.

The new "system" that emerged in the 1970s was one in which exchange rates, liquidity, and adjustment became largely determined by decentralized financial markets, with governments playing a more indirect role. Exchange rates among the main currency areas were left to float; the financing of external positions was predominantly driven by

private capital flows; and adjustments were induced by either the threat or the reality of a market reaction. Needless to say, this evolution from a government-led to a market-led system (Padoa-Schioppa and Saccomanni 1994) did not take place overnight. In fact, it had started well before the breakdown of Bretton Woods, in part contributing to its demise. But by the mid- to late 1990s it was largely complete. The underlying force driving the change was financial liberalization, both within and across national borders, together with the quickening pace of financial innovation, supported by technological advances in the elaboration and transmission of information. The end result was the "second globalization" wave of the century.[17]

The new global system, while unique, shared a number of characteristics with its predecessors. With the gold standard it had in common the freedom for financial capital to move unimpaired within and across national jurisdictions. From Bretton Woods it had inherited the governments' ambition to pursue autonomous macroeconomic objectives based on the management of national currencies. Unlike Bretton Woods, though, it had dropped even the pretense of an external anchor in the form of gold. The floating of exchange rates among the main currency areas was the most tangible sign of the system's mixed antecedents. It reflected the wish to regain autonomy in the management of the domestic economy, and the growing difficulties in maintaining fixed rates in a world of increasing capital mobility. Efforts to fix rates were limited to regions, notably Europe, or left to countries' unilateral decisions, notably in the developing world.

The forms of cooperation that developed were the offspring of the new challenges that policymakers faced in this unfamiliar environment and of the mindsets with which they approached them. Cooperation in

[17] For comparisons between the two globalization waves, see, for instance, Bordo, Eichengreen, and Irwin (1999), James (2001), and, especially for the real side of the economy, Feenstra (1998) and O'Rourke and Williamson (1999).

macroeconomic, and hence monetary, issues followed divergent paths at the global and regional levels. By contrast, financial cooperation inexorably gained ground, evolving from the purely technical to the political and from the core of industrialized countries to the global economy.

Monetary Cooperation

Domestically, the emergence of stagflation in the early 1970s shook policymakers' long-held beliefs about the workings of the economy and cast doubt on their ability to reconcile full employment with price stability. It also resurfaced long-standing differences of perspective between key countries – notably the United States, on the one hand, and Germany, on the other – whose historical memories had been deeply scarred by two contrasting defining moments in the interwar period, namely the Great Depression and hyperinflation, respectively. Internationally, a central question for much of the period remained how to address US balance of payments deficits while maintaining world non-inflationary growth: the United States would typically seek to foist expansion on reluctant partners abroad and other countries would expect an equally reluctant United States to retrench, notably by cutting its budget deficits in the 1980s.

Macroeconomic cooperation efforts, for which the informal grouping of the G5/G7 took increasing responsibility, waxed and waned in the light of the evolving political, economic, and intellectual backdrop (Volcker and Gyohten 1992; James 1996; Truman 2003). A high-profile example was the Bonn summit of 1978. This, however, was soon followed by disillusionment with the real growth results and with the subsequent flare up of inflation. After a lull, by the mid-1980s high-profile multilateral cooperation efforts had largely become limited to coordinated intervention to address perceived large-scale misalignments in the dollar, as exemplified by the Plaza (1985) and Louvre (1987) Accords: macroeconomic policy coordination took a back seat as central banks became increasingly reluctant to sacrifice monetary orthodoxy on the altar of global

cooperation. As under the classical gold standard, policymakers became increasingly convinced that the best way of maintaining economic stability was to keep "one's own house in order." Faith in the ability to influence exchange rates through intervention failed to elicit a consensus sufficient to underpin anything other than sporadic actions (e.g., Galati and Melick 2002; Saccomanni 2002; Cooper 2005a). The long battle against the Great Inflation, finally won in the 1990s, remained essentially a domestic affair, if in various ways shaped by global conditions.

By contrast, macroeconomic cooperation was intensified at the regional level, notably in the case of the European Monetary System. The establishment of economic and monetary union in 1999 crowned a long period of closer monetary and exchange rate cooperation in the area. The project yielded undoubted economic benefits, not least shielding the area from the episodic financial turbulences in global markets. But its success was above all testimony to the importance of a strong political consensus in this field: from its inception, the project had been first of all political, and only secondarily economic. Moreover, it was underpinned by the willingness to accept German leadership in the fight against inflation (e.g., Giovannini 1988). By the end of the period, embryonic signs of closer regional monetary cooperation could be seen elsewhere, including in the Gulf countries and Asia, in perspective, Latin America.

Financial Cooperation

Cooperation in the financial sphere, by contrast, had a more linear evolution. The trigger was the increasing frequency and severity of episodes of financial instability. These emerged particularly in the wake of the liberalization of financial systems and capital flows, echoing developments that had already been seen under the gold standard and during the interwar period (Goodhart and Delargy 1998; Bordo et al. 2001; Bordo and Flandreau 2001). These episodes varied in breadth and intensity, variously affecting individual institutions, whole banking systems, and countries' external debt.

Learning how to operate in a liberalized and more competitive environment, how to price and manage risks after so many years of financial repression, would inevitably be a long process, for the authorities and market participants alike. Initially, it was the unexpected rapid rise in inflation and efforts to bring it down that caused the major problems. Subsequently, it was booms and busts in credit and asset prices, even in the context of low inflation (BIS 1997; Borio and Lowe 2002; Borio and White 2003). Especially in emerging market countries, problems were exacerbated by the interaction between volatile global capital flows and macroeconomic or structural deficiencies (e.g., Goldstein and Turner 1996; G10 1997).

Obviously, not all episodes of financial instability could act as a trigger for cooperation. As long as such instability remained a domestic affair, there was no need. Purely domestic instability played a role only insofar as it raised the authorities' awareness that the challenge was a shared one. But in an increasingly globalized economy, in which financial markets knew no borders, instability could not entirely be contained within national boundaries. If the eurodollar markets had epitomized this internationalization as far back as in the 1960s, their subsequent rapid growth during the period in the wake of the recycling of oil surpluses now took center stage. Even the failure of a single, rather small institution, heavily involved in foreign exchange transactions, could easily spread instability abroad, as shown by the collapse of Bankhaus Herstatt in 1974. The financial difficulties of a sovereign or a banking system could cause major losses to foreign lenders and investors. And, arguably more than before, problems at the periphery could easily be transmitted to the core, owing to the greater economic weight of the countries involved. The major banking crisis threatened by the sovereign debt crisis of Mexico in 1982 represented a watershed in this domain. Moreover, in a highly competitive international environment, unilateral action by regulators in one country risked putting their firms at a competitive disadvantage. This was all the more so now that other restrictions on financial activity were

being, or had been, dismantled; hence the pressure from the regulated firms to ensure a "level playing field."

Against this background, cooperation followed two trajectories that by the end of the 1990s had fully converged. On the one hand, following the failure of individual financial institutions in the mid-1970s, supervisory authorities and central banks began the long journey to strengthen prudential regulation and the payment and settlement system infrastructure. On the other hand, starting with Mexico's default in 1982, policymakers also made strenuous, if not very successful, efforts to address emerging market countries' debt crises. Here, while the central banks played an important technical supporting role, the main decisions were made by national treasuries and coordinated by the IMF. Following the Asian crisis of 1997, these two strands met in the stepped-up concerted attempt to strengthen the "international financial architecture" (Camdessus 1998). The root cause was the recognition that deficiencies in the financial infrastructure of individual countries could have a first order effect on financial instability, both domestically and internationally (e.g., G10 1997). This heralded a paradigm shift in policymakers' and academic thinking – one which, paradoxically, was rediscovering lessons already learned at the time of the gold standard: the macroeconomy and the financial sector were inextricably intertwined.[18]

Cooperation at the BIS

The BIS adapted to this new environment, which implied a shift in the forms of cooperation. The room for global macroeconomic cooperation was somewhat reduced by central banks' focus on domestic price stability

[18] Contrary to the prevailing macroeconomic approach, it would no longer be possible to evaluate the soundness of macroeconomic policies or the sustainability of external positions without making a thorough assessment of the strength of the financial sector and of global financial market conditions.

and by the concern of some of them that cooperation might undermine this stability when it called for expansionary policies at home to correct global imbalances. Moves to strengthen central banks' independence to increase their credibility in pursuing price stability limited this room further (e.g., Simmons 1996). At the same time, negotiations on tough policy questions took place elsewhere or on a bilateral basis, with the involvement of governments. Even so, the BIS did function as a place where central banks exchanged views, improved mutual understanding of issues of common interest, and influenced the solutions reached. At a regional level, the BIS built on its tradition in support of European integration. Above all, a world of increasingly seamless capital markets, in which international banking and finance played such a pivotal role, was also one which naturally placed central banks, and the BIS, in a prominent position (see also Kahler 2000). This was so by virtue of their knowledge of payment systems and market functioning, their closeness to the banking sector, and their long-standing responsibilities for financial stability, often complemented by banking supervisory functions. In this area, their independence actually facilitated joint initiatives; arguably, it provided a degree of insulation from the political process that helped to keep decisions at a more technical level. Let us consider each area in turn.

Monetary Cooperation

In relation to global exchange rate cooperation, the role of the BIS was one of indirect support. Exchange rates were discussed in the regular meetings, especially by the Gold and Foreign Exchange Committee, at the technical level. And the BIS provided secretariat support for the G7 Working Group on Foreign Exchange Intervention that produced the Jurgensen Report (1983), which defined the policy consensus of the time on the issue. While concluding that intervention could be useful under certain circumstances in the short run, the report stressed the importance of complementary

macroeconomic policies for longer-lasting effects (Volcker and Gyohten 1992; Truman 2003). This conclusion was confirmed in a subsequent G7 statement and set the basis for further coordinated policy actions in this area, up to the present day.

The BIS maintained its support for closer monetary cooperation in Europe, resuming a thread that had started with the EPU and had already seen some significant further developments beginning in the 1960s. For it was in 1964 that the Committee of Governors of the Central Banks of the Member States of the European Economic Community had been established. Importantly, contrary to a proposal by the European Commission, the Committee would regularly meet in Basel and not in Brussels, and would not operate under the Commission's leadership – a way for the governors to underline their wish to retain independent room for maneuver. Likewise, the mandate of the Committee, watered down relative to the initial proposals, was "to hold consultations concerning the general principles and broad lines of policies of the central banks" and to "exchange information at regular intervals about the most important measures that fall within the competence of the central banks." Over time, however, the Committee also took over more operational tasks, starting in 1970 with the setting up of a system to provide short-term financing to address temporary balance of payments deficits and continuing with the operation of the "snake" one year later (Baer 1994).

In the period following the breakdown of Bretton Woods, the BIS's support for the journey toward closer monetary arrangements in Europe took various forms. The BIS continued to provide secretariat services to the Committee of Governors of the EEC central banks (Baer 1994) and to host regular meetings of officials who discussed regional and global monetary issues. Notably, the BIS acted as a facilitator for the work of the Delors Committee, whose 1989 Report set the roadmap for European Monetary Union (EMU), laying out concrete stages to achieve the objective and the general contours of the final goal, taking into account the lessons from the less successful Werner Report of

1970 (Baer 1994; Lamfalussy 2005).[19] The new Report also set the basis for the Statute of the European System of Central Banks, subsequently approved almost without change. Operationally, the BIS provided the technical infrastructure for the European exchange rate arrangements, starting in 1973 with the agency function for the European Monetary Cooperation Fund. And it also acted as a clearing agent for the "private ecu," a claim issued by banks mimicking the composition of the official ecu basket, the fulcrum of the exchange rate mechanism adopted in 1979.

Did the BIS also make a material contribution to the global fight against inflation? Here, the assessment is necessarily more speculative. Operationally, the fight against inflation was not founded on policy coordination. At the same time, it is possible that the regular and frank discussions among governors and senior officials that took place in Basel may have helped to develop a common understanding of the problem, to consolidate the determination to address it in difficult conditions, and to elaborate adequate solutions.

Financial Cooperation

The BIS's role in cooperation in the financial sphere involved both crisis management and crisis prevention. The crisis management role echoed its activities during 1931. Crisis prevention aimed at strengthening three core elements of the financial system, namely institutions, payment and settlement systems, and market functioning. These two strands evolved in complex ways, sometimes quite independently, at other times crossing each other's path as a result of common catalytic events, normally in response to crises. For these reasons, in what follows, rather than proceeding strictly chronologically, we discuss each aspect in turn.

[19] Governors served on the Committee in a personal capacity alongside three external experts, including Alexandre Lamfalussy, then BIS General Manager. The two independent rapporteurs were Tommaso Padoa-Schioppa and Gunter Baer, the latter from the BIS.

The operational aspects of crisis management largely took the form of bridge financing to countries experiencing financial difficulties, generally intended to prefinance disbursements by the IMF. The financing was granted with the backing and guarantee of a range of central banks, often comprising the G10. The BIS rarely took on credit risks. The catalyst for this type of operation was the Mexican crisis of 1982. The crisis had largely caught policymakers by surprise (but see later paragraphs). The BIS could thus exploit its comparative advantage in speedy execution, based on the mutual trust among governors honed by the regular meetings, and its fully functional operating infrastructure (Volcker and Gyohten 1992), not least as the conditions for an IMF stabilization loan were not yet in place (Cooper 2005a). The Mexican bridging loan was just the first of a long list of similar operations, several to help contain the shockwaves from the Mexican crisis,[20] and others in subsequent episodes, including Mexico and Argentina in 1995 at the time of the Tequila crisis, and Thailand in 1997 during the Asian crisis. Special disbursement procedures introduced by the IMF in the late 1990s seemed to remove the need for BIS prefinancing. Nevertheless, it was felt that multilateral support packages of this kind could on occasion reduce the risk of a financial crisis in one country spreading elsewhere. This was the case with the last (and largest) BIS-coordinated package, granted to Brazil in 1998 to supplement, rather than prefinance, IMF lending, with the intention of boosting market confidence. The BIS applied no policy conditionality to this type of lending and remained reluctant to tie up its resources for long (e.g., BIS 1984).

Following the failure of Bankhaus Herstatt and Franklin National Bank of New York in rapid succession in June and October 1974, in December that year the G10 Governors established the BCBS, at the time known as the Committee on Banking Regulations and Supervisory

[20] The Mexican debt crisis led to the rescheduling of two-thirds of the outstanding debt of twenty-five developing countries (Lamfalussy 2000).

Practices. The Committee brought together for the first time central banks and banking supervisory authorities (in those cases where supervision was not performed by central banks). The initial motivation for establishing it was to exchange information on the condition of internationally active banks, since at the time these were not providing consolidated statements of their activities (Kapstein 1994).[21] Unsurprisingly, the proposal came from the Bank of England, with London playing host to hundreds of foreign banks operating in the most active segment of the euromarket. No one could have imagined at the time, though, that the Committee would, over the years, become the core body influencing banking supervisory standards worldwide.

The Committee's evolution was marked by several milestones. Reflecting its original purpose, it started with a low-key agreement allocating cross-border supervisory responsibilities among member authorities ("the Concordat") in 1975, closely followed by the principle of home-country consolidated supervision.[22] But it rapidly extended its activity to developing good practice guidelines and then standards in all areas of banking regulation and supervision. The first landmark agreement was the development of minimum capital standards in 1988 (Basel I), designed to raise banks' cushions against failure and to adapt them to the growing off-balance sheet exposures. In some respects, the agreement was a distant child of the Mexican debt crisis, since the US Congress's insistence on tighter capital standards for US banks as a *quid pro quo* for granting higher resources to the IMF and its concern with avoiding a loss in US banks' international competitiveness played a catalytic role (Kapstein 1991). A second landmark agreement was the Core Principles for Effective Banking Supervision in 1997. In this case, the catalyst was

[21] In fact, the press communiqué announcing the establishment of the Committee in February 1975, at the time of its first meeting, simply stated that its objective was "to assist the governors in their continuing work of surveillance and exchange of information."
[22] The Concordat was subsequently revised and tightened twice, in 1983 and 1991, following the failures of Banco Ambrosiano and BCCI, respectively.

the Mexican crisis of 1995 and the contagion it caused, which highlighted the need to strengthen banking systems in emerging market countries. The Core Principles were designed as a model for banking supervision regardless of the specifics of individual banking systems. In subsequent years, the principles were adopted by supervisors across the world. A third landmark was the revision of minimum capital standards in 2004, known as Basel II. This was in part motivated by the need to adapt the previous, admittedly coarse, standards to advances in risk management techniques, which had encouraged regulatory arbitrage. Beyond individual measures, though, what makes the Basel Committee important is that its processes set an example for international cooperation efforts of other regulatory authorities in the financial field (Zaring 1998; see also following paragraphs).

The intellectual, if distant, origins of the CPSS also go back to the disruptions caused to foreign exchange settlements by the failure of Bankhaus Herstatt. The episode raised awareness of the critical, if underestimated, role of wholesale payment and settlement systems in securing financial stability. In contrast to the gold standard period, when concerns with payment systems had largely pertained to disruptive shifts between bank deposits and cash, now they focused entirely on the credit and liquidity risks incurred in the process of executing transactions (Borio and Van den Bergh 1993). The reason was the unprecedented surge in gross payment and settlement flows associated with the quantum leap in financial activity, a distinguishing feature of the second globalization wave of finance compared with the first. As guardians of domestic payment systems, as active participants and as suppliers of a risk-free settlement medium, central banks were in an ideal position to take the lead in joint action.

The forerunner of the CPSS was the Group of Experts on Payment Systems, established in 1980. But it was not until 1990 that standard setting work started in earnest, as the CPSS was established following a report setting principles for wholesale net settlement systems (the "Lamfalussy

Report"). Thereafter, the CPSS continued its activities, analyzing issues of common concern, setting standards, and encouraging the adoption of risk mitigation techniques by the private sector (BIS 1994; Borio 1995). The latest such example was the establishment of Continuous Linked Settlement (CLS) in 2003, a private sector scheme aimed at reducing the settlement risk in foreign exchange transactions – the risk originally highlighted by Herstatt's failure some thirty years previously (Galati 2002).

Following the end of Bretton Woods, the concerns of the Euro-Currency Standing Committee gradually shifted from monetary issues toward financial instability and its focus shifted from the euromarkets *per se* to market functioning more generally. In the mid-1970s the Committee improved the coverage of its international banking statistics to cast light on the rising exposure of banks to the developing world. The statistics started being published in 1974, and in 1978 were complemented by information on the exposures' maturity structure. These figures revealed the extent of the massive growth in countries' indebtedness and its increasingly short-term character, which was sowing the seeds of the subsequent crisis. By 1978, the BIS *Annual Report* was drawing attention to the risks involved. In the meantime, behind-the-scenes efforts were being made by the BIS General Manager at the time, Alexandre Lamfalussy, with the agreement of the G10 Governors, to encourage banks to exercise greater prudence in their lending, but to little effect.[23] Once the Mexican crisis did erupt, the Committee further upgraded the coverage of the statistics. Enhancements were again made in the wake of the Asian crisis of 1997 (Wooldridge 2002) and have continued to the present day.

In addition, the Euro-Currency Standing Committee took the lead in the study of market functioning generally, with specific attention to the implications of financial innovations. The first study in this domain was the "Cross Report" in 1982, a key reference at the time for the

[23] These efforts, based on a checklist of questions drawn up by Arthur Burns, Chairman of the Fed at the time, are discussed in detail in Lamfalussy (2000).

understanding of derivatives markets. Several subsequent studies laid the basis for the development of statistics for over-the-counter derivatives as well as the foreign exchange markets. Improving the flow of information to the markets so as to contribute to their smooth functioning has been a *Leitmotiv* of the Committee since its inception. This has included, *inter alia*, work aimed at improving the disclosure of official foreign exchange reserves in 1999, conducted jointly with the IMF and subsequently incorporated into the SDDS (Special Data Dissemination Standard). Over time, the Committee systematized its monitoring of global markets with a view to identifying potential vulnerabilities. Partly to reflect this shift, in 2000 it was renamed the Committee on the Global Financial System (CGFS).

With the BIS-hosted Committees active across a range of areas relevant to the strengthening of financial systems, it was not surprising that, following the 1997 Asian crisis, they became more closely drawn into efforts to shape the new international financial architecture. Two developments epitomize this change. First, when in 1999 the G7 established the Financial Stability Forum (FSF) to help coordinate and catalyze initiatives, the BIS was represented on it in various forms. The FSF brought together senior representatives of central banks, supervisory authorities, and finance ministries alongside international regulatory bodies and international financial institutions. All three Committees – BCBS, CPSS, and CGFS – as well as the BIS had separate seats at the table; in addition, the BIS hosted the FSF's secretariat and gave the body its first Chairman, Andrew Crockett, at the time BIS General Manager (albeit serving on the FSF in a personal capacity). Second, the core principles issued by the BCBS and the CPSS became part of the set of twelve codes and standards seen as critical for the new architecture.

From the viewpoint of the instruments of cooperation, probably the most interesting aspect of the workings of the BIS-based Committees, pioneered in the financial regulatory field by the Basel Committee, has been the reliance on "soft law." Setting standards through non-binding

agreements reached by national authorities, implemented largely through peer-group pressure within national jurisdictions, possibly after adjustments to the local law, and with the support of market forces, has become the norm for most of the standards underpinning the new architecture. Arguably, "soft law" is particularly well suited to financial matters, where it can provide a balance between quality, speed, flexibility, and efficiency, on the one hand, and ownership and accountability, on the other. This balance is necessary for the subsequent acceptance and implementation of the standards. Financial arrangements are highly technical, evolve quickly, and differ considerably across countries, reflecting different historical experiences, cultures, and legal traditions. Working together, national experts are in a good position to ensure the quality of the regulatory framework. Moreover, accountability of the experts to the national political institutions and implementation through peer-group pressure can foster close ownership.

While "soft law" has allowed a solid body of codes and standards to be put in place, as the importance and geographical reach of the task have grown, some questions have begun to emerge. There have been calls for greater inclusiveness. Notably, the Basel Committee process was initially designed for internationally active banks, not necessarily for setting standards with a global reach. In addition, the process has become more politicized, as national legislatures have taken a keener interest in its outcomes, and sometimes even raised issues about the degree of accountability.[24] The Basel Committee has been adjusting to the new

[24] The issue of the "accountability" and "democratic deficit" of international financial institutions has risen to prominence in the wake of the second globalization wave; given space limitations, it is not possible to do justice to it in this short essay. For a detailed discussion of these issues, see, in particular, Keohane and Nye (2001) and Kahler (2004). Within this broader debate, a specific question has been whether "soft law" processes such as those typified by the Basel Committee, based on networks of subgovernment agencies, are more or less accountable than those enshrined in "hard law" processes such as those that underlie the operation of the World Trade Organization (WTO) or IMF. Those who see legitimacy arising from the operation of governments, as the

environment, especially by intensifying and broadening its dialogue with regulatory authorities beyond member countries as well as with the industry and by greatly increasing the transparency of the process. The merits of the "soft law" approach in the financial area have been highlighted by the recent move within the European Union to adopt a framework for regulatory standard setting that in some respects resembles the one used by the Basel Committee (the so-called Lamfalussy approach), with a clearer distinction between primary and secondary legislation and a more intense and broader consultative process than in the past (Lamfalussy 2001).

A Broadening Geographical and Institutional Reach

The increasing breadth of the activities performed by the BIS during this historical phase naturally went hand in hand with a functional and geographical widening of its client base.

Functionally, the shift in focus toward financial stability meant that the BIS provided an increasing range of services to non-central bank

supreme representatives of sovereign nation-states in the international arena, tend to argue that "hard law" processes are more accountable, and regard with some suspicion the room for maneuver afforded to the agencies (e.g., Keohane and Nye 2001; and, in particular, Alston 1997; Picciotto 1997). By contrast, those who favor a more "disaggregated" notion of the state and sovereignty and allow for the legitimate direct operation of transnational networks at the subgovernment level in the international arena argue that the latter can afford some advantages also from the perspective of accountability (Slaughter 1997, 2004). In the specific case of central banks, their delegated "independence" in the domestic context naturally extends to their international operations. While this independence is largely intended to insulate their monetary policy functions (e.g., Cukierman 1992; Berger, de Haan, and Eijffinger 2001), similar arguments have been put forward also for financial supervisory functions and hence supervisory authorities more generally (e.g., Quintyn and Taylor 2003). This raises interesting questions about the meaning and substance of accountability in these situations, about the balance between autonomy and accountability, and about the trade-offs that might arise between "effectiveness" and "politicization" (see, for instance, De Gregorio et al. 1999, who argue for reduced oversight of the IMF by national governments, by analogy with national central banks).

supervisory authorities. The Basel Committee was just the first case in point. Accordingly, partly in order to better reflect the shift of supervisory responsibilities away from central banks in some key jurisdictions, in 2004 the Basel Committee began to report directly to a body bringing together the governors and heads of banking supervision of member countries. In addition, in 1999 the BIS set up the Financial Stability Institute, which has largely concentrated on disseminating best practice and providing training services to supervisory authorities. And in 1998 and 2002, respectively, the BIS began to host, although without providing secretariat services, the International Association of Insurance Supervisors (IAIS) and the International Association of Deposit Insurers (IADI).[25]

Geographically, the changes were even more extensive, as the BIS came under growing pressure to become more global. On the "push" side, the establishment of the European Central Bank (ECB) meant that part of the activities, including purely banking ones, previously centered in Basel moved to Frankfurt. On the "pull" side, the growing weight of emerging market countries in the world economy acted as a powerful magnet for an institution whose policy setting functions were already extending their geographical reach. The challenge the institution faced

[25] The cooperative efforts aimed at preventing systemic strains associated with computer failures at the turn of the century are another example of the broadening range of BIS services. In 1998, the Basel Committee, the CPSS, the IOSCO (International Organization of Securities Commissions), and the IAIS (International Association of Insurance Supervisors) set up the Joint Year 2000 Council in order to ensure high-level attention to the year 2000 challenge and promote a coordinated, consistent approach across the financial sector regulatory community. The secretariat of the Council was provided by the BIS. While its activities were principally directed to financial market authorities, the Council also worked closely with other groups, such as the G7 finance ministers, the United Nations, the World Bank, the IMF, the European Commission, the OECD (Organisation for Economic Co-operation and Development), the FSF, the G10 Governors, and the Global 2000 Coordination Group (the latter representing globally active financial firms that undertook to stimulate the year 2000 readiness of market participants around the world).

was how to become more global while at the same time retaining that "clublike" atmosphere so much treasured by its founders. The strategy followed included changes in the composition of the Board of Directors,[26] extension of membership, broader participation in its various activities, a rebalancing of the analytical work toward the emerging regions of the world, and greater physical proximity through the opening of representative offices. By the end of the period, the range of central banks participating in BIS meetings had been greatly expanded, the number of shareholding central banks had risen from thirty-two in the early 1990s to fifty-five, and the BIS had opened representative offices for Asia and the Pacific in Hong Kong SAR (in 1998) and for the Americas in Mexico City (in 2002). Partly echoing its technical services in support of European monetary integration, in 2003 the BIS started to provide assistance to joint financial efforts by central banks in Asia. This took the form of managing ABF1 (Asian Bond Fund 1, 2003) and acting as administrator for ABF2 (2005), a dollar and a local-currency bond fund, respectively, set up by EMEAP (Executives' Meeting of East Asia and Pacific central banks) to encourage the development of bond markets in the region (Ma and Remolona 2005).

CONCLUSIONS

This chapter has investigated three main issues: How have changes in the international monetary and financial system shaped the objectives and tools of central bank cooperation? Under what conditions could central bank cooperation develop? Did the existence of the BIS make any difference in promoting central bank cooperation? It is now possible to pull together and summarize the partial answers hinted at in the various parts of the chapter.

[26] The US Federal Reserve, the Bank of Japan, and the Bank of Canada joined the Board of Directors in 1994.

Targets, Tools, and Intensity of Central Bank Cooperation

While the tasks of cooperation have consistently been the pursuit of international monetary and financial stability, the definition of these tasks, their relative importance, and mutual interaction have evolved alongside the global monetary and financial regimes, international relations, and developments in economic thinking.

Under the gold standard, monetary and financial stability were perceived as largely coincident for practical purposes. Monetary stability was broadly identified with gold convertibility. And financial instability could and did threaten gold convertibility. In a financial environment characterized by open financial markets and the absence of a framework for prudential regulation, authorities responded to monetary and financial instability by bilateral emergency liquidity assistance. The pursuit of a generalized reintroduction of the gold standard in the 1920s induced the first attempts at multilateral central bank cooperation. The creation of the BIS also responded to the perceived need for an institutional and permanent approach to central bank cooperation. The BIS received its baptism of fire during the international financial crisis of 1931, when the battle was fought, and lost, with the old weapons of international emergency lending. It was then, however, that experts at the BIS realized the limitations of the instrument, given the complex links between Central Europe's underlying banking problems, liquidity crises, and exchange rate stability.

In the following years of uncertainty about the international monetary system and generalized administrative controls on capital movements, the monetary and financial stability objectives of cooperation ceased to have any practical meaning of immediate relevance. Central bank cooperation at the BIS continued only in the form of low-key exchanges of information and the provision of mutual technical services.

Under Bretton Woods, cooperation was also focused on convertibility of domestic currencies at fixed exchange rates, as under the gold

standard. But its relationship to monetary and financial stability objectives markedly changed. On the one hand, monetary stability was more firmly identified with domestic price stability. This would be easily achieved, it was believed, as long as domestic demand was not pushed too hard beyond full employment. Fixed exchange rates were seen as a means of avoiding the chaotic beggar-thy-neighbor policies of the 1930s and of supporting the orderly reduction of trade barriers and global trade expansion. Financial repression, both domestic and international, provided a check on overt financial instability, so that securing financial stability was not a major policy objective. Toward the end of the period, though, the rapid growth of the eurocurrency market – both a reaction to financial repression and the herald of the arrival of a new era of international capital mobility – began to raise financial stability issues separate from those of monetary stability.

In the post-Bretton Woods years, the aims of central bank cooperation progressively shifted from monetary to financial stability, and new tools were introduced. The experience of the Great Inflation of the 1970s convinced central banks that domestic monetary stability, their overriding responsibility, could be pursued primarily by domestic policy. After some disappointing attempts in the 1970s, cooperation on exchange rates became largely subordinated to the pursuit of that objective. At the European level, cooperation in pursuit of the stability of the European Monetary System, created in 1978, rested on accepting the leadership of Germany in bringing inflation down. At the global level, cooperation on monetary issues became less feasible once the more inflation-conscious countries or currency areas saw it as not entirely consistent with domestic price stability.

At the same time, financial liberalization allowed the reemergence of overt financial instability. It became increasingly clear that such instability could no longer be fought with *ex post* emergency lending only. To be sure, emergency liquidity lending to countries in financial distress was stepped up, echoing similar actions during the gold standard period. But now an

elaborate prudential regulatory apparatus was in place, set up following the widespread banking crises of the Great Depression, and central banks in most countries enjoyed supervisory powers over the banking system. Between the 1930s and the 1960s, regulatory powers had largely been used as a complement to financial repression policies. In the new context of international capital mobility, prudential regulation became a crucial element in the pursuit of financial stability, within the ambitious aim of creating a new international financial architecture. Central banks led international cooperative efforts to strengthen prudential frameworks, helping to prevent an international race to the bottom in deregulation.

In the evolving framework of international monetary and financial regimes, economic conditions and consensus on priorities and policy tools, the effectiveness of central banks' specific contribution to multilateral cooperation also depended on a broader set of conditions, some of which were directly related to central banks themselves. In particular, we have seen how central bank cooperation was more intense in periods when international relations were friendlier and oriented to multilateral rather than bilateral cooperation, when the reputation and independence of central banks was high, and when the issues requiring a cooperative approach were such that the technical expertise of central banks would make a difference.

Did the "International Bank" Make a Difference?

Did the BIS make a difference? Or would an equally active cooperation have taken place in its absence?

There is no obvious way of proving a case one way or the other. Economists, divided on the pros and cons of cooperation itself, are rather mute on the merits of its institutionalization. By contrast, those political scientists in the institutionalist tradition are naturally predisposed to assigning a positive coordinating role to international institutions (for instance, Keohane 1984).

We believe the case for the BIS to be fairly well grounded: the institution appears to have made a material difference, at least when conditions allowed.

There are good *a priori* reasons to believe that an institutionalized and permanent mechanism for cooperation enjoys a number of advantages over *ad hoc* cooperative tools. First, it provides a kind of "neutral territory" for cooperation to take place, largely thanks to an independent secretariat, which can allay concerns about national biases. Second, it guarantees a continuity and depth that would be harder to achieve through looser, *ad hoc* arrangements. Third, through regular meetings at all levels in a familiar setting, it creates an environment particularly well suited to the development of a mutual understanding, to learning from each other's experience, to building consensus and to breeding close and long-lasting personal relationships. Finally, through these channels and the presence of a functioning infrastructure, it can make it easier to take speedy decisions at times of need. It is the sometimes uneventful series of meetings in more tranquil times that lays the basis for more effective action-oriented cooperation when such is required.

From a more empirical perspective, one can point to the governors' revealed preferences. For seventy-five years they made time in their busy schedules for regular and frequent visits to Basel; they also placed their senior staff in the various Committees based at the BIS and insisted on assiduous participation. And they went a long way toward preserving its viability and very existence, at times against the indifference or even the opposition of their own governments. It is likely that they believed the BIS to be a facilitating tool for cooperation.

Beyond *a priori* reasoning and the governors' revealed preference, in the absence of a clear counterfactual, it is hard to find uncontroversial evidence for the usefulness of the BIS in promoting multilateral cooperation. It is, however, possible to point to a number of instances consistent with the notion that it did make a difference. Here are just a few of them.

As soon as it was established, the BIS received a request for support in a stabilization scheme for the peseta, breaking with the previous practice of organizing such support packages on a bilateral basis. As soon as the EPU was created, the BIS turned out to be ideally placed to provide the needed international clearinghouse services. It is also telling that the secretariat of the European Communities (EC) Governors was not located in Brussels but in Basel, despite political pressures to the contrary. It was certainly not by chance that cooperation among prudential supervisors started in Basel, acting as a model for regulatory authorities in the securities and insurance industries. Likewise, the ease with which emergency liquidity assistance was put together at the time of the Mexican crisis would be difficult to imagine in the absence of an institutionalized cooperative mechanism (Volcker and Gyohten 1992).

The Mexican crisis also highlights one of the idiosyncratic advantages of the BIS: that of being set up as a bank. As such, it was able to provide a number of services to member central banks (gold swaps, shipments and custody, deposits and short-term loans in various currencies, reciprocal settlements, etc.) and to pay for the meetings, statistics, reports, support staff, and secretariat without requiring appropriation from its members, a feature that contributed to the independence of the institution. Moreover, the availability of financial resources on a swift commercial basis allowed the BIS to provide international lending either alone or, more frequently, as a member or leader of a consortium of central banks. If the BIS's resources were never of a magnitude that could make a major quantitative difference to international lending, its participation was seen as the seal of approval by a reputable financial institution appreciated by markets and private lenders.

One should perhaps also point to the resilience of the BIS, its ability not only to survive but to reinvent itself at various junctures. Created to facilitate the transfer of German reparations, when these ended in 1931 the BIS found a natural role as the locus for central bank cooperation for

the stability of the gold standard. When gold lost its glitter after 1936, the BIS refined a system of international settlements to adjust it to the increasing regulations restricting currency convertibility. This showed its worth again in the 1950s, when the EPU was established. As an institution designed for a fixed exchange rate environment, the BIS seemed to be destined to policy irrelevance after the end of Bretton Woods only to prove its usefulness in support for the European journey toward monetary union and, above all, in a new role centered on financial stability and prudential regulation. In the process, the BIS extended its provision of cooperative services beyond the central banking community to include non-central bank supervisory authorities – a step that should stand it in good stead in future, given the incipient trend in shifting supervisory responsibilities away from central banks.[27] And when the establishment of EMU and broader geopolitical shifts risked limiting the global relevance of its activities, the BIS responded by expanding its membership, by involving a much broader set of central banks in its activities and by establishing *in loco* offices in Asia and the Americas. This capacity to respond to unexpected events has been the key to the institution's continued relevance.

We are obviously not arguing that cooperation among central banks would not have taken place without the BIS. Central bank cooperation predates the birth of the Institution. However, while scholars disagree about the extent of such cooperation before 1930, they do agree that it was mostly *ad hoc* and always bilateral. This is why personalities like Governor Montagu Norman of the Bank of England, and others before

[27] Consistent with this shift, in its own analytical work the BIS has been highlighting the tight nexus between monetary and financial stability as well as the importance of paying due attention to the systemic (macroprudential) orientation of prudential frameworks, thereby highlighting the complementary role that monetary and prudential authorities can play and the need for cooperation between the two (e.g., Crockett 2001b; Borio and White 2003; BIS 2005).

him, had long advocated the creation of an "international bank." Our conclusion from looking back at seventy-five years of history is simply that the presence of the BIS has facilitated and deepened cooperation, ensuring a degree of continuity and effectiveness that would otherwise have been harder to attain.