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Are International Organizations Like the Bank for International Settlements Unable to Die? A historical Case Study of the BIS.

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1. The Attack of the United States against the Bank for International Settlements (BIS).

At the Bretton Woods Conference in July 1944 the following resolution was passed:

„The United Nations Monetary and Financial Conference recommends: The liquidation of the Bank for International Settlements at the earliest possible moment.“

Behind this resolution stood according to the confidential report of a Swiss observer the American delegation headed by Harry White from the US Treasury who *„maintained a fanatical hatred against the BIS, since it had been mentioned by several quarters as the institute which could take the place of the [World] 'Bank' “*. He stood behind the attack brought forward by the Norwegians in the commission [Commission III]: *„The proposal to liquidate the BIS in Basel put forward by the Norwegians of this commission led to a general surprise.“* (p.21)

„They [Harry White and his clique] also proposed during the discussion a new formulation with the content that no country could become a member of the 'Fund' [the IMF] as long as it maintained relationships with the BIS. This proposal was defeated by a majority after furious debates.

It will be scarcely possible, to stop the liquidation of the BIS, even if the Bretton Woods proposals should be rejected by the different parliaments, except if the whole net of bad rumors would be exposed by an energetic counter-attack.“ (pp. 23 f.)¹.....

At a meeting of the Directorate of the Swiss National Bank in July 1944 its President, Weber, asked whether he should not step down as President of the Verwaltungsrat (Board) of the BIS. He had assumed this position since it seemed to be advisable to the BIS to fill it with a personality from a neutral country during the war . But now Weber pointed out that according to reports in the press the liquidation of the BIS had been demanded at the Bretton Woods conference. But the other members of the directorate argued against such a step, as did the President of the Bankrat, the institution controlling the National Bank. However, the

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Bosshardt (1944)

Directorate decided to also put the question to the Bankausschuss, the controlling subcommittee of the Bankrat.²

The Bankausschuss decided after a discussion that it would not be adequate for President Weber to withdraw from his position at the BIS.³

In spite of the violent attacks the BIS is still existing with widely extended activities, and in Summer 2007 the former President of the Deutsche Bundesbank, Hans Tietmeyer said that the survival of the BIS were more important than that of the IMF.⁴

2. General Reasons for the Survival of an International Organization

How could this miraculous rescue of the BIS occur against the intentions of the Treasury of the most powerful country of the world? Or is this just the most prominent example of an often observed fact, namely that public organizations, and specifically international organizations have a hard time to die? Since a discussion of the fate of the BIS may cast some light on this question, a short analysis may be adequate. But before turning to the specific reasons responsible for the survival and flourishing of the BIS it seems adequate to analyze the factors which may be present or required so secure the survival of international organizations.

Public international organizations are in all cases created by international treaties. This fact already provides them with an advantage compared to national public organizations or agencies. Namely, they can be dissolved only by an agreement of several states. Even if the original treaty contains a clause that an international organization can be dissolved by a simple majority of participating states, this makes it still much more difficult to get rid of it than if just one government can take the decision. True, one or even some participating members may cut their financial contributions to the organization and thus try to starve it. But even this may lead to critique or even to countermeasures by other participants. Even more, the organization may be successful in efforts to become financially independent, so that this avenue to influence or to abolish it may no longer be available.

The existence of any organization is threatened if the tasks for which it has been created are becoming unimportant or have even vanished. Thus the impressive development of international capital markets during the last decades has made the IMF ever less important, and it seems only to regain some of its earlier standing because of the deep international financial crisis of 2008. Consequently two factors are of the greatest significance for the future survival of an international organization. Namely first that the tasks assigned to it in the founding treaty are rather broad, and second that, if at all possible, it is granted the right to extend itself the domain of its activities.

Next, an international organization needs supporters strongly interested in its services, who are even prepared to assist it when attacked by strong opponents. This is obviously related to the range of its tasks and their usefulness to several groups. But that is not all. For support can also be won and maintained if the organization provides amenities and the hope of future prestigious or well-paid jobs to politically influential personalities. Let me illustrate this with one example. When the "Meltzer Committee", which had to evaluate the workings of the international organizations for the US Congress some years ago, proposed to abolish the IMF and the world bank, the US Treasury answered immediately with a statement rejecting their arguments and proposals.

² Minutes of the meetings of the Directorate of the Swiss National Bank No. 829, pp.923-924, July 27, 1944.

³ Minutes of the Bankausschuss, August 31/September 1, 1944, pp. 287-289.

⁴ Personal remark to the author in Summer 2007.

3. Laying Sound Foundations for Future Survival

It is well-known that the BIS was originally founded to regularize the execution of the reparations inflicted on Germany by the Versailles Treaty and reduced by the Dawes Plan, approved by the governments in August 1924, and the Young Plan, signed in 1929. The latter led again to a substantial reduction of reparation payments „in exchange for the commercialization of a major part of the reparations through the BIS“, founded in February 1930.⁵ The committee who worked out the Plan, already revealed, in the competencies proposed for the BIS, the interests of the central banks of the participating countries to exclude all political influences and to extend the fields in which it could operate. In fact, central banker had already for a long time striven to create a formal setting for central bank cooperation

“In 1925, [Montagu] Norman [Governor of the Bank of England] first floated the idea of a central banks' club, which was eventually reached with the creation of the BIS. *'I rather hope,'* he wrote in September of that year, *'that next summer we may be able to inaugurate a private and eclectic Central Banks' 'Club', small at first, large in the future'*. [Benjamin] Strong [Governor of the Federal Reserve Bank of New York] soberly agreed that *'a quiet meeting of some of the heads of the central banks'* might be useful.⁶

It seems also that the leading central bankers hoped to achieve more independence from their governments by creating a forum for their cooperation. Anyhow, they successfully used the occasion to create the BIS to commercialize the problem of German reparations to realize this idea, as is clearly revealed by these passages in the proposal of the experts which found their way into the treaty:

„The Board of Directors shall be made up in the following manner:

1. The Governor ... of the central bank of each of the seven countries to which members of the present committee belong, or his nominee, shall be director of the Bank ex officio. ...

The Directors shall elect a Chairman annually from among their own number. ...“(p. 63).

„The purpose of the Bank is to provide additional facilities for the international movement of funds, and to afford a ready instrument for promoting international financial relations. In connection with the German reparation annuities, it shall perform as trustee for the creditor countries the entire work of external administration of this Plan, ...“(p. 57)

„In particular, the Board of Directors [of the BIS]

1. shall have the right to adopt, modify, limit or extend the statutes of the Bank in such a manner as shall not be inconsistent with the provisions of the Plan, ...“(p.61).

„The Bank may in particular have the right

- a) to deal directly with central banks, or
- b) to deal through central banks which have agreed to act as its agent and correspondent, or
- c) to deal with banks, bankers, corporations and individuals in performing any authorized function, provided the central bank of that country does not enter

⁵ Toniolo (2005), p. 39. Toniolo provides a detailed discussion of these events and of the creation of the BIS.

⁶ Toniolo (2005), p. 30.

objection. ...“(p.66).⁷

Already from this short sketch it is obvious that a firm base for the survival of the BIS had been created. First, since the central banks of the participating countries were strongly interested in this institution, where they could meet and cooperate outside of political influences; second, since the Directorate of the BIS was empowered to change its statutes on its own and third, since the BIS had the right to transact with all kinds of institutions in financial markets. In this way it was enabled to earn money and to be independent from outside financing. And since the governors of the central banks became the only directors of the BIS, they were in final control of it, were able to enjoy its amenities and thus personally interested in its survival. Moreover, the Bank was protected by the international treaty creating it, so that it could only be abolished by a three quarters majority in the General Meeting.

4. Surviving the American Attack

It follows that central bankers had the greatest interest to prevent the dissolution of the BIS after 1944. Already during the war the German Reichsbank and the Banca d'Italia made clear that they were interested to keep the BIS alive for the time after the war.⁸ The Bank of England took a similar position: As Dr. Pfenninger reported from a visit at the Bank of England on November 27, 1939 to the Directorate of the Swiss National Bank (SNB):

*“Sir Otto [Niemeyer, Director of Bank of England] stressed that the BIS should be kept alive as an institution and with its present apparatus until the end of the war. It has to be expected that the return to a peace economy will lead to problems, and that for their solution the BIS can cooperate in one way or another. Though there exists today a great uncertainty about the nature of these later tasks, it is justified to assume that the Institute can provide services of great importance in rebuilding the economy.”*⁹

And after the dissolution of the BIS had been demanded at the Bretton Woods' Conference in 1944 it was stressed at a meeting of the Bankausschuss of the SNB :

*“It is a wish of all central banks that the BIS will survive. It is true that the SNB would not have a special reason to oppose a possible abolishment of the BIS. But it is unpleasant for the managers of the BIS to be now under suspicion to have given preferential treatment to some belligerents; whereas the BIS has always striven to maintain a strictly neutral policy.”*¹⁰

The same attitude was maintained after the end of the war by the Bank of England, but also the Federal Reserve Bank of New York, and the central banks of the Netherlands, Belgium, France and soon Italy. By contrast, the strongest supporters of the dissolution were the governments, especially of the United States, led by Treasury Secretary Morgenthau and his Deputy, Harry White. Both hated the BIS because of its asserted role in favor of the Axis Powers; and also saw it as an obstacle for their plans for a new international monetary order with the IMF and the Bank for Reconstruction and Development as its pillars. But the members of governments changed and the central banks, especially the Bank of England succeeded in motivating their Treasuries to postpone the dissolution of the BIS for so long, until the political climate and the international monetary environment had changed enough that the governments were prepared to accept the further existence of the BIS. But this only

⁷ Sachverständigenausschuss (1929).

⁸ Minutes of the Directorate of the Swiss National Bank [subsequently just „Minutes“], Nos. 903, p.1078, of October 26/27 1939 and 91, p. 108 of 5/6 February 1942.

⁹ Minutes, No. 18, January 12, 1940.

¹⁰ Minutes of the Bankausschuss, August 31/September 1, pp. 288

after it had agreed in May 1948 to return 3740 kg of looted gold it had received during the war.¹¹

The support by the European central banks of the BIS can also be judged from the fact that its first General Meeting after the war on June 15/16 1947 was well attended by their governors.

*“The coming together of the Governors of the most important European central banks offered the occasion to clarify in personal discussions several problems relating to Switzerland.”*¹²

Change in climate and environment was, however, helped by the actions of the BIS itself. It had survived the war nearly intact and its expertise soon proved
*„...useful to central banks for the execution of gold sales entailing forward repurchase and in exchanges of the yellow metal between markets, reducing physical transfers to a minimum.”*¹³

Moreover, in
*„November 1947, well before the Marshall Plan was enacted, an Agreement on Multilateral Monetary Compensation was signed by France, Italy and the Benelux countries. They designated the Bank for International Settlements (BIS) as the agent to which countries would report their bilateral balances each month.”*¹⁴

It is characteristic, that the BIS and not the Bretton Woods institutions were obviously capable to provide this service so important in moving again towards a multilateral system of exchange and international trade. Moreover, it is also important to note that the BIS took these activities in the face of a still threatening dissolution.

These activities of the BIS are not surprising, for the members of each organization or institution have an interest in preserving it because of the income, prestige and reputation offered to them by it. But obviously there were also creative members present who put to good use their knowledge and competencies preserved during two decades of exchange controls and bilateralism.

With the service just mentioned, a precedent was set. When under American pressure the European Payments Union was established within the framework of the Marshall Plan in 1950, to move Europe back towards multilateral and more liberalized trade, the BIS was again selected as the agent managing the payments system. And this against initial opposition by the IMF and the USA.¹⁵ As reported by the President of the Swiss National Bank from the meeting of the Board of the BIS on March 16, 1950:

*“the creation of a new bank-like institution shall be prevented. The new administration shall be limited to a small committee (with secretariat), which decides the general rules for the administration of the “Payments Union”; all the technical services shall be managed by the BIS; ...”*¹⁶

Already in May 1947 the mood had changed so much,
“that Mrs. Governor Frere [of the Banque de France], President of the Board [of the BIS], and Director General Auboin [of the BIS] had returned from Washington. According to their reports the Bretton Woods circles will no longer urge for a liquidation of the BIS. One seems

¹¹ Minutes, Nos. 892, July 24/25 and 1017, August 15, 1946. The Directorate of the SNB had advised the BIS not to do so, presumably because it wanted to prevent a precedent which might hurt the Bank. See also Toniolo (2005), p. 278.

¹² Minutes, No. 817, June 19, 1947.

¹³ Toniolo (2005), p. 299.

¹⁴ Kaplan and Schleiminger (1989), p. 24.

¹⁵ Kaplan and Schleiminger (1989), pp. 38, 41 and 45. It is interesting that the Swiss delegation was instructed to support those countries who wanted to design the BIS and not a new institution to handle the payments system. Bernholz (2007), p.137.

¹⁶ Minutes, No. 272, March 16, 1950, p. 356.

to have recognized the importance of the BIS as a link among the European central banks. ... The legal position of the BIS shall not be changed. Her statutes remain unchanged."¹⁷

And in December the Swiss National Bank noted that according to a report by President Frere

"The relationships [with the American authorities] is still overshadowed by the resolution agreed on in Bretton Woods. But Mr. Frere has the definite impression, that the American Treasury and the International Bank are wishing to cooperate with the BIS. Mr. Frere is convinced that no danger is threatening the BIS any longer from the American side and that there is no longer a question of its liquidation. It is planned to extend the already existing information service between World Bank and BIS.

Governor Sproul of the [New York] Federal Reserve Bank thinks that the efforts to further the balancing of financial payments between Italy, France, Belgium, the Netherlands and Luxembourg are of great psychological importance; he very much appreciated the use of the use of the BIS for the technical performance of this service."¹⁸

Still, it is revealing the deep hatred of American institutions against the BIS that Japan was required by the peace treaty with the USA to leave the BIS.¹⁹ Today, of course, the Bank of Japan, is again a member of the BIS since long years.

The crisis engendered by World War II was not the only crisis survived by the BIS. To mention just another one: The creation of the European Monetary Union moved a part of the services provided by the BIS to the European Central Bank in Frankfurt. For instance, the most important ones of the central banks supporting the BIS had now become members of the System of European Central Banks and their governors meet now regularly in Frankfurt. The BIS reacted to this change by extending its membership of central banks to several of the strongly developing countries of Eastern Europe, East Asia and Latin America. The membership reached a number of fifty-five central banks in 2006. China and Mexico are now represented on the Governing Board of the BIS by the Governors of the People's Bank of China and the Banco de Mexico²⁰. Moreover it established a branch in Hong Kong in 1998²¹, and afterwards another one in Mexico City. It follows that the success of the BIS to overcome all adversities depended mainly on its capability to provide services wanted by central banks and central bankers and the international financial community. The title of Tonioli's book *Central Bank Cooperation at the Bank for International Settlements, 1930-1973*, is revealing in this respect, for it was written for the BIS at the occasion of its 75th anniversary.²² Finally, the BIS was protected, as mentioned before, by its well-designed statutes and its capability to finance itself without any government contributions by its own earnings.

Over the decades the BIS has extended the range of its services stupendously. Its activities can be summarized under four headings:

1. The BIS operating as a banker to central banks;
2. as a forum for international monetary and financial cooperation
3. as a center for monetary and economic research;
4. as a participant in international crisis management.

¹⁷ Minutes, No. 618, May 8, 1947.

¹⁸ Minutes, No. 1604, December 11, 1947, pp. 2285-86.

¹⁹ Minutes, No. 777, July 12, 1951, p. 884.

²⁰ BIS (2006), pp. 213 and 215.

²¹ BIS (1999).

²² See also the volume presenting the papers of a conference at the occasion of this anniversary: Borio et al. (eds.) (2008): *Past and Future of Central Bank Cooperation*.

A full description of the nature and scope of the services of the BIS for her clients would be far too extensive for the body of this paper. Consequently, it has been preferred to present and evaluate these services from a normative economic perspective in the appendix.

Appendix^{*}

1. Normative Economic Principles Concerning the Sphere of Government

Economics as a positive science does not pass value judgments. Still, some principles have been developed to judge whether and which government activities are warranted, provided that certain value postulates are accepted. The normative postulates presuppose the validity of three positive propositions :

1. Competitive markets are more efficient - except for the existence of public goods or externalities (see below) - and innovative than political or bureaucratic decision-making processes if safe property rights and an adequate legal framework are provided. Thus they are superior in supplying goods and services to the population.
2. In contrast to political decision processes there are no outvoted minorities in markets. Everybody can buy what he or she wants, even if a majority would prefer that they should spend their money on other goods.
3. Free market regimes provide more freedom to individuals.

Thus if an optimal provision of goods and services to the population and maximal individual freedom are accepted as postulates, markets should be as extended as possible and political and bureaucratic decision-making as limited as possible. It follows that government activity has to be justified in each case by what economists call „market failures“. The same is true for international and supranational organizations, including financial organizations like the International Monetary Fund (IMF), the World Bank and the Bank for International Settlements (BIS), which have been founded by and are more or less dominated by governments.

But what are market failures? Apart from insufficient competition economists have identified two such failures:

1. There exist external economies which are not taken into account by market participants when they take decisions. Negative externalities are present, e.g., when a firm or cars pollute the rivers or the air. Positive externalities are present when for example the production of honey has the side effect that fruit trees are fertilized and bear more fruit. Education may be another example. In all these cases the negative or positive side effects do not enter the calculation of firms or consumers. Thus an overextension (underextension) of the production or consumption of goods or services for negative (positive) externalities takes place. An inefficient use of resources is the consequence.

^{*} First written at the request of the Meltzer Commission under the title: The Bank for International Settlements: Which Activities Can Be Justified from a Normative Economic Perspective. In: International Financial Institution Advisory Commission, Allan H. Meltzer, Chairman (A Commission Advising and Reporting to the U.S. Congress): Expert Papers, March 2000, 24 pp.

2. Public goods are produced in an insufficient amount or not at all if their provision is left to markets. Public goods are in the jargon of the economist goods which can be consumed or used by everybody at the same time. Whereas a piece of meat or bread can only be consumed by one individual, a television broadcast can be seen by everybody at the same time without loss of quality. Another example of a public good is a legal system. Because of the fact that everybody can use a public good, people are motivated not to pay for public goods, once they are demanded by other individuals with the most intensive preferences for them, since they can get them free. Thus an underprovision of public goods results, if there are no means available to exclude (at sufficiently low costs) individuals who are not paying.

The existence of externalities and (or) of such public goods, from whose use non-paying individuals cannot be excluded, is thus a **necessary** condition for government activities. Government could in the case that this condition is fulfilled help to prevent negative externalities, to provide an adequate amount of public goods and to see to it that no underprovision of goods and services related with positive externalities results. However, the existence of such market failures is not a **sufficient** condition for government activity because of two reasons:

1. As shown by Public Choice Theory there also exist „government failures“ like bureaucratic inefficiency and overextension, political favors to interest groups, outvoting of minorities and thus neglect of their wishes.
2. In some cases it may be possible that private organizations and (or) activities are spontaneously developed which adequately take care of market failures, especially if one takes the possibility of government failure into account. One example is the financing of television by advertisement, another the development of arbitration of business conflicts by private courts.

Many economists would argue that there is a third reason for government intervention, namely income redistribution in favor of the poor and needy. Since the BIS does not and should not undertake such redistribution activities, we need not address this point subsequently.

In the following sections we have to ask ourselves which activities of the BIS could be justified because they are preventing negative or providing positive externalities or public goods.

2. Activities of the BIS

The BIS was founded „under the Hague Agreements of January 1930, ...whose main purpose was to facilitate the German reparations after World War I,...“ (BIS, 1999, pp.1-2). But from the very beginning the further expansion of its tasks was facilitated by article 3 of the original statutes, „to promote the cooperation of central banks and to provide additional facilities for international financial operations“. From the perspective of Public Choice Theory and the Theory of Bureaucratic Organizations the history of the BIS can be interpreted as an effort to safeguard its further existence and to extend its activities by adopting ever new tasks. It succeeded to do so after its original task of facilitating German reparations had been mainly lost, and even after its liquidation had been decided at the Bretton Woods Conference in 1944. A new surge of activities and an extension of activities can be again observed after the

creation of the European Monetary Union, which ended several of the existing tasks of the BIS.

It is not the aim of the present paper to examine and to explain the historical development or the present tasks of the BIS from this public choice and bureaucratic theory perspective (see Vaubel 1999a and 1999b for such an approach, mainly directed at the IMF). Moreover, even if one is convinced like the present author that such a perspective is fruitful, this does not preclude that the BIS provides public goods and (or) positive externalities, or prevents negative externalities, so that its existence may be justified from this point of view. In examining the activities and the possible tasks from this different perspective, four categories of activities of the BIS have to be considered:

1. The BIS operating as a banker to central banks;
2. as a forum for international monetary and financial cooperation
3. as a center for monetary and economic research;
4. as a participant in international crisis management.

It is obvious that these categories overlap somewhat. Nevertheless, it is convenient to examine them separately in the following sections.

3. The BIS as a Banker to Central Banks

The balance sheet of the BIS stood at US\$ 131 billion, and its own funds (capital and reserves) at US\$ 5.7 billion on March 31, 1999 (BIS 1999). An amount of US\$ 112 billion was placed by around 120 central banks as currency deposits with the BIS, representing about 7% of the foreign exchange reserves of the world. Since these deposits have to be available at short notice, they are mainly reinvested with short-term maturity by the BIS with top-quality commercial banks or in short-term government securities. Besides these banking operations the BIS conducts a much more limited range of foreign exchange and gold operations on behalf of its customers. In recent years the investment services offered to central banks also include instruments of up to five years and tailor-made portfolio management schemes. The BIS is not allowed to make advances to governments or to open current accounts for them (Art. 24 of Statutes). Its operations have to be in conformity with the monetary policy of the central banks of the countries concerned (Art. 19).

There can be no doubt that these banking services could also be provided by private banks. It seems, however, that central banks prefer to deposit some of their reserves with the BIS because of the following reasons:

1. Confidentiality: The counterparts to transactions with the BIS do not know which central bank invests or withdraws its (foreign exchange) reserves.
2. Greater security is provided by the strong reserve position of the BIS and its more cautious investment policies. It has 20% one tier reserves compared to the average 4% for private banks. On the other hand, the return paid on deposits by the BIS is somewhat lower.
3. US authorities prefer to place deposits through the BIS instead of US banks not to be accused of discriminating among them, which might prove harmful politically.

It seems possible that these advantages of the BIS as seen by central banks could be overcome as obstacles to a placement with private financial institutions by adequate institutional

arrangements with them. They certainly have scarcely the character of public goods or are connected with positive externalities. On the other hand, it is obvious that they make the BIS independent of financing by governments (apart from the initial capital provided minus dividend payments received) and allow it to finance the services it provides out of its own resources. For the fiscal year ending March 31, 1999 the profits of the bank amounted to about US\$ 598 million, of which US\$ 113 million were disbursed as dividends (BIS 1999, pp.172-173).

4. Activities of the BIS in Providing a Forum for International Monetary and Financial Cooperation.

One of the main tasks of the BIS is to act as a host for, to participate in and to provide secretarial support for international committees and groups working to promote monetary and financial stability (compare BIS 1999, White 1998 and 1999). At the moment there are at least nine committees or groups of this kind (See the Appendix for a more detailed list). These are first committees resulting from the collaboration of the Group of Ten (including Switzerland as an eleventh member):

1. Committee of Governors of the central banks of the G-10 countries, who presently meet seven times a year. Here the future representation is in flux because of the founding of the European Monetary Union and the European Central Bank. A reduction of the number of meetings is envisaged.
2. Basel Committee on Banking Supervision, who meets four times a year (G-10).
3. Committee on the Global Financial System, who meets four times a year. It is composed of representatives from the central banks of the Group of Ten countries and of systematically significant emerging market countries (G-10 „plus“).
4. Committee on Payment and Settlement Systems (G-10), who meets three times a year.
5. Committee on Gold and Foreign Exchange (G-10), who meets seven times per year.

The last four committees mentioned are working under the auspices of the G-10 Governors and comprise about twenty standing and had hoc sub-groups or working groups. Second, there are committees and groupings whose secretariats are located at the BIS:

6. Financial Stability Forum (G-7 plus and International Financial Institutions) with four sub-groups and ad hoc working groups, who meet twice a year.
7. Secretariat of the Group of Ten Ministers and Governors; twice a year.
8. International Association of Insurance Supervisors, who meet four times a year.
9. Joint Year 2000 Council, meeting twice a year. This council is formed jointly by the Basel Committee on Banking Supervision, the Committee on Payments and Settlement Systems,

Moreover, there are other meetings of Central Bank Governors:

10. Meetings of Governors of the G-10 and of systematically significant emerging market economies (G-10 plus);
11. Meetings of the Governors of the BIS shareholding central banks.
12. Regular meetings of central bank experts. There are thirteen groups of experts of different composition (e.g. G-10 plus, G-10 plus EU central banks, G-10 and CEEC/CIS central banks), the International Organization of Securities Commission (IOSCO) and the International Association of Insurance Advisors (IAIS).

Besides these activities the BIS, partly in collaboration with other central banks and international institutions) is also organizing seminars and training courses to disseminate knowledge.

Beginning in 1999 the Financial Stability Institute, founded as a joint initiative of the BIS and the Basle Committee on Banking Supervision, took up its work. It should also be mentioned that the BIS has recently opened an office in Hong Kong, has strongly extended its membership of central banks after the formation of the EMU, and organizes now also meetings outside of Basle.

5. Taking a Closer Look at Some of the Service Activities Related with the BIS

We have now to analyze whether the activities undertaken and the services supplied by the committees provide public goods or positive externalities, or prevent negative externalities from arising. How could this be the case? It should be clear that well-functioning market economies need a sound institutional framework. This is also true for stable money, financial institutions and financial markets. As recent banking, currency and financial crises like in South East Asia and in Latin America have again demonstrated, instability of financial institutions including banks as well as instability and overreactions of financial and foreign exchange markets can still pose a threat for and damage the workings of the real economy. They also showed that such crises have a tendency to spread internationally because of the openness and the interrelations of financial markets all over the world. Even if one shares the view that such crises arise mainly as a consequence of mistaken fiscal and monetary policies and of weaknesses of the institutional structure of domestic banks and of domestic financial markets of the countries concerned, there may be possibilities for beneficial outside influence and intervention.

Central bankers and banking supervisors may be trained, regulations to improve the behaviour of banks may be invented, developed, disseminated and (or) coordinated, information about international indebtedness be spread and bookkeeping standards be harmonized. Central bankers may regularly meet behind closed doors and critically discuss the policies of their colleagues and thus contribute to better monetary policies, supported by the reputation at stake and the social pressure present in primary groups.

It follows from the definitions in Section 1 that through such activities public goods may be provided and positive externalities be created or negative externalities be prevented (For a more comprehensive discussion of Public goods or bads or negative externalities related to financial markets see Wyplosz 1999). For example, the supply of needed information about domestic and international indebtedness in domestic and foreign currencies provides a public good. For knowledge is not lost to those supplying it and can also be used to prevent risky investments by those receiving it. The invention and introduction of beneficial regulations and standards for sound banking practices leads to positive external effects for other members of the international community. Their creation can be considered to be a supply of public goods. The training of central bankers leads to positive externalities as far as it allows to pursue better monetary policies. The standardization of good bookkeeping practices of banks offers better possibilities of monitoring the soundness of their financial position and to prevent negative externalities.

In looking at the work of these committees (compare BIS 1999, White 1998 and 1999), it is obvious that we have, because of lack of space, to concentrate on the more important aspects of the work done in the „BIS committees“ and by the BIS itself. In doing so we propose to

look at their contributions mainly from the perspective of promoting financial stability. After the description of activities an evaluation will follow.

5.1 Activities of the Basle Committee on Banking Supervision

We begin by describing the efforts undertaken to develop and to introduce institutional frameworks which may contribute to the stability of the international financial system and turn first to the **Basle Committee on Banking Supervision**. Established in 1974, this committee first sought to secure that all internationally active banks were adequately supervised. The Basle Concordat of 1975 established the principle that no foreign banking establishment should escape supervision and that the home supervisors of the country in which the parent banks resided should supervise them on a consolidated basis. In the **Minimum Standards** paper of 1992 four standards were accepted to ensure that home supervisors do practice effective supervision and that they get adequate information about cross-border activities of banks. If the first requirement is not secured, the host country of the branch can refuse a banking license. If the second requirement is not followed, the home supervisor can refuse to allow the continuation of the foreign business. Still, since legal impediments to a free flow of information still remained, delegates from 150 countries at the **International Conference of Banking Supervisors** in Stockholm in 1996 endorsed a report prepared by a joint working group of the Basle committee and the **Offshore Group of Banking Supervisors**. It proposed procedures for the conduct of cross-border inspections by home authorities monitoring their own banks and for closing potential supervisory gaps depending on certain corporate structures.

The committee sought (like other committees mentioned below) the cooperation of representatives of major banks, mainly to get information on the possible consequences of regulations considered. The Committee has also worked closely together with non-G-10 supervisors, the IMF and the World Bank in the Basle Committee's **Core Principles Liaison Group** during the last years to strengthen the financial systems of emerging market economies by promoting the **Core Principles for Effective Banking Supervision** that were finalized in September 1997. A main task is now to promote and to monitor the implementation of the core principles. The Liaison Group is currently trying to establish criteria for assessing implementation of these principles in different countries. The dissemination of the Core Principles has also been a big step in the sense that it served as a model for the creation of core principles for other areas. To better insure the implementation of the Core Principles for Effective Banking Supervision another code has been prepared by the IMF together with the BIS and relevant international committees of regulators, namely a **Code of Good Practices on Transparency in Monetary and Financial Practices**. It suggests that there should be transparency with respect to the supervisors' mandate, the effectiveness of their powers, and their democratic accountability to other bodies. The Code will be monitored by the **IMF**.

The efforts undertaken to secure worldwide banking supervision may conflict with ideas about national sovereignty supported by special interest groups. Thus France and Singapore still do not allow inspection by foreign home country supervisors. Others like the United States are afraid that information given to foreign supervisory agencies may find their way into the public domain given the laws of the respective country. It is thus a policy of the BIS related committees to involve national authorities from the very beginning and to try to reach unanimous agreement.

Because of the breakdown of sectoral barriers and the growth of international financial conglomerates the attention of the Basle Committee has now also been directed to the supervising problems related with the securities and insurance industries. In doing so it has established close contacts with the **International Organization of Securities Commissions (IOSCO)**²³ and the **International Association of Insurance Advisors (IAIS)**²⁴. The secretariat of the latter moved to Basle in 1998. All three groups meet now regularly in the **Joint Forum on Financial Conglomerates**.

A second task of the Basle Committee has been to develop and to promulgate **minimum capital adequacy requirements** in tune with the risks banks are running. In 1988 the Basle Capital Accord was published, and by September 1993, all banks of the G-10 countries with significant international operations were meeting these minimum requirements. During the last years the Committee has devoted increasing attention besides credit risk to market risk and the risk connected with the growing use of credit derivatives. It is also now prepared to use the results generated by the firm's own internal models for its calculation of exposure to market risk, albeit under certain restrictions. Here again, a collaboration with representatives of major private banks took place. Some problems, like the treatment of short-term capital flows to emerging markets via domestic banks, have still to be solved by the committee.

A third task concerns the complications posed by **different accounting practices** in the G-10 countries. The implied problems have been discussed between the **Accounting subgroup** of the Basle supervisors and the **International Accounting Standards Committee** with the intention to solve them.

We turn now to the **normative evaluation** of the Basle committee. The efforts to ensure **international supervision of all banks** together with the **design of supervising standards** and to come to an agreement on who should supervise, if successful, clearly provide positive externalities or prevent negative externalities. Banks and other financial institutions presumably become more stable, so that the probability of financial crises and of their contagion effect decreases. The development of effective and superior supervising standards (of Core Principles) can be considered to be the creation of new public goods, since they are available to all countries and can be applied by all of them at the same time. The same is true for the design and spreading of identical **accounting standards**, provided that they are good standards. The efforts to include more and more countries, especially emerging market economies, have also positive externalities in the sense that the beneficial consequences are the more pronounced the more countries are applying the same standards. Also, emerging

²³ „IOSCO is a private, not for profit, international organization that was created in 1983 by amending the By-laws of a previously regional interamerican association of securities regulators to transform it into an international body. All the voting members of IOSCO are agencies having securities regulatory responsibilities. A number of self-regulatory organizations (such as major stock exchanges) and international organizations having a mission related to either the regulation or the development of securities markets (such as the IBDR), have the status of affiliate members. Individuals cannot become IOSCO members.“ “ IOSCO is financed by a yearly contribution from its members .“ (Peter Clark, Secretary General of IOSCO in a Fax of Sept. 8, 1999, to the author)..

²⁴ „The IAIS ...is a public organization and legally speaking an association under Swiss law (Verein). ..The members of the IAIS are insurance supervisory or regulatory bodies i.e., public organizations. ...The IAIS activities are financed by its member fees. The Swiss Government supported the establishment of the IAIS Secretariat in Basel by a subsidy that was paid from 1997 till 1999. The BIS supports the IAIS Secretariat by providing office space and equipment free of charge and also administrative support. There exist no special arrangements regarding the co-operation with the different BIS committees.“ (Letter from Knut Hohlfeld, Secretary General of IAIS to the author of September 14, 1999.

market economies as well as underdeveloped countries are usually those lagging in the application of good banking supervision and bookkeeping standards. The sanctions agreed on for the case of ineffective supervision and of providing inadequate information concerning cross-border supervision of foreign branches of the banks supervised can be seen as measures to spread the use of the public goods.

According to information from a major private bank, the processes initiated by the Basle Committee have become a catalyst for improving the internal risk management of banks. Before major banks had looked at their risk management as one part of their potential competitive advantage. Consequently no sharing of information and no codification of best practice took place. This has changed with the activities of the committee, since major banks now realize that they may be hurt themselves by liquidity problems or failures of other important banking institutions. The Basle Committee is seen as a honest broker. Also, the banks believe that they have great influence in the process since they are able to transmit the nature of their concerns.

The design of **minimal capital requirements** can also be described as the provision of a new public good. With the further development of financial instruments and the breakdown of dividing lines between banks and other financial institutes, the extension of the activities of the Basle Committee to market and derivatives risks and to standards for the insurance and securities industries may create similar positive externalities and public goods. The major banks seem, however, to be somewhat critical of the nature of the minimal capital requirements. They agree that the committee has provided a valuable service. This insofar as it has removed the discussion, of how to best meet credit risks, from the barriers to a free flow of information stemming from the conception that a better risk management is again mainly an aspect of competitive advantage. But it is argued that these minimal capital regulations look at the problem from an outdated perspective, namely that capital has the function of being a safeguard against possible losses. Today, however, it is said, only current post tax revenues are used as a buffer for current losses. This is so since the importance of commercial lending has substantially decreased and since banks are mainly using credit instruments in whose valuation the expected risk exposure is already included. As a consequence, only the risks implied by market volatility have to be covered, which is done by using revenue. To build minimum capital requirements on the own capital of financial institutions is according to this view distorting market behavior, since many decision are now taken with a view as to how the capital considered by regulations is affected.

Some other possible problems have to be mentioned. Whereas the **collaboration with the IMF and the World Bank** in the **Principles Liaison Group** and to develop the **Code of Transparency** may be helpful to implement the standards, it may also create an unwanted and unnecessary overlap with these institutions. Whether it is preferable or not that the **IMF** and the **World Bank** monitor the implementation of the Code (and possibly of other Codes developed by other Basle Committees), given their main tasks, is an open question. Also, though the international application of identical effective standards has certainly positive externalities, one should not overlook that it may hinder the development of even better standards. For the competition among different actors to invent and to apply new standards is reduced, since this task is then left solely to the Basle Committee and its collaborators. The same may be said about the collaboration with **IOSCO** and **IAIS** in the **Joint Forum on Financial Conglomerates**. Whereas this collaboration allows, through the exchange of information and ideas, to develop standards and to close gaps in the supervision of the securities and insurance industries, it again may mitigate innovative competition. Depending

on the nature of the agencies with whom the Basle Committee combines forces there may also be a danger that the interests of pressure groups can enter into the proposals and agreements. Finally, we have to point to the potential **danger of systemic risk** which may arise from a simultaneous introduction of supervising and bookkeeping standards, and especially of minimal capital requirements in several countries. For whereas these standards and minimal requirements are beneficial in the sense indicated, once they have been introduced, the introduction itself may lead to a deterioration of the existing situation or even to a crisis. For instance, the introduction of minimal capital requirements in many countries at the same time may lead to restrictive behaviour by banks in extending credit and thus to a credit crunch, especially in times of tight conditions or of unstable expectations. The art to introduce new standards and regulations at the right time and (or) successively is thus itself an effort to prevent negative externalities.

5.2 Activities of the Committee on the Global Financial System

The name of the former **Euro-currency Standing Committee** was changed by the G-10 Governors in February 1999 and its mandate extended to monitor developments in financial markets and national economies and to examine the relationship between monetary and financial stability. It was originally established to look into the expansion of international bank lending, and was mainly preoccupied in the 1980s with the debt crisis of the less developed countries. The Committee gave **a mandate to the BIS to coordinate the collection and dissemination of international banking data** to better enable official and private sectors to monitor risk in this field. These banking statistics have greatly expanded in content and geographically in recent years.

The BIS is now also maintaining an extensive data base on international securities markets and has strongly expanded its reporting on derivatives markets. This analysis also tries to highlight strains in the international financial system. Recent examples since 1996 included comments on the heavy exposure of Korean and Thai banks to short-term foreign currency financing, and the strong reduction of risk premia concerning both credit and market risk associated with risky investments worldwide. Presently the Committee is overseeing the improvement of the BIS international banking and derivatives statistics and the promotion of greater dissemination about official reserve positions. The improvement of the timeliness, quality and coverage of the BIS consolidated banking statistics is a further task. In March 1999 the BIS, the IMF, the World Bank and the OECD jointly published for the first time a set of creditor-based measures of countries' external debt.

Presently the Committee is working on the possible enhancement of disclosure practices by financial institutions in relation to market and credit risks resulting from their trading activities, including those involving off-balance sheet instruments.

Whereas this work of the Committee relates to improvements in transparency, another concern after the Asian crisis has been the promotion of deep and liquid markets. Three reports were completed on these issues in 1998/99. One report prepared by a joint study group with the **Committee on Payment and Settlement Systems (CPSS)** reviewed settlement procedures and risk management practices in over the counter derivatives markets and identified measures which could be taken to mitigate risk. A second report studied the functioning of repo markets and outlined preconditions for a proper working of them.

The Committee has also focused its attention during the last decade on the implications of financial innovations, especially the rapid growth of derivative markets, for the functioning and stability of financial markets. Though they concluded that derivatives enhance market efficiency, they also think that these innovations led to a diminution of transparency, so that it became more difficult for market participants to evaluate the creditworthiness of counterparties. The Committee has thus in association with the Supervisors taken steps to encourage market participants to improve their public disclosure practices by drawing on information generated by their internal risk-management systems. The semi-annual statistics on derivatives markets, which the BIS began to collect in mid-1998 should also help in this evaluation.

We turn now to the **normative evaluation**. The Committee together with the BIS takes responsibility for the timely gathering and transmission of information to banks, other financial institutions, regulating agencies and central banks. Such provision and transmission of information is a public good, since many agents can use this information without reducing the quality or amount of its use by others. Also, information, e.g. about international indebtedness of banks, about foreign exchange exposure and about the volume of derivative obligations may have the positive external effect of preventing financial crises, since market participants may behave more cautiously given the better information.

Since the Commission has given the mandate to the BIS to collect and disseminate international banking data and recently also on international securities and derivative markets, the **BIS** is in this case directly involved in the provision of public goods and positive externalities. The efforts to increase the quality, coverage and timeliness thus have to be judged positively, too. By highlighting in its reports strains, the BIS further tries to help to prevent the negative externalities arising from financial markets because of contagion and their effects on the real economy. Whether, however, the recent collaboration of the BIS with the IMF, the World Bank and the OECD in providing the first publication of creditor-based measures of countries' external debt is warranted, can be questioned. Whereas such collaboration may make easier the collection of data, it again presents an overlapping of the tasks of international institutions.

The second task taken up by the committee has been the promotion of deep and liquid markets. As far as its proposals are accepted and implemented this would also help to prevent or at least to mitigate crises and their contagion effects, and thus remove negative externalities.

5.3 The Committee on Payment and Settlement Systems

Besides financial institutions and financial markets the payment and settlement system has been called the third pillar of the international financial system. With the huge increase of the gross volume of transactions in recent years, a bad functioning of the payments and settlements system could easily lead to liquidity problems for financial institutions which might spread to other market participants. The same could happen if payments are not settled in time. While the focus of the Committee has been on the timely settlement of large-value transfers, issues relating to retail payment systems, especially to innovations and to the implications of electronic money, have also begun to receive attention.

One of the Committee's first projects was a detailed review of the development of payment systems in the G-10 countries, the results of which were published in a „Red Book“ in 1985. Since then similar studies have been done on the payment systems of other countries and considerable efforts have been spent to explore and evaluate different cross-border and multi-currency interbank netting schemes. Reports, which have been agreed on by the G-10 central banks, have established minimum standards for private sector systems. Recently the Committee focused on banks **Real-Time Gross Settlement Systems**. The Report is the first of its kind and not only provides an overview of principal concepts and main design features, but looks also into the risks associated with such systems and policy implications.

During the last years the Committee has extended its interest to settlement systems for securities and foreign exchange, with efforts focusing on a disclosure framework for systems operators that will allow participants to better evaluate the risk they are running. Here the Committee has been engaged in an ongoing dialogue with private sector groups. It established that settlement exposures in foreign exchange markets are much greater than previously thought (Report of July 1998). Thus in a Report published in 1997 ways were indicated how to reduce such risks. The Report also strongly suggested that participants take such measures to avoid punitive response from public authorities. Another Report published in 1997 reviewed systematically clearing arrangements for exchange-traded derivative instruments, identified weaknesses and made proposals for remedying them.

In cooperation with IOSCO the Committee is continuing to promote greater transparency in securities settlement arrangements by implementing the **Disclosure Framework for Securities Settlement Systems**, published in February 1997. A great number of such systems have now made information publicly available. A **joint working group with IOSCO** has also analyzed how securities lending influences transactions on securities clearance and settlement systems, and what implications this has for securities regulators and central banks. The working group consists of representatives of central banks and securities regulators from G-10 and emerging market countries. Ongoing efforts are directed to define „Core Principles“ for the design and operation of payment systems. The **Task Force** developing these principles comprises G-10 central banks, an equal number of other central banks, the European Central Bank, the IMF and the World Bank.

When looking at the work of the Committee from a **normative economic perspective** we have first to agree that deficiencies in settlement systems can lead to financial crises or make them more probable because of the domino effect. And this would imply, as already stated, negative externalities for market participants and the real economy. The development and implementation of **minimum standards for settlement systems** thus provides a public good which helps market participants in preventing these negative externalities. Proposals to limit settlement exposures in foreign exchange markets serve a similar purpose, since financial crises can also originate or be strengthened in exchange markets. The extension of the work of the Committee to **securities settlement systems** has a similar effect, since problems in securities markets may easily spread to other markets. The effort to develop and to implement **disclosure frameworks for settlement systems** has again a positive external effect, since the better evaluation of exposure risks may help market participants to limit such risks, so that the probability of financial crises originating in settlement systems is lowered.

The effort to develop Core Principles should thus also have a positive effect. But whether the collaboration in the **Task Force** with the IMF and the World Bank does not create another unwanted overlap instead of a clear division of responsibilities may be questioned. Moreover,

the collaboration with IOSCO may prevent competition in the development of new and better solutions for payment systems.

5.3 Committee on the Global Financial System, other Working Groups and the Financial Stability Forum

The Committee and its groups (see Appendix) are working on problems connected with the global financial system, the reasons of the recent financial crises in Asia, Eastern Europe and South America and possible remedies.

A **Working Group on Transparency and Accountability** studied which contributions transparency and accountability could make to better economic performance, and the information needed for this purpose. Another **Working Group on Strengthening Financial Systems** tried to reach a consensus on principles and policies that help the development of a stable and efficient financial system. It also set out options for an enhanced cooperation and coordination among national and international authorities concerned with financial stability. A third **Working Group on International Financial Crises** developed principles and examined policies that could prevent or facilitate the orderly solution of future financial crises. These three groups comprised representatives from central banks and finance ministries of industrial countries and emerging market economies. Their recommendations were endorsed by the Finance Ministers and central bank Governors of 26 countries during the 1998 annual meetings of the IMF and the World Bank.

Since the release of the reports of the three working groups, senior officials from 33 countries met at the initiative of the G-7 countries in Bonn and Washington to discuss topics ranging from the maintenance of sustainable exchange rate regimes to proposals for strengthening the IMF and the World Bank and policies to minimize the social impact of crises. As is well-known, one result of these discussions has been the creation of a **Financial Stability Forum** to improve international cooperation with respect to actions to strengthen financial systems. The BIS and other international financial institutions and organizations participate in the meetings of the Forum. In addition, the General Manager of the BIS serves, in his personal capacity, as a Chairman of the Forum. Its secretariat is located at the BIS with at the moment five people. In a sense, the Forum extends the work of the Basle Committees, now including governments. It is hoped by members of the BIS that the Forum will be able to set priorities, to coordinate activities and to locate gaps in the often overlapping and compartmentalized efforts to find ways to increase the stability of the international financial system.

The BIS and the Basle Committee took a joint initiative in 1997 to create the **Financial Stability Institute**, whose first Chairman took up his position on 1 February, 1999. The Institute will also focus on strengthening financial systems and institutions, starting with banking and gradually adding securities dealers and insurance.

Finally, secretariats are also located at the BIS of the **G-10 Ministers and Governors**, the **International Association of Insurance Supervisors** and the **Joint Year 2000 Council**. The latter is formed by the Basle Committee on Banking Supervision, the Committee on Payment and Settlement Systems, the IOSCO and the IAIS. It has been working on the year 2000 computer problems, their solution and their possible consequences.

Looking at the activities of the three working groups from a **normative point of view**, they may have provided a positive externality if they contributed in their recommendations

valuable new ideas on strengthening the international financial system. It has, however to be said, that it is not clear whether they have not only replicated the work done by the Committees discussed above. The same may happen with the newly created **Financial Stability Forum**, of which the BIS together with other international financial institutions and organizations is a member. In the extreme, the Forum may just be an example of „symbolic action“ versus real benefit. On the other hand, if the Forum should succeed to set priorities, to locate and to close gaps, it could usefully supplement the provision of the public goods contributing to international financial stability. Moreover, since the Ministers of Finance are also behind this effort, it may be easier to implement the recommended steps. However, the possible introduction of politics, quite in contrast to the other Committees, into the deliberations may have negative consequences for the recommendations and their implementation. The participation of many international institutions and organizations together with this fact may lead to dubious compromises. It also may imply again an overlapping of activities.

5.4 A Monetary Policy Forum for Central Bankers

According to personal communications by participants, an important service has been provided by the BIS in serving as a regular meeting place for the G-10 governors (presently seven times a year). It allowed the governors to exchange confidential information, to have critical discussions about and sometimes to coordinate actions concerning monetary policies away from the attention of the mass media. Peer group pressure in favor of stable monetary policies should also not be underestimated. Personal acquaintance allowed the building of mutual confidence so important in times of crises. In recent years efforts have been made to include the Governors of emerging market economies in this process. Thus the Governors of the G-10 are now also meeting seven times a year with Governors of emerging market economies. Moreover, the Deputy Governors of emerging market economies, too, are now meeting at the BIS.

As can be seen from the Appendix, these meetings are supplemented or prepared by regular meetings of different groups of central bank experts. Examples are the groups of central bank economists, statisticians, on domestic monetary policy and on monitoring emerging markets.

From a **normative perspective** the regular meetings of the governors seem to have been very useful, as confirmed by private communication by participants. The frank and critical discussions behind closed doors together with peer group pressure seem to have had a positive effect on the spreading of sound and stable monetary policies. They thus had a positive external effect. Related to these meetings, the regular meetings of the specialists of the central bank in different fields should have contributed to better implement such stable monetary policies. In this sense they also contributed to the positive external effects.

5.5 Training Services Provided

The BIS, sometimes in cooperation with other financial institutions, is organizing regular workshops and seminars. E.g. the **Committee on Payments and Settlement Systems** has supported an increasing number of payment system workshops and seminars, which were jointly organized by the BIS together with regional central bank groups.

The training needs of countries in transition were addressed within the framework of the **Joint Vienna Institute**, which is sponsored by the BIS, EBRD, IBRD, IMF, OECD and

recently the World Trade Organization, and was established in late 1992. More than 10000 officials have attended courses and seminars until now.

The **Financial Stability Institute** also intends to hold seminars in which heads of supervision from emerging markets will interact with those from industrialized countries and experienced financial sector participants. Moreover, training programs for middle-level senior supervisors are planned with seminars in Basle and each of the major regions of the world. Cooperation with the World Bank, the IMF and central banks is envisaged.

From a **normative perspective** it can be stated that the training of central bank employees, of banking supervisors etc., especially from emerging market economies and from underdeveloped countries, is a necessary, but not sufficient condition for the implementation of sound monetary policies and banking practices. Training spreads knowledge and the knowhow how to acquire and to use information without taking it away from others. It therefore creates positive externalities not only for the individuals concerned but also for the countries where participants apply what they have learned. It has, however, again to be asked whether the collaboration of the BIS and other international financial institutions and organizations allows economies of scale in education, or whether an unnecessary overlap is created.

5.6 General Evaluation of the BIS Services from a Normative Economic Perspective

We have concluded in the subsections above that the activities of the different Committees and Groups located at the BIS provide public goods and (or) positive externalities in many cases. They do so in helping to prevent or mitigate future financial crises by developing good standards of supervision, sensible minimal capital requirements (though there remain some doubts here), standards for well-working settlement systems, by providing training for central bank officials and regulators and by encouraging the spread of good monetary policies with the help of mutual information, critical discussions and peer pressure. Thus a rather positive picture emerges from a normative economic viewpoint. And this though we had to point out some possible overlap with the activities of other financial institutions, a possible limitation of competition for the development of institutional innovation and, for some cases, the danger of political and interest group influence.

This positive evaluation does, however, not necessarily imply a positive evaluation of the activities of the BIS. For except in the few cases mentioned, the BIS is not itself an active member of these Committees and Groups. Their members are usually national experts, whereas the staff of the BIS, especially those providing secretarial help to the Committees and to prepare the sessions, have as their primary function the support of the cooperation of others. This approach makes the BIS quite different from all other international financial institutions. The BIS also provides the localities for the meetings and secretariats at its own expense. Apart from the exceptions of direct participation in Committees, the provision of training and the gathering and dissemination of information concerning international financial data, the BIS thus only indirectly provides public goods and positive externalities by serving these Committees and Groups. But these supportive services do not necessarily themselves constitute public goods or provide positive externalities.

As a consequence, the question has to be asked whether these services could not be provided by others organizations. What then, are the comparative advantages of the supply of these

services by the BIS? It seems that the BIS has in fact developed a trustworthy and confidential atmosphere and a specific knowledge of efficiently organizing such meetings. It has created a crystallization point allowing different Committees to be formed²⁵ and permitting them and their members to come together to discuss critical and new issues away from the attention of the mass media, to exchange information and to get stimulation for new developments. This hypothesis is clearly supported by the observation that more and more central banks and other actors obviously prefer to act within the framework provided by the BIS. It is also supported by the fact that the General Manager of the BIS has been elected to serve as Chairman of the Financial Stability Forum, and that the previous General Manager served as a member and another BIS official as the secretary of the Delors Committee, which had the task to prepare the proposal on the European Monetary Union. In a way, the BIS is creating, besides a confidential and stimulating atmosphere, economies of scope for the different committees and groups. It allows them to cross-fertilize each other with ideas, to innovate and to produce public goods or positive externalities at less cost. The fact, that the BIS usually bears the cost for the secretarial help and for the location may help, but it is certainly not the decisive factor why so many committees and working groups have been connected with the BIS.

A second question which may be asked is whether the activities and innovations undertaken by the different Committees and Groups could not be left to private organizations. For as explained in Section 1, the provision of public goods or positive externalities is only a necessary but not a sufficient reason for the activity of international organizations. And indeed, we have examples of related private activities. The credit ratings of firms provided by Moodys or by Standard and Poor are examples, as are more recently indexes of economic freedom calculated by the Fraser Institute in Vancouver and the Heritage Foundation in Washington. Thus it could even be that the „unfair“ competition by the public Committees and Groups meeting at the BIS prevents the development of further private activities in developing international bookkeeping and monitoring standards. It seems, however, that this is not the case. It is rather doubtful whether enough of a private demand for such standards would exist, given that they are public goods. The risk for private firms to invent and to try to sell such standards is and would thus probably be too high to motivate them to make the necessary investments. This should be even more true for regulations and minimal capital requirements concerning banks and financial institutions. And the implementation of such public goods by market pressure alone would probably also not be sufficient, so that an involvement of the different national authorities appears to be necessary. We thus conclude, that at least for the time being, most of the activities undertaken by the Committees and Groups located at the BIS fulfill a useful function in providing public goods and positive externalities.

²⁵ An interesting example is the formation of the Offshore Group of Banking Supervisors. According to a fax message received from its chairman, Colin Powell OBE, on September 8, 1999, „in 1979 the Basle Committee on Banking Supervision decided that there would be virtue in initiating a meeting of Banking Supervisors representing offshore centres. ... [It] was concerned that the banks for which its member countries were responsible were at risk because it was thought their subsidiaries or branches in offshore centres, through which loans were being booked, were not subject to a sufficiently high standard of supervision.“ Thus it was at the initiative of the Basle Committee that the first meeting of Offshore Banking Supervisors was held in Basle at the BIS in 1980. Today eighteen offshore financial centers are members of the Group, which only admits new members guaranteeing effective banking supervision according to the rules promulgated by the Basle Committee and make a commitment against money laundering.

6. Functions of the BIS as a Trustee

The BIS continues to act as a Trustee for the Dawes and Young loans. It also acts in the capacity of Collateral Agent to hold and to invest collateral for the benefit of the holders of certain long-term US dollar denominated Brazilian, Peruvian and Côte d'Ivoire (here also of French Franc) bonds under agreements signed 1994, 1997 and 1998, respectively.

Concerning these tasks no public goods or positive externalities seem to be provided. For apart perhaps from the special trust which participants have in the BIS, such a function could certainly be fulfilled by private banks.

7. Financial Assistance to Central Banks

The BIS has since decades also been involved in providing short-term bridging loans to central banks during financial crises. Since the BIS has been able to act much more quickly and without conditions, i.e. over night, than other financial institutions, especially the IMF, it has sometimes played an important role in this field. It has usually granted these short-term financial assistance until substituted by IMF or other credits. The BIS credits were always guaranteed by the participating central banks. They could be given without conditionality and political pressures. The BIS broke with this tradition to give only bridging loans with its participation in the international financial support program for Brazil in late 1998. In this case it made funds available without a commitment that they were soon substituted by other credits, though they were again for the most part backed or guaranteed by the 19 participating central banks. For most of this Credit Facility of up to US\$ 13.28 billion in favor of the Banco Central do Brasil the BIS thus coordinated the assistance of the 19 central banks. Since nineteen bilateral agreements with Brazil would have been difficult to negotiate in a short time, one can speak of economies of scale which resulted because the BIS quickly acted as an intermediary in providing the facility.

One can argue that by preventing the spread of a financial crisis with the help of financial assistance positive externalities are provided to other financial institutions and, if the crisis is prone to have negative consequences for the real economy, even to producers, workers and consumers. This would also hold for the BIS as long as the other international financial institutions are not able to help quickly and perhaps as long as it is not influenced itself by political pressures. Positive externalities strengthened by economies of scale would also be present if the BIS is superior in quickly coordinating needed financial help by a number of central banks. On the other hand, there seems to be an unnecessary overlap with the activities of other international financial institutions, especially the IMF. The argument that the BIS could act more quickly is, however, no longer valid after the Supplemental Reserve Facility of the IMF has been created in the end of 1997. Also, it may be doubted, whether the political independence can be maintained if the financial assistance should no longer consist only of short-term bridging loans. But if this is true, then only the important function of coordinating the help granted by several central banks would remain. And here some people might ask whether this task is really better served by the BIS than the IMF.

8. Conclusion

Studying the different activities of the BIS we have come to the following conclusions. The main contribution of the BIS in supplying international public goods and positive externalities consists in the services it provides to the many Committees and Groups which are located at the BIS and (or) whose meetings are organized by it and whose secretariats it provides. The public goods and positive externalities are mainly created and implemented by these Committees who develop new standards, regulations etc. which increase international financial stability. The BIS seems to be an efficient provider of support which allows economies of scope, a congenial and confidential atmosphere and cross-fertilization among different Committees and Groups, and which furthers the provision of new international public goods at low cost. The BIS itself supplies such goods directly by gathering and disseminating financial information concerning an increasing number of countries, financial markets and institutes. It participates itself in some of the Committees as a member and provides positive externalities by organizing and sponsoring training programs for international financial specialists.

However, the recently increasing collaboration with other international financial institutions like the **IMF**, the **World Bank** and even organizations like the **OECD**, is not without problems. For though it may sometimes help to collect information and to better implement internationally certain innovations, it creates more and more overlapping activities. The influence of politics and perhaps even of certain interest groups may increase, the bottom-up approach followed by the BIS may get into conflict with the top-down approach of the IMF and the World Bank. Also coordination, though clearly helpful in setting common standards and regulations, may sometimes restrict the competition to develop even better public goods. It is, however, not the task of the present paper to judge whether the participation of the IMF and the World Bank in the tasks usually followed by the „BIS- Committees“ is warranted, given their own main tasks.

Whereas the service activities of the BIS contribute directly or indirectly to the creation and implementation of international public goods and (or) positive externalities, this cannot be said in the same way of its other activities. This seems neither to be the case concerning its function as a trustee nor as a lender to central banks during crises. In favor of the former activity only the reputation of trustfulness and competence enjoyed by the BIS can be mentioned. The argument in favor of the latter, namely the ability to arrange short-term bridging loans speedily and without conditionality to help to overcome financial crises, is no longer valid after the introduction of the Supplemental Reserve Facility by the IMF in 1997. Only the economies of scale in arranging skillfully and speedily multilateral agreements on financial help by several central banks with countries needing support may be helpful.

The banking activities of the BIS as a banker to central banks serve scarcely to produce public goods or positive externalities, though they are valued by central banks because of their confidentiality and safety. One could only make an argument that the confidentiality allows to create a positive externality since it prevents private banks from observing the investment or withdrawal of foreign exchange reserves of central banks in financial markets. Such withdrawals could be seen as a sign of a need to spend reserves for foreign exchange market interventions and that the remaining other reserves are no longer sufficient. This itself might engender capital flight and thus contribute to financial instability. Apart from this argument it has to be recalled that the profits from its banking operations make the BIS financially independent and allow it to finance its service activities, besides distributing an annual dividend.

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Endnotes:

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„IOSCO is a private, not for profit, international organization that was created in 1983 by amending the By-laws of a previously regional interamerican association of securities regulators to transform it into an international body. All the voting members of IOSCO are agencies having securities regulatory responsibilities. A number of self-regulatory organizations (such as major stock exchanges) and international organizations having a mission related to either the regulation or the development of securities markets (such as the IBDR), have the status of affiliate members. Individuals cannot become IOSCO members.“ “IOSCO is financed by a yearly contribution from its members .“ (Peter Clark, Secretary General of IOSCO in a Fax of Sept. 8, 1999, to the author).

² „The IAIS ...is a public organization and legally speaking an association under Swiss law (Verein). ..The members of the IAIS are insurance supervisory or regulatory bodies i.e., public organizations. ...The IAIS activities are financed by its member fees. The Swiss Government supported the establishment of the IAIS Secretariat in Basel by a subsidy that was paid from 1997 till 1999. The BIS supports the IAIS Secretariat by providing office space and equipment free of charge and also administrative support. There exist no special arrangements regarding the co-operation with the different BIS committees.“ (Letter from Knut Hohlfeld, Secretary General of IAIS to the author of September 14, 1999).

³ An interesting example is the formation of the Offshore Group of Banking Supervisors. According to a fax message received from its chairman, Colin Powell OBE, on September 8, 1999, „in 1979 the Basle Committee on Banking Supervision decided that there would be virtue in initiating a meeting of Banking Supervisors representing offshore centres. ... [It] was concerned that the banks for which its member countries were responsible were at risk because it was thought their subsidiaries or branches in offshore centres, through which loans were being booked, were not subject to a sufficiently high standard of supervision.“ Consequently it was at the initiative of the Basle Committee that the first meeting of Offshore Banking Supervisors was held in Basle at the BIS in 1980. Today eighteen offshore financial centers are members of the Group, which only admits new members guaranteeing effective banking supervision according to the rules promulgated by the Basle Committee and make a commitment against money laundering.

I. Meetings in the context of the G-10 Central Banks

Committee of Governors of the Central Banks of G-10 Countries (7x per year)

Committees working under the G-10 Governors auspices:

- Basel Committee on Banking Supervision
- Committee on the Global Financial System
- Committee on Payment and Settlement Systems
- Committee on Gold and Foreign Exchange

Basel Committee on Banking Supervision (G-10) (4x per year)

Standing sub-groups:

- Capital Group
- Research task force
- Models task force
- Core Principles Group
 - Core principles coordinating group
 - Core principles liaison group
- Risk Management Group
- Joint Forum Group on Financial Conglomerates (with IOSCO and IAIS)

Ad hoc sub-groups:

- Y2K task force
- Working Group on highly leveraged institutions
- Working Group on core principle methodology
- Working Group on cross-border banking
- Task force on commercial real estate

Committee on the Global Financial System (G-10 „plus“) (4x per year)

- Working Group on financial market events in Autumn 1998
- Working group on lender of last resort
- Working Group on enhanced transparency regarding aggregate positions
- Working Group on macro-stress testing
- Multidisciplinary Working Group on enhanced transparency

Committee on Payment and Settlement Systems (G-10) (3x per year)

- Task force on payment system principles and practices (G-10 „plus“)
- Working Group on retail payment systems
- Sub-group on foreign exchange settlement risk
- Joint Working Group on securities lending

Committee on Gold and Foreign Exchange (G-10) (7x per year)

II. Other meetings of central bank representatives organized by the BIS

Other meetings of Central Bank Governors (7x per year)

- Meeting of Governors of the G-10 and of significant emerging market economies (G-10 „plus“)
- Meeting of Governors of BIS shareholding central banks
- Meeting of Deputy Governors' of Emerging Market Economies

Regular meetings of central bank experts

- Central bank economists (G-10 „plus“)
- Working party on domestic monetary policy (G-10 plus EU central banks)
- Central bank statisticians (G-10 „plus“)
- Group of experts on monetary and economic data bank questions (G-10 „plus“)
- Central bank econometricians/model builders
- Emerging markets monitoring group (G-10 „plus“)
- Coordinators of technical assistance and training of G-10 and CEEC/CIS central banks
- Special Study Group (SSG-2) (Bank note printers)
- Computer Experts Group
- Working party on IT security issues
- Central bank security managers
- Group of central bank heads of internal audit
- Central bank legal experts

III. Committees or groupings whose secretariats are located at the BIS

Financial Stability Forum (G-7 „plus“, IFIs) (2x per year)

- Standing Chairman's sub-group
- Ad hoc working groups:
 - HLIs/Leverage
 - Short-term capital flows
 - Offshore centers

Secretariat of the Group of Ten Ministers and Governors (2x per year)

- Standing Group of Ten Deputies

International Association of Insurance Supervisors (IAIS) (4x per year)

Joint Year 2000 Committee (2x per year)

- jointly formed by the Basle Committee on Banking Supervision, the Committee on Payment and Settlement Systems, the International Organization of Securities Commissions (IOSCO) and IAIS

