Ruling The World of Money

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Ten times a year— once a mouth except in August and October— a small elite of well dressed men arrives in Basel, Switzerland. Carrying overnight bags and attache cases, they discreetly check into the Euler Hotel, across from the railroad station. They have come to this sleepy city from places as disparate as Tokyo, London, and Washington, D.C., for the regular meeting of the most exclusive, secretive, and powerful supranational club in the world. Each of the dozen or so visiting members has his own office at the club, with secure telephone lines to his home country. The members are fully serviced by a permanent staff of about 300, including chauffeurs, chefs, guards, messengers, translators, stenographers, secretaries, and researchers. Also at their disposal are a brilliant research unit and an ultramodern computer, as well as a secluded country club with tennis courts and a swimming pool, a few kilometers outside Basel.

The membership of this club is restricted to a handful of powerful men who determine daily the interest rate, the availability of credit, and the money supply of the banks in their own countries. They include the governors of the U.S. Federal Reserve, the Bank of England, the Bank of Japan, the Swiss National Bank, and the German Bundesbank. The club controls a bank with a $40 billion kitty in cash, government securities, and gold that constitutes about one tenth of the world's available foreign exchange. The profits earned just from renting out its hoard of gold (second only to that of Fort Knox in value) are more than sufficient to pay for the expenses of the entire organization. And the unabashed purpose of its elite monthly meetings is to coordinate and, if possible, to control all monetary activities in the industrialized world. The place where this club meets in Basel is a unique financial institution called the Bank for International Settlements-or more simply, and appropriately, the BIS (pronounced "biz" in German).

THE BIS was originally established in May 1930 by bankers and diplomats of Europe and the United States to collect and disburse Germany's World War I reparation payments (hence its name). It was truly an extraordinary arrangement. Although the BIS was organized as a commercial bank with publicly held shares, its immunity from government interference, and even taxation, in both peace and war was guaranteed by an international treaty signed in The Hague in 1930. Although all its depositors are central banks, the BIS has made a profit on every transaction. And because it has been highly profitable, it has required no subsidy or aid from any government.

Since it also provided, in Basel, a safe and convenient repository for the gold holdings of the European central banks, it quickly evolved into the bank for central banks. As the world depression deepened in the Thirties and- financial panics flared up in Austria, Hungary, Yugoslavia, and Germany, the governors in charge of the key central banks feared that the entire global financial system would collapse unless they could closely coordinate their rescue efforts. The obvious meeting spot for this desperately needed coordination was the BIS, where they regularly went anyway to arrange gold swaps and war-damage settlements.

Even though an isolationist Congress officially refused to allow the U.S. Federal Reserve to participate in the BIS, or to accept shares in it (which were instead held in trust by the First National City Bank), the chairman of the Fed quietly slipped over to Basel for important meetings. World monetary policy was evidently too important to leave to national politicians. During World War 11, when the nations, if not their central banks, were belligerents, the BIS continued operating in Basel, though the monthly meetings were temporarily suspended. In 1944, following Czech accusations that the BIS was laundering gold that the Nazis had stolen from occupied Europe, the American government backed a resolution at the Bretton Woods Conference calling for the liquidation of the BIS. The naive idea was that the settlement and monetary-clearing functions it provided could be taken over by the new International Monetary Fund.

What could not be replaced, however, was what existed behind the mask of an international clearing house: a supranational organization for setting and implementing global monetary strategy, which could not be accomplished by a democratic, United Nations-like international agency. The central bankers, not about to let their club be taken from them, quietly snuffed out the American resolution.

After World War 11, the BIS reemerged as the main clearing house for European currencies and, behind the scenes, the favored meeting place of central bankers. When the dollar came under attack in the 1960s, massive swaps of money and gold were arranged at the BIS for the defense of the American currency. It was undeniably ironic that, as the president of the BIS observed, "the United States, which had wanted to kill the BIS, suddenly finds it indispensable." In any case, the Fed has become a leading member of the club, with either Chairman Paul Volcker or Governor Henry Wallich attending every "Basel weekend."

Originally, the central bankers sought complete anonymity for their activities. Their headquarters were in an abandoned six story hotel, the Grand et Savoy Hotel Universe, with an annex above the adjacent Frey's Chocolate Shop. There purposely was no sign over the door identifying the BIS, so visiting central bankers and gold dealers used Frey's, which is across the street from the railroad station, as a convenient landmark. It was in the wood-paneled rooms above the shop and the hotel that decisions were reached to devalue or defend currencies, to fix the price of gold, to regulate offshore banking, and to raise or lower short-term interest rates. And though they shaped "a new world economic order" through these deliberations, according to Guido Carli, the governor of the Italian central bank,, the public, even in Basel, remained almost totally unaware of the club and its activities.

In May 1977, however, the BIS gave up its anonymity, against the better judgment of some of its members, in exchange for more efficient headquarters. The new building, an eighteen story-high circular skyscraper that rises over the medieval city like some misplaced nuclear reactor, quickly became known as the "Tower of Basel" and began attracting attention from tourists. "That was the last thing we wanted," Dr. Fritz Leutwiler, its president told me, when I interviewed him in 1983. "If it had been up to me, it never would have been built." While we talked, he kept his eyes glued to the Reuters screen in his office, which signaled currency fluctuations around the globe.

Despite its irksome visibility, the new headquarters does have the advantages of luxurious space and Swiss efficiency. The building is completely air-conditioned and self-contained, with its own nuclear-bomb shelter in the sub-basement, a triply redundant fire-extinguishing system (so outside firemen never have to be called in), a private hospital, and some twenty miles of subterranean archives. "We try to provide a complete clubhouse for central bankers ... a home away from home," said Gunther Schleiminger, the supercompetent general manager, as he arranged a rare tour of the headquarters for me.

The top floor, with a panoramic view of three countries, Germany, France, and Switzerland, is a deluxe restaurant, used only to serve the members a buffet dinner when they arrive on Sunday evenings to begin the "Basel weekends." Aside from those ten occasions, this floor remains ghostly empty.

On the floor below, Schleiminger and his small staff sit in spacious offices, administering the day-today details of the BIS and monitoring activities on lower floors as if they were running an out-of-season hotel.

The next three floors down are suites of offices reserved for the central bankers. All are decorated in three colors— beige, brown, and tan— and each has a similar modernistic lithograph over the desk. Each office also has coded speed-dial telephones that at a push of a button directly connect the club members to their offices in their central banks back home. The completely deserted corridors and empty offices, with nameplates on the doors and freshly sharpened pencils in cups and neat stacks of incoming papers on the desks, are again reminiscent of a ghost town. When the members arrive for their forthcoming meeting in November, there will be a remarkable transformation, according to Schleiminger, with multilingual receptionists and secretaries at every desk, and constant meetings and briefings.

On the lower floors are the BIS computer, which is directly linked to the computers of the member central banks and provides instantaneous access to data about the global monetary situation, and the actual bank, where eighteen traders, mainly from England and Switzerland, continually roll over short" term loans on the Eurodollar markets and guard against foreign-exchange losses (by simultaneously selling the currency in which the loan is due). On yet another floor, gold traders are constantly on the telephone arranging loans of the bank's gold to international arbitragers, thus allowing central banks to make interest on gold deposits.

Occasionally there is an extraordinary situation, such as the decision to sell gold for the Soviet Union, which requires a decision from the "governors," as the BIS staff calls the central bankers. But most of the banking is routine, computerized, and riskless. Indeed, the BIS is prohibited by its statutes from making anything but short-term loans. Most are for thirty days or less that are government guaranteed or backed with gold deposited at the BIS. The profits the BIS receives for essentially turning over the billions of dollars deposited by the central banks amounted to $162 million last year.

As skilled as the BIS may be at all this, the central banks themselves have highly competent staffs capable of investing their deposits. The German Bundesbank, for example, has a superb international trading department and 15,000 employees— at least twenty times as many as the BIS staff. Why then do the Bundesbank and the other central banks transfer some $40 billion of deposits to the BIS and thereby permit it to make such a profit?

One answer is of course secrecy. By commingling part of their reserves in what amounts to a gigantic mutual fund of short term investments, the central banks created' a convenient screen behind which they can hide their own deposits and withdrawals in financial centers around the world. And the central banks are apparently willing to pay a high fee to use the cloak of the BIS.

There is, however, another reason why the central banks regularly transfer deposits to the BIS: they want to provide it with a large enough profit to support the other services it provides. Despite its name, the BIS is far more than a bank. From the outside, it seems to be a small, technical organization. Just eighty-six of its 298 employees are ranked as professional staff. But the BIS is not a monolithic institution: artfully concealed within the shell of an international bank, like a series of Chinese boxes one inside another, are the real groups and services the central bankers need-and pay to support.

The first box inside the bank is the board of directors, drawn from the eight European central banks (England, Switzerland, Germany, Italy, France, Belgium, Sweden, and the Netherlands), which meets on the Tuesday morning of each "Basel weekend." The board also meets twice a year in Basel with the central banks of other nations. It provides a formal apparatus for dealing with European governments and international bureaucracies like the IMF or the European Economic Community (the Common Market). The board defines the rules and territories of the central banks with the goal of preventing governments from meddling in their purview. For example, a few years ago, when the Organization for Economic Cooperation and Development in Paris appointed a low-level committee to study the adequacy of bank reserves, the central bankers regarded it as poaching on their monetary turf and turned to the BIS board for assistance. The board then arranged for a high-level committee, under the head of Banking Supervision at the Bank of England, to preempt the issue. The OECD got the message and abandoned its effort.

To deal with the world at large, there is another Chinese box called the Group of Ten, or simply the "G-10." It actually has eleven full-time members, representing the eight European central banks, the U.S. Fed, the Bank of Canada, and the Bank of Japan. It also has one unofficial member: the governor of the Saudi Arabian Monetary Authority. This powerful group, which controls most of the transferable money in the world, meets for long sessions on the Monday afternoon of the "Basel weekend." It is here that broader policy issues, such as interest rates, money-supply growth, economic stimulation (or suppression), and currency rates are discussed-if not always resolved.

Directly under the G-10, and catering to all its special needs, is a small unit called the "Monetary and Economic Development Department," which is, in effect, its private think tank. The head of this unit, the Belgian economist Alexandre Larnfalussy, sits in on all the G-10 meetings, then assigns the appropriate research and analysis to the half dozen economists on his staff. This unit also produces the occasional blue-bound "economic papers" that provide central bankers from Singapore to Rio de Janeiro, even though they are not BIS members, with a convenient party line. For example, a recent paper called "Rules versus Discretion: An Essay on Monetary Policy in an Inflationary Environment," politely defused the Milton Friedmanesque dogma and suggested a more pragmatic form of monetarism. And last May, just before the Williamsburg summit conference, the unit released a blue book on currency intervention by central banks that laid down the boundaries and circumstances for such actions. When there are internal disagreements, these blue books can express positions sharply contrary to those held by some BIS members, but generally they reflect a consensus of the G-10.

Over A bratwurst-and-beer lunch on the top floor of the Bundesbank, which is located in a huge concrete building (called "the bunker") outside of Frankfurt, Karl Otto Pohl, its president and a ranking governor of the BIS, complained to me in 1983 about the repetitiousness of the meetings during the "Basel weekend." "First, there is the meeting on the Gold Pool, then, after lunch, the same faces show up at the G-10, and the next day there is the board which excludes the U.S., Japan, and Canada, and the European Community meeting which excludes Sweden and Switzerland." He concluded: "They are long and strenuous-and they are not where the real business gets done." This occurs, as Pohl explained over our leisurely lunch, at still another level of the BIS: "a sort of inner club."

The inner club is made up of the half dozen or so powerful central bankers who find themselves more or less in the same monetary boat: along with Pohl are Volcker and Wallich from the Fed, Leutwiler from the Swiss National Bank, Lamberto Dini of the Bank of Italy, Haruo Mayekawa of the Bank of Japan, and the retired governor of the Bank of England, Lord Gordon Richardson (who had presided over the G-10 meetings for the past ten years). They are all comfortable speaking English; indeed, Pohl recounted how he has found himself using English with Leutwiler, though both are of course native German-speakers. And they all speak the same language when it comes to governments, having shared similar experiences. Pohl and Volcker were both under secretaries of their respective treasuries; they worked closely with each other, and with Lord Richardson, in the futile attempts to defend the dollar and the pound in the 1960s. Dini was at the IMF in Washington, dealing with many of the same problems. Pohl had worked closely with Leutwiler in neighboring Switzerland for two decades. "Some of us are very old friends," Pohl said. Far more important, these men all share the same set of well-articulated values 'about money.

The prime value, which also seems to demarcate the inner club from the rest of the BIS members, is the firm belief that central banks should act independently of their home governments. This is an easy position for Leutwiler to hold, since the Swiss National Bank is privately owned (the only central bank that is not government owned) and completely autonomous. ("I don't think many people know the name of the president of Switzerland-even in Switzerland," Pohl joked, "but everyone in Europe has heard of Leutwiler.") Almost as independent is the Bundesbank; as its president, Pohl is not required to consult with government officials or to answer the questions of Parliament-even about such critical issues as raising interest rates. He even refuses to fly to Basel in a government plane, preferring instead to drive in his Mercedes limousine.

The Fed is only a shade less independent than the Bundesbank: Volcker is expected to make periodic visits to Congress and at least to take calls from the White House-but he need not follow their counsel. While in theory the Bank of Italy is under government control, in practice it is an elite institution that acts autonomously and often resists the government. (In 1979, its then governor, Paolo Baffi, was threatened with arrest, but the inner club, using unofficial channels, rallied to his support.) Although the exact relationship between the Bank of Japan and the Japanese government purposely remains inscrutable, even to the BIS governors, its chairman, Mayekawa, at least espouses the principle of autonomy. Finally, though the Bank of England is under the thumb of the British government, Lord Richardson was accepted by the inner club because of his personal adherence to this defining principle. But his successor, Robin Leigh-Pemberton, lacking the years of business and personal contact, probably won't be admitted to the inner circle.

In any case, the line is drawn at the Bank of England. The Bank of France is seen as a puppet of the French government; to a lesser degree, the remaining European banks are also perceived by the inner club as extensions of their respective governments, and thus remain on the outside.

A second and closely related belief of the inner club is that politicians should not be trusted to decide the fate of the international monetary system. When Leutwiler became president of the BIS in 1982, he insisted that no government official be allowed to visit during a "Basel weekend." He recalled that in 1968, U.S. Treasury undersecretary Fred Deming had been in Basel and stopped in at the bank. "When word got around that an American Treasury official was at the BIS," Leutwiler said, "bullion traders, speculating that the U.S. was about to sell its gold, began a panic in the market." Except for the annual meeting in June (called "the Jamboree" by the staff), when the ground floor of the BIS headquarters is open to official visitors, Leutwiler has tried to enforce his rule strictly. "To be frank," he I have no use for politicians. They lack the judgment of central bankers." This effectively sums up the common antipathy of the inner club toward "government muddling," as Pohl puts it.

The inner-club members also share a strong preference for pragmatism and flexibility over any ideology, whether that of Lord Keynes or Milton Friedman. Rather than resorting to rhetoric and invoking principles, the inner club seeks any remedy that will relieve a crisis. For example, earlier this year, when Brazil failed to pay back on time a BIS loan that was guaranteed by the central banks, the inner club quietly decided to extend the deadline instead of collecting the money from the guarantors. "We are constantly engaged in a balancing act-without a safety net," Leutwiler explained.

THE FINAL and by far the most important belief of the inner club is the conviction that when the bell tolls for any single central bank, it tolls for them all. When Mexico faced bankruptcy in the early eighties. The issue for the inner club was not the welfare of that country but, as Dini put it, "the stability of the entire banking system." For months Mexico had been borrowing overnight funds from the interbank market in New York-as every bank recognized by the Fed is permitted to do-to pay the interest on its $80 billion external debt. Each night it had to borrow more money to repay the interest on the previous night's transactions, and, according to Dini, by August Mexico had borrowed nearly one quarter of all the "Fed Funds," as these overnight loans between banks are called.

The Fed was caught in a dilemma: if it suddenly stepped in and forbade Mexico from further using the interbank market, Mexico would be unable to repay its enormous debt the next day, and 25 percent of the entire banking system's ready funds might be frozen. But if the Fed permitted Mexico to continue borrowing in New York, in a matter of months it would suck in most of the interbank funds, forcing the Fed to expand drastically the supply of money.

It was clearly an emergency for the inner club. After speaking to Miguel Mancera, director of the Banco de Mexico, Volcker immediately called Leutwiler, who was vacationing in the Swiss mountain village of Grison. Leutwiler realized that the entire system was confronted by a financial time bomb:

even though the IMF was prepared to extend $4.5 billion to Mexico to relieve the pressure on its long-term debt, it would require months of paperwork to get approval for the loan. And Mexico needed an immediate 1.85 billion dollar loan to get out of the interbank market, which Mancera had agreed to do. But in less than forty eight hours, Leutwiler had called the members of the inner club and arranged the temporary bridging loan.

While this $1.85 billion appeared in the financial press to have come from the BIS, virtually all the funds came from the central banks in the inner club. Half came directly from the United States -$600 million from the Treasury's exchange-equalization fund and $325 million from the Fed's coffers; the remaining $925 million mainly from deposits of the Bundesbank, Swiss National Bank, Bank of England, Bank of Italy, and Bank of Japan, deposits that were specifically guaranteed by these central banks, though advanced pro forma by the BIS (with a token amount advanced by the BIS itself against the collateral of Mexican gold). The BIS undertook virtually no risk in this rescue operation; it merely provided a convenient cloak for the inner club. Otherwise, its members, especially Volcker, would have had to take the political heat individually for what appeared to be the rescue of an underdeveloped country. In fact, they were true to their paramount values: rescuing the banking system itself.

Inner club members publicly pay lip service to the ideal of preserving the character of the BIS and not turning it into a lender of last resort for the world at large. Privately, however, they will undoubtedly continue their maneuvers to protect the banking system at whatever point in the world it seems most vulnerable. After all, it is ultimately the central banks' money at risk, not the BIS's. And the inner club will also keep using the BIS as its public mask, and pay the requisite price for the disguise.