

# The Bank for International Settlements and the dark history of finance during World War II

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**Abstract:** *During the 1930s came the world's oldest international financial institution – the Bank for International Settlements. Yet now, 88 years from its creation, both the academic community, not to mention the general public, know so little about it. On the basis of the bank's dark history, the goal of this paper is to reveal the dangerous and hidden aspects behind the globalization of finance which started during the interwar and war period.*

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**Introduction:** The issues related to the activity, history and future development of international relations and institutions have always been at the center of the public and academic debate. In this sense, it is puzzled that the history of the Bank for International Settlements, the oldest international financial institution, the institution responsible for shaping much of the inter-war and post-war financial order, is so poorly known. Actually it is not surprising, giving the fact that in its 88 years of existence only one serious investigative research into the bank's shadow history was done.<sup>1</sup> The fundamental connection of this issue to the understanding of the political and economic problems related to the inter-war and the war period, as well as to the aspects of the global financial integration after the Second World War, necessitates its consideration in this paper.

The Bank for International Settlements (hereinafter referred to as BIS) is undoubtedly one of the most important international institutions that as we have already mentioned most people have not heard of at all. The reason for this, according to one of its longest-serving employees, the chief manager of BIS for the period 1938-1958 Roger Auboin, is not hiding in something secret or mysterious about her activities, but in the fact that they are purely technocratic, complex and incomprehensible (Auboin 1955: p.1). With this article, the author aims to enable the readers to judge for themselves, whether the only reason lies solely in that. In this sense, the author aims to prove that the poorly known institution owes its shadowy history to the politically inconvenient specifics of its activities during the Second World War. Activities which supported illegal and immoral capital and raw material transfer between financial and industrial circles during WWII, revealing the dangerous aspects of war and post-war financial globalization.

**Discussion:** The founding of BIS is usually associated with the problems caused by Germany's military reparations related to her involvement in World War I. Reaching an agreement on the issue of German obligations was a slow, complicated and politically difficult process, not only in terms of their astronomical proportions. World War I, had already internationalized the military conflict to unprecedented degree, in similar fashion the financial problems that followed had been globalized. The underdeveloped international financial system at that time was not designed to cope with the complex challenges posed by the war and post war global conflict. Where would Germany find the money to pay? What would be the mechanisms

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<sup>1</sup> Adam LeBor's "Tower of Basel: The Shadowy History of the Secret Bank that Runs the World" is the first serious investigative research into the bank's shadow history.

by which it would do so? Who would oversee and regulate the reparations payments? It was these confidential discussions that shaped the role, structure, and privileged legal status of the future BIS (LeBor 2013:p.18).

In 1919, as in 1945, two ideological groups formed among the victors of the war: the punishers and the rebuilders. Intoxicated by the victory France and individual UK officials, lead the group of the punishers. The founders of the future BIS, who included most of Wall Street were leading the rebuilders. The last ones represented the corporate interests of the largest financial and industrial companies in the United States, United Kingdom and Germany. This was also the group with far more strategic and pragmatic ideas - the recovery of Europe and, in particular, the promising German economy in order to strengthen their own positions in the processes of economic globalization (LeBor 2013:p.19). The main representatives of this group in the future Bank were: from British side - Montagu Norman, Governor of the Central Bank of England, through the first chairman of the BIS board of directors Sir Otto Niemeyer. From Germany: Hjalmar Schacht, member of the board of BIS, Governor of the Central Bank of Germany and Minister of Economy during the Nazi party's rule. From America, the interests of the major businessman and banker J.P. Morgan and his associate Thomas Lamont were indirectly backed by Wall Street's strongest law firm Sullivan & Cromwell, by its prominent associate and US intelligence representative in Switzerland Alan Dulles (the future first director of CIA) and directly by the second BIS governor since 1940, the American lawyer Thomas McKittrick (LeBor 2013:p.28). It is the combination of the ideas and interests of these two political and economic circles that prepared the ground and even supported the repetition of the 1914 catastrophe in the period between 1939-1945 (Sutton A, 1976).

Until 1924, the mechanism of servicing the debts of the states who lost the war were governed by the ideas and representatives of the so-called “punishing group”. The effect of the overwhelming reparations on the German economy logically materialized in a catastrophic way. Degrading and disintegrating social relations, rising unemployment, hyperinflation, and the intensification of the influence of far-right and left-wing groups led to the total insolvency of the debtor, and later to the Nazi party's coming to power. The growing European political and economic crisis, arising from the unresolved pre-war and post-war conflicts, created the right conditions for the intervention of the second ideological group. Leading position was taken by its American representatives through the head of the new reparations committee in 1924 - the

American banker Charles Dawes. According to the so-called “Dawes Plan” Germany would receive a huge stabilization loan and its debt payments would be sharply reduced till a future recovery of its economy. Unlike Europe, World War I caused an economic boom and a drastic increase in US capital, allowing its banking system to support aggressive investments by US companies in the German industry (LeBor 2013:p.19) .

Between 1924 and 1928 Germany received each year 600 million \$ in loans, half of which came from American banks. Much of it returned from where it had come. The loans revolved and eventually returned to the US, serving both Germany's repayment obligations to England and France, and theirs to US. Secondly, although the loans were officially given to Germany to ensure the payment of reparations, in reality, they were designed to restore the country's military-industrial potential. In fact, the Germans paid off the loans with shares of German companies, allowing American capital to actively integrate itself into the German economy. The total amount of foreign investment in German industry from 1924-1929 amounted to nearly 63 billion gold marks (the loans accounted for 30 billion of this), and 10 billion in reparations was paid off. American bankers - primarily J.P. Morgan, provided Seventy percent of the Germany's financial income. As a result, as early as 1929, Germany's industry was second in the world, but to a large extent it was in the hands of America's leading financial-industrial groups (Ahamed L. 2010: p.216; Sutton A, 1976).

Thus, I.G. Farben, the company that became the German war machine's key component, was under the control of Rockefeller's Standard Oil at the time it funded 45 percent of Hitler's election campaign in 1930. In the pearl of Germany's chemical industry have invested even leading politicians from opposing countries such as the UK Prime Minister from the period 1937-1940 - Neville Chamberlain (Sutton A, 1976).

Through General Electric, J.P. Morgan controlled the German radio and electrical industry in the form of AEG and Siemens (by 1933, General Electric owned a 30 percent stake in AEG). Through telecom company ITT, he controlled 40 percent of Germany's telephone network and 30 percent of aircraft manufacturer Focke-Wulf. Opel was taken over by the Dupont family's General Motors. Henry Ford held a 100 percent stake in Volkswagen. In 1926, with the participation of Rockefeller bank, Dillon Reed and Co., the second largest industrial monopoly emerged – metallurgical firm Vereinigte Stahlwerke (Unified Steel Trusts) of Thyssen, Flick, Wolf, Fegler, etc (Sutton A, 1976).

American cooperation with Germany's military-industrial complex became so intense and pervasive that, by 1933, American capital had reached key sectors of German industry and even major banks like Deutsche Bank, Dresdner Bank, Donat Bank, etc. (Sutton A, 1976).

The resulting financial expansion ended at the end of 1929 with the outbreak of an economic bubble in the US stock market, a tide in investment and a global economic crisis. Once again, Germany was threatened by an economic catastrophe. The answer to the seemingly endless problems with the German reparations was of course, a new conference and a new committee. The initiative continued to be in the hands of the American lobby and this time headed by the industrialist, banker and diplomat Owen Young. The financial plan in his own name served as a pretext for the establishment of the Bank for International Settlements.

In Economics textbooks, more attention is usually paid to the new conditions, parameters and financial benefits associated with the Young Plan, but not to the unique banking institution specially designed to administer them. The main ideologist of this new financial institution was Helmär Schacht, Governor of the Central Bank of Germany, who even allowed himself to call the BIS "my bank" (LeBor 2013:p.12; Schacht 1956). Documents from the Central Bank of England show that Schacht's close friend and Bank of England's Governor Montagu Norman, proposed the creation of such a bank to US Central Bank Governor Benjamin Strong as early as 1925 (LeBor 2013:p.18). During the debates with the creditors in 1930 Hjalmar Schacht explained that the scheme by which Germany has so far serviced its debt, namely by borrowing from other countries, is unacceptable and will no longer be fulfilled. If creditors really want Germany to continue with her obligations, they must invest the repayment instalments in Germany or finance the purchase of German goods from third countries. It is with the main purpose of serving this process that Schacht offered the creation of the Bank for International Settlements (Schacht, 1956).

On 20 January 1930 the governments of Great Britain, France, Germany, Belgium, Italy, Japan and Switzerland signed one of the most unusual legal documents in modern history. The Bank of International Settlements, established through the said act is fully immune to national and international law. Article 10 of the BIS Constituent Charter noted: "The Bank, its property and assets and all deposits and other funds entrusted to it shall be immune in time of peace and in time of war from any measure such as expropriation, requisition, seizure, confiscation,

prohibition or restriction of gold or currency export or import, and any other similar measures.”  
(LeBor 2013:p.27)

By exploiting the chaos of German reparations, international circles actually succeeded in establishing the most privileged and legally protected financial institution in history - an institution far beyond the goals initially proposed and set by its creators. The new Institution had the legal status of an international organization and a bank working for the profit of its shareholders at the same time. The shareholders were supposed to be only Central Banks, except for the Federal Reserve, which until the 1950s was represented by three private banks - JP Morgan, the First National Bank of New York and the First National Bank of Chicago. The governors of the founding central banks were ex officio members of the board of directors. Each could appoint a second director of the same nationality. The second director did not have to be a central banker. He could be drawn from finance, industry, or commerce - a provision that would later prove crucial in ensuring Nazi influence over the BIS. (LeBor 2013:p.28)

The initial capital of the bank was 500 million gold Swiss francs, the authorized activities being: management of the repayment instalments under the Young Plan, trading in gold for its own account or at the expense of its shareholders, trading in securities except shares, acceptance of deposits and maintaining central bank accounts, entering agreements to act as a trustee or agent in connection with international settlements. With the idea of attracting future shareholders and customers from all central banks, especially those in smaller countries, BIS offered specific services under better conditions than those by any central bank. For example, if the Bank of Greece held gold at the Bank of France and wanted to buy another currency, it first had to buy francs from the Bank of France. The Bank of Greece then converted the francs to the second currency, with all the usual losses of exchange rates and commissions. However, if the Bank of Greece held gold at the Bank of France in the name of the BIS, the BIS could “give the Bank of Greece any currency it desires at any time and can fix an agreed rate without going through the actual exchange operation.” And, the BIS did not charge any commission. (LeBor 2013:p.29).

But as we will see, the relationships between the central banks of small countries with BIS can hide not only advantages but also catastrophic disadvantages.

When it came to the conditions for the employees of the bank alone, there were only positives. It doesn't come as a surprise that thirteen thousand people applied for a job at BIS until the end of 1930s. Of these, only 95 were appointed. It is interesting to note that only a few were

bankers. Most of them were either lawyers (including the bank's second governor in the critical period from 1940-1945), economists, members of the League of Nations or the Dawes committee. Their wages were high and exempt from taxes. The lowest wage for an employee was \$15,000 bearing an average US salary of \$2,000 prior taxing (LeBor 2013:p.30).

As a full contrast to the working conditions in the bank, the political environment in Germany evolved. Only two years after its founding, BIS lost its main intended purpose for existence - to facilitate the reparations imposed on Germany by the Treaty of Versailles after World War I, and to act as a trustee for the German Government's Young Loan. After the moratorium and the Lausanne Conference of 1932, reparation payments were suspended, and shortly thereafter, followed the cancellation of payments for the Dawes and Young Plan. For a "final" Hitler arrived in Germany. The possibility of a new war was emerging more evidently and it was once again one between the governments of the major shareholders in BIS. The unique financial institution, contrary to expectations, did not cease its activity - that would completely contradict the spirit of its corporate culture.

During World War II, the manager of the board was an American - Thomas McKittrick. While General Manager, Roger Abuin, was Frenchman, his deputy Paul Heckler - German (member of the Nazi party), Secretary-General Rafael Pilotti - Italian, and the Bank's chief economic advisors were Swedes and Britons (LeBor 2013:p.30). The relations between BIS employees and shareholders remained professional and cooperative prior, during and after the end of the war. Their nationalities did not matter, they were all technocrats who had given their loyalty to the religion of opportunism and international finance. And in this religion there is a completely different moral code, one in which the highest value is to sustain the financial channels open. Survival, adaptation and achievement of results at every opportunity were guaranteed. And opportunities, especially in times of global conflicts, are never absent. Contrary, this is the period in which the financial oligarchy and her serving staff found their highest and most destructive form of expression.

Such expression first arose in 1938 after the annexation by Germany of the Sudetenland in Czechoslovakia. The National Bank of Czechoslovakia had providently transferred most of its gold reserves beyond the Channel. The gold had been deposited on two accounts - one at the Central Bank of England, the other - again back there, but rather on a BIS account, whose agent in the United Kingdom was, indeed again, the Bank of England. The security of the young Czech

Republic's gold reserves was much more than a monetary problem - they were a material expression of a national sovereignty. The head of the National Bank of Czechoslovakia, Josef Malik , believed that regardless whether the Germans would take an entire possession of his homeland, if the gold reserves remain safe, the potential for future independence of the country would survive (LeBor 2013:p.54). It turned out, however, that he was deeply wrong. His trust in BIS and the leadership of the Central Bank of England remained, to put it mildly, unjustified. Only three days after the Germans invaded Prague, under the threat of death, German officials ordered the leadership of the National Bank of Czechoslovakia to demand the transfer of gold reserves from its two accounts to Reichsbank's London account in BIS. Without notifying the British government (although he was instructed to do so), Bank of England's manager Montagu Norman quickly transferred the gold from the BIS Czech's account to Reichsbank's (LeBor, 2013)

The operation on the other account was delayed due to fears of a political and public scandal, but one was still accomplished. George Strauss, Labor MP, speaking in the House of Commons described the situation like this: “The Bank for International Settlements is the bank which sanctions the most notorious outrage of this generation—the rape of Czechoslovakia.” (Elston P., 1998)

Subsequently accounts in BIS of all the forcibly occupied by Germany European countries were seamlessly transferred to Reichsbank without hindrance. For the honorary titled "Grand Officer of the Order of the Crown", Baron Montagu Norman there were no real legal or moral consequences. The consequences were left only for the London's regular citizens and the millions of front-line soldiers, on whose heads the bombs materialised by the transferred assets were poured.

In this way the all too valued by Montagu Norman independence of the entrusted Central Bank and its special clients, was bought at a very high price.

Only two years later - in 1940, Russia occupied Lithuania, Latvia and Estonia. The Soviet authorities similarly ordered the governors of the three central banks to instruct BIS in transferring their gold reserves into the account of the Russian Central Bank. The parallel with the Czech's gold was more than obvious, but the result was radically opposite. The new bank manager, the American lawyer Thomas McKittrick, not only refused to execute the transaction but was also legally justified, citing the important Article 10 of the BIS statute. An article which forbids

coercive measures against bank clients under the influence of political interests and institutions. (LeBor 2013:p.65)

The real scale, specificity and nature of the Bank's activity in the period 1939-1945 was gradually revealed only a few decades after the end of the Second World War. According to collected data, it turns out that the management's announcement of cessation in activity and compliance with neutrality were a high form of criminal manipulation and cynicism. In this period BIS acted as the only real international branch of the German Reichsbank with its ability to perform necessary mediation in payments to external suppliers of strategic raw materials. In order to keep the necessary financial channels open, Germany continued to serve strictly its financial obligations to BIS, thus transferring some of its monetary resources to the British government (against which it lead military action simultaneously). Virtually, 82% of the bank's income came only from the interest payments for assets invested in the German economy (Toniolo and Clement 2007; Interrogation reports May 29 1945; Higham 1983; LeBor 1997).

Thanks to the research by historian Piet Clement (who was also a BIS employee at that time), we know that 21.5 metric tons of gold were physically transferred from Germany into the BIS account (located in Swiss Central Bank's treasury) for payments to its shareholders. It was found that most of the gold with which Germany continued to pay its liabilities was indeed the BIS-retained reserves from Germany's occupied countries, as well as assets of individuals sent to concentration camps (including gold from dental seals worth \$ 3 million) (Toniolo and Clement, 2007; Interrogation reports, May 29 1945).

A much more interesting question was left unanswered. What amount of gold had been transferred to the Reichsbank Swiss account through which the Hitler government payed out its strategic external suppliers and even more importantly, concealed military profits. Regardless of Hitler's attempts and great desire to achieve an autarky (a self-sufficient economic system where trade relations with the outside world are very limited or non-existent), during the war, Germany needed large amounts of strategically imported raw materials. These were, for example, lubricants and US petroleum products, Swedish steel, Romanian oil, Portuguese tungsten, South American meat, all of which had to be paid in stable currency (gold). It is for this reason that the Nazis and their business partners desperately needed well-functioning financial channels at the bordering neutral country. This is one of the main reasons why Switzerland had never been occupied. After the war, it turned out that despite the huge material and human destruction,

German industrial companies had managed to maintain and reinvest their huge profits, Germany's capital stock its productive equipment, buildings, infrastructure, and other assets was actually greater in 1948 than in 1936( Higham 1983; LeBor 1997; Sutton 1976 ).

Archives and memoirs of US Treasury officials reveal that the BIS activities were subject to serious criticism and investigation by senior officials from the President Roosevelt's administration. The main opposition to BIS and its US director, Thomas McKittrick, emerged from the Finance Minister, Henry Morgenthau, and his deputy, the prominent economist - Harry Dexter White (Henry Morgenthau diaries, 1944). Harry White saw the BIS clearest, the bank's emphasis on its supposed neutrality was an alibi for its future role in reconstructing Europe, he argued:

“They hope to be a moderating influence in the treatment of Germany during the peace conference. That is why Germany has treated it with the greatest of care. She has permitted her to pay dividends; she has let the people in BIS come and go across enemy territory; she has been extremely careful and well-disposed to the BIS, because she nursed that baby along in the hope that that would be a useful agency that would protect her interests beyond those that any other institution around the peace table would.” (Henry Morgenthau diaries 1944, p.193)

During the 1944 international conference in Bretton Woods, on which the post-war financial issues had been discussed, Morgenthau, Dexter White and the representative of the Norwegian delegation strongly urged for the bank's closure. At first, no one spoke publicly, but after Morgenthau had submitted a draft resolution stating that no country can participate in the future International Monetary Fund without ending its participation in the BIS, there was a strong reaction from the British delegation. It's most prominent member, the British economist John Maynard Keynes actually acted as a representative of the most influential financial circles and furiously opposed. With other prominent US and British financiers behind him, the resolution had been rejected (Keynes to Morgenthau, July 19 1944).

Consequently after the death of President Roosevelt, the professional careers of Henry Morgenthau and Harry Dexter White, the main critics of the BIS were destroyed. The career of BIS's wartime director Thomas McKittrick developed in the opposite direction. He returned to America, to be appointed vice president of Chase National Bank and manager of their foreign loans department. No one ever compelled him to testify about the activity of the unique and shadow institution he was managing during the Second World War. Instead, he was invited to

Brussels and decorated with the royal Order of the Crown of Belgium, as ironic as it may sound, the honor, noted a press release, was “in recognition of his friendly attitude to Belgium and his services as President of the Bank for International Settlements during World War II.” (LeBor 2013:p.93;137) McKittrick retired in 1954, and only five years after the end of the War, he welcomed a dear guest in New York – his close friend former Reichsbank vice president, BIS director and member of the Nazi party, Emil Puhl. (LeBor 2013:p.126) Puhl had received a minimal conviction from the Nuremberg trials, similar was the fate of the bank's main ideologist, former Reichsbank's Governor Helmar Schacht. After a minimum stay in a labour camp, Schacht began a highly successful career as an investment consultant for developing countries and even founded his own private bank called Schacht & Co (LeBor 2013:p.112).

**Conclusion:** The Bank for International Settlements managed to survive and maintain its key role in coordinating global financial relations. Like a number of its leading figures, BIS displayed a remarkable ability to adapt and overcome the challenges of its complex and shadow history. Using its unique contacts and legal position during the Second World War, BIS proved to be the indispensable institution, supporting the so-called capital and raw material transfer between the financial and industrial circles of the warring states. A rarely illuminated activity without which the machine of global and regional conflict in a globalizing world would have inevitably and very quickly collapsed. Of course, the more conservative academic and financial circles would like BIS to be remembered solely by its post-war role in the preparation and implementation of the European Monetary Union, the introduction of the euro, the coordination of central bank policies and banking supervision.

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