

The International Lender of Last Resort- An Historical Perspective

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When one looks at the subject of international bank regulation it is clear that most commentators take the view that it is a relatively recent phenomenon; Hallwood and Macdonald state that 'International regulation of banks' capital standards is a recent phenomenon, having been agreed in the *Basel Capital Accord* of 1988'¹; Phillips and Johnson argue that 'International agreement on the regulation of global financial institutions is a relatively recent phenomenon'²; and Alexander's paper on the international supervisory framework for financial services begins by highlighting that the overriding theme of the paper 'concerns how the activities of these institutions exemplify the new phenomenon of international regulatory cooperation in the area of financial markets.'³ Accordingly, it is often argued that consolidated international banking regulation originated with the creation of the Basel Committee in the mid 1970's as a result of the general trend of globalisation and more specifically, the collapse of the Bretton Woods system of fixed exchange rates and the failure of two international banks.⁴

Whilst this analysis might be true in terms of internationally coordinated regulation of a formal nature, in fact, what I will show is that the regulation of international banks has occurred for a much longer period throughout history, albeit characterised by informal episodic cooperation between the central and international commercial banks themselves. This, I argue, is similar in form to the 'club government' that Moran explains ruled the financial landscape of the City of London itself from the Victorian era up until the late 1970's which saw an explosion in formal regulation. Moran highlights that historically the City of London is special in terms of its economy because it is 'the single most important example' of the use of what is called 'self-regulation.'⁵ He recognises that up until the late twentieth century, regulation existed only in the form of 'cultural restraints' and the 'subtle exercise of social controls' conducted via the creation of club-like bodies such as the Stock Exchange and Lloyds.⁶ As this 'club' regulation grew, the Bank of England, technically a privately owned institution, assumed the position of central bank and prudential regulator to the system but because this took place outside the formalities of the law, control was exerted through informal pressure and cooperation. Accordingly, he states that 'By the beginning of the twentieth century, the culture of the City elites...fostered a style of

¹ Hallwood, C.P. and Macdonald, R. *International Money and Finance* 2000 3rd Ed Oxford: Blackwell Publishing at page 397.

² Phillips, R.J. and Johnson, R.D. in Gup, B.E. *The New Financial Architecture: Banking Regulation in the 21st Century* 2000 Westport: Quorum Books at page 1.

³ Alexander, K. *The International Supervisory Framework for Financial Services: An Emerging International Legal Regime* ESRC Centre for Business Research, University of Cambridge, Working Paper No. 81, Dec 1997 at page 4.

⁴ See, for example, Phillips, R.J. and Johnson, R.D. in Gup, B.E. *The New Financial Architecture: Banking Regulation in the 21st Century* 2000 Westport: Quorum Books at pages 5-8; Walker, G.A. *International Banking Regulation: Law, Policy and Practice* 2001 London: Kluwer Law International at pages 23-30.

⁵ Moran, M. *The British Regulatory State: High Modernism and Hyper-Innovation* 2003 Oxford: Oxford University Press at page 52.

⁶ *Ibid* at pages 52-3

regulation that emphasized informality, collegiality, and cooperation'⁷ and participation in these markets 'entailed observance both of the rules of business and the norms of gentlemanly behaviour.'⁸ So essentially, Moran maintains that this period in the regulatory history of financial markets in the City of London was dominated by informal club-like practices rather than formal statute based rules.

I expand on Moran's theory by arguing that this 'club governance' existed not only in the City of London itself, but also on an international scale between international commercial and central banks. In the eighteenth and nineteenth centuries it seems to me that this club culture was about central and other commercial banks performing a kind of international lender of last resort function by coming to the rescue of their counterparts across national boundaries in times of financial need. There was no official basis for this behaviour but rather it was the informal cooperative practice that developed amongst these international and central bankers, partly because of the self-interest of those banks in protecting their own economies. This method of self-regulation developed further in the early twentieth century when central bankers focused their efforts on the formalisation of this club culture into a 'League of Central Bankers'⁹ which was to be governed by a series of informal rules and conditions.¹⁰ This vision was eventually achieved through the creation of the Bank for International Settlements in 1930 which fostered and facilitated cooperation between central bankers and ultimately through the establishment of the Basel Committee on Banking Supervision in 1974 which saw the creation of the first internationally agreed regulatory standards. So much like Moran's theory on the City of London, I argue that the international financial landscape too adopted a self-regulatory style characterised by informal cooperation between banks.

The remainder of this paper will look at what it means to be a 'lender of last resort' in an international context and then it will focus on specific examples of this function being performed throughout history before concluding that this culture of club driven self-regulation was clearly rife throughout history, during a period which far precedes the establishment of the Basel Committee.

The International Lender of Last Resort

The term 'lender of last resort' was first coined in the late eighteenth century by Francis Baring, who made reference to the Bank of England as the *dernier resort* for the other banks in Britain.¹¹ The concept was explored by Henry Thornton in 1802 in his infamous book *An Enquiry into the Nature and Effects of the Paper Credit of Great Britain* and the classic description is now derived from Bagehot's *Lombard Street* which depicts that a lender of last resort must, in times of panic, advance freely and rigorously out

⁷ Ibid at page 56.

⁸ Ibid.

⁹ A vision most fervently pursued by Montagu Norman of the Bank of England; see Ahamed, L. *Lords of Finance: 1929, the Great Depression and the Bankers that Broke the World* 2010 London: Windmill Nooks at page 149 and generally, Sir Henry Clay *Lord Norman* 1957 London: Macmillan & Co.

¹⁰ See generally Bank of England Archives OV 50/1 *Central Banks General 1917-1924*.

¹¹ See Laidler, D. *Two Views About the Lender of Last Resort: Thornton & Bagehot* 2002 Paper presented at a conference on the 'Lender of Last Resort' organised by le Forum, held in celebration of the bicentenary of the publication of *Paper Credit*.

of their reserve at a high interest rate and in good security.¹² Typically, this function is performed by the central bank of a particular country, so for example the Bank of England and the Bank of France have been performing this function in their respective countries since the eighteenth century. What I am concerned to show here is whether there is any evidence of banks performing this regulatory function throughout history in an international context, i.e. whether this lender of last resort function has ever taken place across national boundaries. What follows from here is an analysis of various examples throughout the eighteenth and nineteenth centuries which depict this lender of last resort function taking place on an international scale.

The Amsterdam Banking Crises of 1763 and 1773

Some of the earliest examples of a bank performing what could be called an international lender of last resort function are the actions of the Bank of England in granting credit and allowing specie to be drawn during the Amsterdam banking crises of 1763 and 1773.

The crisis of 1763 followed the end of the Seven Years War which had raged throughout Europe and involved all of the major European powers. The war period saw the vast expansion of credit in Amsterdam, particularly in the form of British war loans and this expansion tempted dealers to grant credits without requiring parallel security in the form of commodities. Furthermore, it was this time that saw the birth of a new breed of financiers seeking to exploit the market who, unlike the official bill-brokers, failed to keep adequate cash reserves at the Bank of Amsterdam and who engaged in the practice of *wisselruiterij* - a risky process which involved bankers and merchants borrowing from one another in chains of bills. When the war came to an end in 1763 there was an extensive inflation of credit and these financiers found themselves unable to meet their obligations, leading to a chain of bankruptcies in Amsterdam and Hamburg.¹³

According to Wilson, this crisis of confidence was 'London's opportunity' and the 'London bankers (including the Bank of England) came to the rescue of their Dutch correspondents'¹⁴ by the granting of extensive credits; he highlights that 'heavy remittances were sent for the support of the Dutch banks, so that perhaps the most conspicuous feature of the crisis as far as London was concerned was the outflow of specie to Amsterdam in August, when there were five consignments, and in September, when there were two.'¹⁵ This is confirmed by a number of other commentators; Kindleberger states that 'In the crisis of 1763 the Bank of England and London private bankers came to the rescue of their Dutch correspondents by granting, in distress, credits larger than those previously given in times of prosperity. Five consignments of gold were shipped in August and two in September'¹⁶; Clapham, who was commissioned to write an extensive account of the history of the Bank of England, states that during this

¹² See Bagehot, W. *Lombard Street: A Description of the Money Market* 1873 London: Henry S. King & Co at pages 196-7.

¹³ See generally, Wilson, C. *Anglo-Dutch Commerce and Finance in the 18th Century* 1966 Cambridge: Cambridge University Press at pages 167-189.

¹⁴ *Ibid* at page 168.

¹⁵ *Ibid*.

¹⁶ Kindleberger, C.P. *Manias Panics and Crashes* 1978 London: The Macmillan Press Ltd at page 183.

particular crisis, 'England's function, successfully performed, was to give what help she could to the continental houses in difficulty'¹⁷; and finally in 'The Wealth of Nations' Adam Smith highlights that upon one occasion, in 1763, the Bank of England is said to have advanced for the assistance of merchants, English or foreign, in one week, about £1,600,000, a great part of it bullion.¹⁸ This action of the Bank of England and other leading houses in granting credits to their equivalents in Amsterdam meant not only that the price of gold in London was raised substantially, but also that the demand for money was more easily met and Holland achieved a more favourable rate of exchange for payments. This coupled with the postponement of the payment of bills by the Bank of England and other leading banks meant that the crisis in Amsterdam was brought under control and confidence restored.

The crisis in Amsterdam of 1772-3 was different in nature from its predecessor some ten years before in that it arose, not because of a disturbance in credit caused by the war, but rather because of the over-speculation of the stock of the East India Company and the risky over-issue of credit by the Scottish Banks which led to a crisis in England and Scotland, and then spread to Europe. The root of this crisis in relation to the East India Company came from the prediction that 'peace conditions plus an abundance of money would push East Indian shares to 'exorbitant heights.'¹⁹ This prediction saw the money markets of London and Amsterdam immerse themselves in the gambling of futures in the East India stock which proved lucrative to some, but in 1772 the first high profile casualty of this risky practice was revealed. Alexander Fordyce and his associates had often engaged in the practice of speculation; in 1766 he had backed the East India Company stock heavily in favour of a rise and he won some £100,000, off of which he was able to live a very extravagant lifestyle for some time.²⁰ However, his run of luck ran out when he engaged in even heavier but unsuccessful speculations in 1772 as a result of which he lost more than he had previously won, absconded to France, and left his associates Neal, James and Roffey with obligations of over half a million pounds.²¹ It did not end there however- amongst their other operations, Fordyce and his associates had been engaged in the practice of accepting dubious bills for the Ayr Bank of Scotland (otherwise known as Douglas, Heron and Company); the mission of this Scottish bank was to 'liberalise banking policy in Scotland'²² which meant that not a single member of the Board of Directors was a professional banker. The original capital of the Ayr Bank of £150,000 was quickly exhausted and so it began to manufacture paper money which was done by the presentation of a chain of bills on London where firms, including Fordyce would accept these bills on the account of Ayr Bank at a commission; with these notes, the Bank purchased further bills of exchange on London from Edinburgh bankers.²³ In 1770 the debts of the Ayr Bank totalled £85,000 and when it was announced in June 1772 in Edinburgh that

¹⁷ Clapham, J. *The Bank of England, Vol I 1694-1797* 1944 Cambridge: Cambridge University press at page 239.

¹⁸ Smith, A. *The Wealth of Nations* I at page 301.

¹⁹ Wilson, C. *Anglo-Dutch Commerce and Finance in the 18th Century* 1966 Cambridge: Cambridge University Press at page 170.

²⁰ *Ibid.*

²¹ *Ibid.*

²² *Ibid* at page 171.

²³ *Ibid.*

Fordyce had fled, this not only precipitated the fall of the Scottish branch of Fordyce and Malcolm which had both been involved in the questionable affairs of the Ayr Bank, it also meant that the Ayr Bank itself was forced to close its doors on 22nd June. The fall of the Ayr Bank had a domino effect in relation to its correspondents in London- in the immediate aftermath of the Ayr Bank's closure, London saw the collapse of a whole host of banks including: Charles Ferguson and Son, Fordyce grand and Co, Immanuel Mackintosh, Thomas and William Jolly, Ogilvie and Micklem, Richard Blackburn and James Hunter, Perewell Barker, Alexander Dove, R & R Boyle, William Adam & Co, Adam Wood and Borrow & Co.²⁴

Towards the latter parts of 1772 this crisis spread onto the continent. As Clapham highlights, 'London and Amsterdam were in very close touch. Fordyce the speculator had Amsterdam connections. The same complaints had affected both markets- gambling in shares and commodities; abuse of the bill of exchange.'²⁵ Panic was sparked in Amsterdam with the fall of a very great house, one that was 'far greater than any of those that got into difficulties in London'²⁶ - Clifford and Sons. This house was older than even the Bank of England and they were well renowned merchants and international financiers, but eventually in October 1772 they broke. The cause of this failure, like Fordyce in London, was the over speculation of East India stock. This precipitated a string of further failures and a general state of crisis throughout Amsterdam- according to Wilson, 'Conditions...were even worse than in 1763...there was paper enough but no cash; hardly a man on the Bourse or in the bill business could produce 50,000 guilders; credit was non-existent, the circulation of money had stopped and so had the discount business; loans on bonds and goods were scarce, and only a little business was being done on foreign securities. Some houses stood seven to eight hundred guilders in debt.'²⁷

Anglo-Dutch trade was paralysed meaning that 'Amsterdam was helpless, and only London could help. Everything therefore depended on the policy of the Bank of England.'²⁸ The Bank of England accordingly adopted two strategies in order to save its counterparts in Amsterdam; first, the Bank 'threw open its windows and allowed specie to be drawn against presentation of notes and government stocks'²⁹ and second, the Bank, rather controversially, 'refused to discount doubtful paper.'³⁰ Accordingly, a vast amount of specie was sent by different merchants to their correspondents in Amsterdam by boat- for example Sir Joshua van Neck is said to have sent £500,000 to correspondents in Amsterdam. While this served to inject much needed capital into the economy of Amsterdam, which restored a certain degree of confidence, the Bank also engaged in the somewhat provocative tactic of refusing to discount doubtful paper. This had the immediate effect of breaking a large number of Jewish houses which had been involved in the speculation and shortly after this, the Bank refused to discount Scottish paper, and finally,

²⁴ Ibid at page 171-2. It should be noted that this host of failures related only to those who had been involved in the speculation- there was no general run on the banks in London- business was back to normal by September.

²⁵ Clapham, J. *The Bank of England, Vol I 1694-1797* 1944 Cambridge: Cambridge University press at page 248.

²⁶ Ibid.

²⁷ Wilson, C. *Anglo-Dutch Commerce and Finance in the 18th Century* 1966 Cambridge: Cambridge University Press at page 176.

²⁸ Ibid.

²⁹ Kindelberger, C.P. *Manias Panics and Crashes* 1978 London: The Macmillan Press Ltd at page 184.

³⁰ Ibid.

all discount was brought to an end.³¹ It is argued that this step was taken by the Bank 'quite deliberately to break up the group of Dutch speculators' and 'naturally there was much indignation on the Amsterdam Bourse' but there were those who came to the defence of the Bank of England, highlighting that the speculative business in shares was highly dangerous and it was a result of this risky practice that had ultimately led to the crisis, not the policy of the Bank of England in refusing to discount questionable paper.³²

The financial crisis of 1825

The year of 1825 marks a year well known for hosting the 'most severe financial crisis of the century.'³³ This crisis was the result of a number of different circumstances coming together including, 'the collapse of the absurdly overblown boom in foreign loans and company promotions, speculative overtrading in imported commodities, rashness on the part of the country banks [and] Bank of England policy that veered between complacency and an over sharp contraction of credit.'³⁴ The background to these circumstances is explained well by Bordo, who highlights that it was following the end of the Napoleonic wars in 1815 that the Bank of England adopted a deflationary policy in order to revert to its pre-war parity and following the success of this policy, the British economy 'began a period of rapid expansion, characterized by both an export boom and an investment boom. The opening up of the newly independent states of Latin America stimulated a boom in exports. At the same time, important infrastructure projects (e.g., gas lighting, canals, and railroads) stimulated investment expenditures. The sale of stocks to finance these ventures, in addition to gold and silver mines (some real, some fictitious) in Latin America, and sovereign government debt (initially European and later Latin American) propelled a stock market boom.'³⁵ He continued; 'The stock market boom became a bubble as investors bid up the prices of real and imaginary stocks (e.g., bonds from the imaginary South American Republic of Poyais). Asymmetric information led to adverse selection, and legitimate firms found it more difficult to obtain finance, except at premium rates. Banks infected with the euphoria let down their guard and made risky loans. As always happens, the bubble burst.'³⁶ It was the collapse of stock prices that triggered commercial failures in mid 1825; by that autumn the money market really began to become uneasy and by December panic had set in across the country.

The Bank of England had been previously cautious with its discounts but it was at this point that it 'reversed its discount policy and began acting as a lender of last resort'³⁷; on the 1st December alone the

³¹ Wilson, C. *Anglo-Dutch Commerce and Finance in the 18th Century* 1966 Cambridge: Cambridge University Press at page 176-7.

³² See for example, *De Koopman*, IV, at page 344.

³³ Kynaston, D. *The City of London: A World of Its Own 1815-1890 Vol 1*, London 1994 at page 65.

³⁴ *Ibid.*

³⁵ Bordo, M. *Commentary* Federal Reserve Bank of St Louis Review May/June 1998 at page 77. See also, Clapham, J. *The Bank of England, Vol I 1694-1797* 1944 Cambridge: Cambridge University press at pages 93-95.

³⁶ *Ibid.*

³⁷ *Ibid.*

bank did over £900,000 of discounts.³⁸ It was not long before 'Lombard Street was nearly filled with persons hastening to the different banks to draw money'³⁹ and in the first six days of December the Bank was discounting at an alarming rate- in these days a total of £5,977,000 of discounts were drawn.⁴⁰ In the week that followed, the Bank found that it could not make the notes and coins fast enough and 'over the weekend it ran out of £5 and £10 notes.'⁴¹ In the nick of time, the following morning a fresh supply of notes came from the printers but in terms of gold, the treasure of the bank was down to a low of £1,027,000.⁴² Just when it was feared that the Bank would run dry, the Bank of France came to the rescue; according to Clapham, 'France was sending gold. It was from Paris that the gold was coming, a first consignment of about £400,000, on Monday the 19th but the arrival was 'subject to the wind and the waves'. Silver had been shipped across and gold was due in exchange, thanks to Rothschilds and the smooth-working French bimetallic system.'⁴³ This is confirmed by a number of other commentators; Kynaston states that 'by Tuesday, courtesy of Rothschild, major infusions of gold were arriving from France. A mild run on the Bank's gold reserves continued until Christmas Eve, but by then the precious intangible- confidence- had been restored'⁴⁴; Bordo highlights that 'The Bank was saved at the last minute from suspension of convertibility by gold flows from France'⁴⁵; and Kindleberg states that 'France participated in an early example of international financial cooperation by shipping gold to London in exchange for silver. The higher price of gold in England than in France (15.2 to 1, instead of 14 ⁵/₈ to 1) favoured the exchange, but the arrival via the house of Rothschilds of £400,000 (mostly in sovereigns) from France on Monday, December 19...helped in timely fashion, for after the peak of the run the previous Saturday, Bank of England coffers were virtually bare.'⁴⁶

This is one of the more quintessential examples of an international lender of last resort in action in the nineteenth century- the Bank of France, through the house of Rothschilds, injected £400,000 of liquidity in to the Bank of England's badly stretched reserves at a time of crisis when it was feared that the Bank of England would have to suspend convertibility.

The 'pretty pickle'⁴⁷ of the Bank of England in 1839

The years 1836-1839 proved particularly turbulent for the Bank of England for a number of reasons, firstly, the boom in the railway and cotton markets in America in 1836 led to extensive capital

³⁸ Clapham, J. *The Bank of England, Vol I 1694-1797* 1944 Cambridge: Cambridge University press at page 98.

³⁹ *Annual Register* 1825 page 123, as quoted in Clapham, *ibid* at page 99.

⁴⁰ *Ibid*.

⁴¹ Kynaston, D. *The City of London: A World of Its Own 1815-1890 Vol 1*, London 1994 at page 70.

⁴² Clapham, J. *The Bank of England, Vol I 1694-1797* 1944 Cambridge: Cambridge University press at page 100.

⁴³ *Ibid* at page 101.

⁴⁴ Kynaston, D. *The City of London: A World of Its Own 1815-1890 Vol 1*, London 1994 at page 70.

⁴⁵ Bordo, M. *Commentary* Federal Reserve Bank of St Louis Review May/June 1998 at page 77.

⁴⁶ Kindleberger, C.P. *Manias Panics and Crashes* 1978 London: The Macmillan Press Ltd at page 184.

⁴⁷ Kynaston, D. *The City of London: A World of Its Own 1815-1890 Vol 1*, London 1994 at page 115.

investment from English and Anglo-American banks⁴⁸ such that when financial panic set in in America in 1837,⁴⁹ the Bank of England were forced to pledge extensive financial assistance to these banks,⁵⁰ but more importantly here, poor harvests from 1836 onwards and an increased population in England led to a drain on sterling because of the need to pay for wheat imports, and this saw the Bank of England have to turn once again to their counterparts in France for financial assistance.

The first half of the 1830's had yielded incredibly rich harvests, leading to the lowest price of wheat ever witnessed in the preceding 50 years, however, from 1836 onwards, these harvests 'lost their brilliance'⁵¹ and the price of wheat rose from 39s. 4d. a quarter in 1835, to over 80s a quarter at the end of 1838, levelling out slightly to approximately 70s. 8d. a quarter in 1839.⁵² These poor harvests meant not only that the price of wheat increased twofold, but also that the amount of wheat needing to be imported increased dramatically, such that 'the amount of wheat imported in that single year [1839] would be appreciably more than it had been in the three years 1834-6 taken together, and worth at those high prices some £10,000,000 a serious item on the trade balance.'⁵³ The implications of this for the Bank of England was that the amount of money it held in its coffers fell from £9,500,000 in 1838, to just over £5,000,000 in May 1839 and to just £3,700,000 at the end of July 1839 despite the fact that the bank's discount rate was raised from 4 to 5 at the end of May, and then to 5 ½ by the end of June, and then to the 'unexampled' level of 6 on 1st August.⁵⁴ This meant that once again, the Bank of England would have to turn to the aid of the foreign money markets for assistance. It was actually in 1838 when the Bank of England was first beginning to feel the pressure that a meeting was arranged with the Governor of the Banque de France whilst he was visiting London, to discuss the opening of a line of credit in Paris, should it be required and it was in the summer of 1839 when, as can be seen from above, the resources of the Bank of England were depleting at a rapid rate that this line of credit was actually drawn upon.⁵⁵ Rather than dealing directly with the Bank of France,⁵⁶ it was agreed that the intermediary

⁴⁸ Seven banks in particular were involved; Barings, Browns, Lazardis, Morrison, Cryden & Co, and the 'three W's' - Wilson, Wiggins and Wildes. See Clapham, J. *The Bank of England, Vol I 1694-1797* 1944 Cambridge: Cambridge University press at page 152.

⁴⁹ This panic was connected to 'the Second Bank of the United States, a surge in land sales, and the actions of President Jackson'; in the late 1820's and early 1830's the federal government sold millions and millions of acres of public land, leading to a general price inflation- this was resented by the population, who blamed inflation on unsound banking policies. At the same time President Jackson was elected and he wanted to reform the Bank of the United States so that its power came under the control of the elected government. One of his actions in order to bring a stop to land speculation was the issuing of the 'Specie Circular' in 1836 which effectively provided that the purchase of public land could only be made in specie and not bank notes. The cumulative effect of these occurrences lead to widespread panic in the United States and a general economic depression for the next 6 years. See generally, Campbell, B.C. *Disasters, Accidents and Crises In American History* 2008 New York: Facts on File Inc. at pages 76-79.

⁵⁰ For example, £200,000 was granted to each of the 'three W's' and £2,000,000 to Browns. See Clapham, J. *The Bank of England, Vol I 1694-1797* 1944 Cambridge: Cambridge University press at pages 157-8.

⁵¹ *Ibid* at page 161.

⁵² *Ibid*.

⁵³ *Ibid*.

⁵⁴ *Ibid* at page 162; see also Kynaston, D. *The City of London: A World of Its Own 1815-1890 Vol 1*, London 1994 at page 115.

⁵⁵ Viner, J. *Studies in the Theory of International Trade* 1937 New York: Harper Brothers Publishers at page 273.

⁵⁶ Which, according to Viner, was not possible because 'the statutes of the Bank of France would not admit of its lending upon foreign bills or securities.' *Ibid*.

services of Baring Brothers would be used on behalf of the Bank of England who drew bills for £2,000,000 on 12 Paris bankers which the Banque de France then discounted.⁵⁷ This arrangement is confirmed by Kindleberger, who states that 'in 1838 it arranged for a line of credit and in 1839, drew on it for £2 million, using the intermediary services of Baring Brothers on the one hand and...Paris banks on the other.'⁵⁸

It was this cooperative action between the two central banks, Barings Brothers, and the syndicate of Parisian bankers which meant that the Bank of England was able to avoid the damning effects of having to suspend specie payments.

The Barings Crisis 1890

One of the most infamous examples of a bank acting as a lender of last resort in an international context was when the Bank of France provided liquidity to the Bank of England during the Barings crisis of 1890.⁵⁹ At this time Barings Brothers was one of the largest, well-respected and well-known banks in the world, indeed, it has been argued that 'It is no exaggeration to say that until the middle of November 1890 the name of Baring Brothers was as good as a bank-note in every port in the civilized world.'⁶⁰ Barings had proved indispensable in coming to the aid of the Bank of England in times of distress in the past and in 1890 the time fell for the Old Lady of Threadneedle Street to return the favour with the assistance of the Banque de France.

The crisis itself stemmed from the investment activities of Britain in the 1880's- during this time British capital was being poured into Argentina at an alarming rate, totalling some £150 million by 1890 and Barings was responsible for investments totalling about a quarter of this sum. Baring's lending activity was being criticised as early as 1888 when *The Statist* published a highly disapproving article on the finance house, highlighting the fact that of the firms thirty-one issues made in the previous six years, all but two had been foreign and stating in no uncertain terms that 'since 1884 Messrs Baring have been growing bolder and bolder in their invitations to the public.'⁶¹ The article goes on to chastise the bank for adopting cavalier practices; 'their prospectuses too frequently are not merely meagre, but quite insufficient to enable anyone to judge the character of the security.'⁶² A similar sentiment can be seen from *The Economist* which wrote in relation to the Baring's crisis: 'it is impossible to withhold sympathy from the victims of misfortune, even when they have brought among themselves the ills that befall them.'⁶³ Unsurprisingly then, the capital provided by Barings proved to be excessively risky and related

⁵⁷ Ibid.

⁵⁸ Kindleberger, C.P. *Manias Panics and Crashes* 1978 London: The Macmillan Press Ltd at page 184.

⁵⁹ See generally, Kynaston, D. *The City of London: A World of Its Own 1815-1890 Vol 1*, London 1994 at pages 422-437.

⁶⁰ Crump, A. *The Baring Financial Crisis* [1891] *The Economic Journal*, Vol. 1, No. 2 at page 389.

⁶¹ As quoted in Kynaston, D. *The City of London: A World of Its Own 1815-1890 Vol 1*, London 1994 at page 423-4.

⁶² Ibid at page 424.

⁶³ *The Liquidation of the Barings* *The Economist*, Saturday, November 22nd, 1890 at page 1465.

to poor investments and 'all might have been well if from late 1889, mirroring the world economy, there had not occurred a sharp crisis of confidence in all things Argentine'⁶⁴; Barings faced bankruptcy.

According to Kynaston 'there was no getting away from the almost unthinkable consequences should Barings go down: not only would the failure of the City's leading accepting house inevitably bring down a host of other firms, including all the discount houses, but the very status of the bill on London would be threatened and thus the pre-eminence of the City as an international financial centre.'⁶⁵ Accordingly, on Saturday 8th November 1890, before their situation became completely untenable, Francis Baring met with William Lidderdale, Governor of the Bank of England, Mr Hambro of Messrs Hambro & Son and Lord Revelstoke and laid before them a statement of their affairs which indicated that they were struggling to meet their liabilities.⁶⁶ Mr Lidderdale gave Barings two more days to prepare a more detailed statement and in the meantime, he discussed the issue with the Chancellor of the Exchequer who 'expressed great concern and a strong desire that the Bank [of England] should support Messrs. Baring Brothers & Coy.'⁶⁷

The problem with turning to the Bank of England for help alone was quite simply that that bank 'with reserves roughly half the size of Barings' estimated liabilities, could not hope to act as sole lender of last resort.'⁶⁸ On top of this, Lidderdale feared that the Bank of England's reserves were wholly inadequate to deal with the enormous increase in demand that would materialise should doubts regarding the credit of Barings come to the attention of the general public.⁶⁹ Accordingly, in order to strengthen their position, on Wednesday 12th November 1890 the Bank of England was able to beg a loan of £3 million from the bank of France through the intermediary of Rothschilds.⁷⁰ This is confirmed by Kynaston who states that 'Rothschild emerged as a constructive figure...persuading the Bank of France to lend £3m in gold to bolster the Bank of England's badly stretched reserves'⁷¹ and Foxwell who states that as a result of the events of 1890 'we [the Bank of England] were obliged, in order to avert disaster, to beg a loan of three millions from a foreign bank.'⁷² Furthermore, a consortium, assembled by Lidderdale, created a fund to guarantee Barings' debts; on the 15th November the Bank of England itself began by pledging £1,000,000 and soon after most of the key banks and finance houses in the city were pledging similar amounts such that by 15th November contributions totalled £10,000,000 and by the 22nd November, they reached some £17,000,000.⁷³

⁶⁴ Kynaston, D. *The City of London: A World of Its Own 1815-1890 Vol 1*, London 1994 at page 425.

⁶⁵ *Ibid* at page 429.

⁶⁶ Bank of England Archive G15/189 Document 15A- *Extract from the minutes of the Court of Directors meeting held on Thursday 20th November 1890.*

⁶⁷ *Ibid.*

⁶⁸ Kynaston, D. *The City of London: A World of Its Own 1815-1890 Vol 1*, London 1994 at page 429.

⁶⁹ Bank of England Archive G15/189 Document 15A- *Extract from the minutes of the Court of Directors meeting held on Thursday 20th November 1890.*

⁷⁰ *Ibid.*

⁷¹ Kynaston, D. *The City of London: A World of Its Own 1815-1890 Vol 1*, London 1994 at page 429 at page 431.

⁷² Foxwell, H.S. *Mr Goschen's Currency Proposals* *The Economic Journal* [1892] Vol 2(5) at page 145.

⁷³ Bank of England Archive G15/189 Document 22A- Letter from Lidderdale, Governor of the Bank of England, to the Chancellor of the Exchequer, dated 22nd November 1890.

This action in bolstering the Bank's reserves and creating the guarantee fund meant that widespread panic was avoided, the Bank was able to take over the obligations of Barings, and the Bank rate was maintained at 6%. That this was the case is summarised well by *The Economist* which, in an article dated November 22nd 1890, which recognised that 'by these measures the bank of England was put in such a position to calm the fear from which all panics originate-the fear, namely, that the cash reserve of the country is insufficient to maintain the fabric of credit that has been reared upon it. The knowledge that gold would be available when required went a long way to inspire confidence, which was further increased by the action of the banks and finance houses in jointly guaranteeing the due payment of the Messrs Baring had incurred up to the date of their virtual liquidation.'⁷⁴

Concluding Remarks

What the above examples show is that there is clear evidence of banks performing international regulatory functions up until the pre-War period. It seems to me that it was a 'rule of the game' that the largest central and commercial banks would come to the rescue of their counterparts when they faced any liquidity crisis- there was no formal legal foundation for this- the international market simply self-regulated in this regard in an informal adhoc way. So while Moran's theory on 'club governance' explains the regulatory landscape of the City of London from the Victorian era up until the late 1970's, it doesn't explain what was happening on an international level and the impulsion that existed for international banks to assist other central and private banks abroad. I think that this behaviour can be explained along similar lines as Moran's theory in that there existed a 'club culture' for international banks to come to the rescue of their colleagues and this was driven in part by the self-interest of those banks in maintaining the stability of their own economies. So, for example, in relation to the assistance granted by the Bank of England to Amsterdam in 1763, Wilson highlights that 'all this...was not pure altruism, but a practical policy dictated by the knowledge that Dutch prosperity was intimately connected with our own, and that heavy failures in Amsterdam would inevitably mean a fall in the Funds and the stoppage of an important source of credit'⁷⁵; in relation to the rescue package of 1839 by the Bank of France, it was recognised that the aim of the transaction between the Bank of France and the consortium of Parisian bankers was to 'rectify the exchanges with the continent, particularly with Paris, and to stop the continued demand to export specie'⁷⁶; and in relation to the French loan of £3m in 1890, the Bank of France commented that the loan was to be made 'In the interests of the two countries, in the interests of French trade, and more particularly in the interests of the Paris market.'⁷⁷ Further, they

⁷⁴ *The Liquidation of the Barings* The Economist, Saturday, November 22nd, 1890 at page 1466.

⁷⁵ Wilson, C. *Anglo-Dutch Commerce and Finance in the 18th Century* 1966 Cambridge: Cambridge University Press at page 169.

⁷⁶ As stated in the contract between the Bank of England and the French bankers, quoted in Viner, J. *Studies in the Theory of International Trade* 1937 New York: Harper Brothers Publishers at page 273; the aim was 'de rectifier les changes avec le Continent, principalement avec Paris, et pour faire cesser les demandes continuelles d'especes qui lui sont faites pour l'export'.

⁷⁷ Bank of England Archive G15/189 Document 58A *Extract from the Annual Report of the Bank of France for the year 1890*.

stated that in making the loan they ‘thereby escaped a dangerous monetary crisis in England, a crisis which would have intensified on the French market and would have obliged the Bank to put up its own discount rate, to the great prejudice of business.’⁷⁸

The period following the end of the First World War saw the continued use of this culture of cooperation to support international, often central banks in crisis- for example, in 1923 the Bank of England lent a considerable sum of money to the National Bank of Austria in anticipation of proceeds from the League of Nations stabilisation loan⁷⁹ and, in 1924 when a large loan of 800 million gold marks was required to jump-start the flailing German economy and enable them to begin making reparations payments, this came from a consortium of American investment bankers, led by Messrs. J.P. Morgan & Co. However it was at this time that the club-like culture that existed between these international and central banks began to develop in other ways; firstly, the relationships between central bankers themselves began to develop in a more personal way- for example, Montagu Norman of the Bank of England and Benjamin Strong of the Federal Reserve Bank of New York struck up a close friendship that was to last the better part of a decade⁸⁰ indicating that the personal relationships that existed among the club like organisations of the City of London itself were beginning to be emulated at an international level; secondly, these bankers had the opportunity to meet on a more formal basis at the inter-war conferences and deal with the issue of the continued development of central bank cooperation head on; and finally 1930 saw the creation of the Bank for International Settlements which paved the way for the development of this club like regulatory style through the periodical, informal, private meetings of the key international bankers of the world.

What this paper has shown is that international bank regulation has a long established history which far pre-dates the creation of the Basel Committee and this history began with the establishment of a ‘club culture’ in the eighteenth and nineteenth centuries which saw central and other international banks self-regulating international financial markets by performing a sort of international lender of last resort function by coming to the aid of their counterparts when they faced financial distress.

⁷⁸ Ibid.

⁷⁹ Cooper, R.N *Almost a Century of Central bank Cooperation* BIS Working Paper Number 198, February 2006 at page 1.

⁸⁰ See Ahamed. L *Lords of Finance: 1929, the Great Depression and the Bankers that Broke the World* 2010 London: Windmill Nooks at pages 90-92. One such personal letter, which shows the extent of their friendship, was written by Norman to Strong when Norman had returned from a trip to visit Strong and accidentally taken one of Strong’s jackets home. He wrote- ‘Dear Ben, Since I wrote on the steamer, a further crime has been discovered. The second evening I was home, as usual I changed clothes in the evening and on going downstairs discovered myself in the disguise of a gentleman, if not a dude! This was due to velvet jacket of good style, fit and finish: in other words, Ben, I can only look respectable with the help of your wardrobe!’ See *Lords of Finance* at page 150.