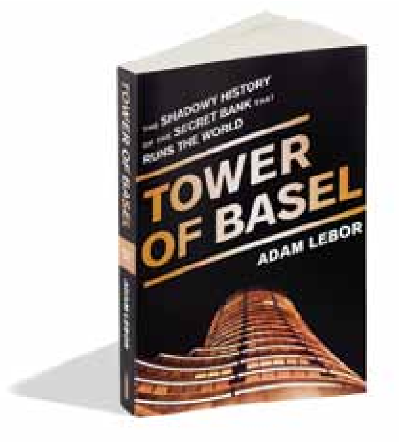
The BIS Gets the Once-over



Adam LeBor

Tower of Basel

The Shadowy History of the Secret Bank That Runs the World

PublicAffairs, New York, 2013, 336 pp., $28.99 (cloth).

BIS is an obscure abbreviation for anyone other than a banker. But readers of the financial pages are all too familiar with the Swiss city of Basel in the context of international standards on banks' capital adequacy and other prudential recommendations by the Basel Committee on Banking Supervision, whose secretariat is at the Bank for International Settlements—or BIS. Adam LeBor, a journalist and author on European current affairs, has written a well-researched 300-plus-page book about this little-known international bank headquartered in a modernistic office tower in Basel.

The book is described on the back cover as the "first investigative history of the world's most secretive global financial institution." I found it an informative—albeit emotional—piece of serious journalism by an author who has read a large body of literature, talked to numerous people, and studied archives. But this is not a disinterested history book. The title itself deems the book the "shadowy history of the secret bank that runs the world."

LeBor has a good eye for issues worth investigating: the story of the BIS is such a topic. Since its inception in 1930 its history has been rich in dramatic turns, and a thorough yet accessible book on this curious institution is long overdue. The BIS has always been special in the complex world of high finance. Even the raison d'être and the present functions of the bank are hard to describe in plain language. It was established after World War I with a delicate mandate: to settle war reparation payments imposed on defeated Germany by the Treaty of Versailles. Technicalities such as collection, administration, and distribution of the funds payable certainly called for a financial institution. Thus the BIS (BIZ in German) was established—an admittedly distinctive institution whose founding owners included not only the central banks of the victors (Belgium, France, Italy, United Kingdom) but also those of Germany, Japan, and—strangely—a consortium of three U.S. banks on behalf of the Federal Reserve. Soon the central banks of Austria, Czechoslovakia, Hungary, and other small European countries joined the bank that was to fill a niche for financial transactions between central banks and for professional contacts. History soon took a sharp turn: German reparations were suspended. Yet the BIS resumed its activities: the unusual mix of shareholders did not prevent the bank from functioning even during the terrible war years.

LeBor believes that the BIS was far from neutral before and during World War II, that it became a de facto German-controlled bank, even though its chairmen, presidents, and key staff were not German. He dwells on the life and activity of a number of key players—Hjalmar Schacht, the president of the Reichsbank; Montagu Norman, the governor of the Bank of England; and the American Thomas McKittrick, BIS president during the war—and accuses the latter two of crimes bordering on treason. The author exposes the reader to the diplomatic, financial, and political complexities of the war years through life histories of important personalities of the age: Allen Dulles, the Swiss director of the U.S. Office of Strategic Services; Henry Morgenthau, the treasury secretary, and his assistant, Harry Dexter White; and Ludwig Erhard, considered the architect of the West German "economic miracle."

LeBor has a good eye for issues worth investigating.

The personal stories, written in a lively essayistic manner, are provocative, but I feel that these mini-essays do not do justice to some of the protagonists, and the book ignores the reasons and drivers behind the bank's successful evolution after World War II into the BIS we know today. In light of my positive personal experience dating to the early 1990s (as Governor of the Hungarian Central Bank, attending the monthly governors' meetings at the BIS), I find the author's conclusion that the ". . . BIS is an opaque, elitist, and anti-democratic institution, out of step with the twenty-first century" (p. 256) harsh and unjustified.

The BIS is an international institution that has had to assume new roles under drastically changing global conditions. Collecting banking data, conducting high-quality research, and providing prudential advice are its vital contribution to the proper functioning of modern finance. The common European currency and the foundation of the European Central Bank presented the BIS with new challenges, as does the growing importance of the so-called BRICS (Brazil, Russia, India, China, South Africa) and other emerging economies, whose central banks want to be heard and taken into account. The BIS will continue and prosper if it keeps reacting as innovatively and efficiently to the objective demands of international high finance as it has throughout its existence.

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Lament for a Textile Town

Edoardo Nesi

Story of My People

Other Press, New York, 2013, 176 pp., $19.95 (cloth).

They say that history is written by the winners. It's a cynical saying, and it's also sometimes untrue. The preeminent history of Rome's victory over ancient Israel was written by Josephus, a general from the losing side. Some of the classic—but by no means uncontested—accounts of India's independence were written by British historians. And now we have another classic by someone on the wrong end of history: *Story of My People*, Edoardo Nesi's book about how Chinese competition devastated the Italian textile industry.

So perhaps the claim needs to be revised. Perhaps one should say that readers prefer histories where the authors can claim virtue for their side, even in defeat. Think of all those books about Athens in the Peloponnesian Wars. But even that argument does not apply in this case. Nesi never claims the moral high ground for Italy. To the contrary, he readily acknowledges that the country was lucky from the 1950s through the 1990s, when any artisan prepared to work hard could succeed. That golden era has ended. It is now the turn of other nations to have their moment in the sun.

Nesi is not bitter about this. Rather, he is sad. So he has written a book that falls into a third, rare, and beautiful category: an elegy on a lost way of life. A people (specifically, the people of the textile-producing city of Prato) whose creativity was prized the world over has found that its skills are no longer in demand. The free market that once gave them prosperity and purpose has now taken both away. Formerly tireless workers now spin out their empty days, feeling exhausted though they've done no work, feeling ashamed though they've done nothing wrong.

The story of Prato's demise is lyrically written and deeply moving. This is somewhat unusual for a book about business. But Nesi is not a typical businessman. Although he inherited his firm from his parents (and grandparents), he always wanted to be a writer. And since he had to sell his firm, he has been free to write, which he has done with extraordinary success. The result is a book that spends more time exploring the impact of failure on people than describing the textile business. There is hardly a number to be found.

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That's not to say the book lacks an argument. Nesi lays out a clear diagnosis of Prato's predicament. The biggest problem was the dismantling of the international clothing regime, which allowed cheap Chinese textiles to flood into Europe. At the time, economists predicted that Italian firms would in return be able to sell their high-priced textiles to China. But this promise proved a chimera, except for a few firms with famous names.

The second main factor was more subtle. The Italian government, aiming to stamp out tax evasion, levied a tax on firms' revenue. That meant that even as profits turned to losses, firms were still liable for taxes. Instead, they just decided to shut down.

Nesi feels strongly that something should be done to help preserve Prato. But he doesn't know what. Instead, he suggests that economists, having given poor policy advice, now have to come up with solutions.

Can they? The answer is unclear. Standard economics says that the benefits from reducing tariffs—lower prices and better products for consumers—exceed the costs. That creates gains from trade, which the winners can share with the losers, for example by training them for new jobs.

But this book argues that such schemes cannot compensate for the loss of a way of life. Instead, governments should limit the process of "creative destruction," or at least slow it down to make it more manageable. This can indeed be done, but at a cost to the rest of society. Britain tried this approach in the 1970s, and found that the costs—the subsidies, the damage to innovation and growth—eventually swelled to the point that society could no longer accept them. There followed an adjustment under Margaret Thatcher that proved all the more painful for having been deferred for so long.

Still, it is impossible to read this book without feeling that something must be done. Some economists agree and have taken up the research challenge. The results of their investigations will come too late for Prato. But other places could benefit, even those—especially those—that are now enjoying their golden eras. For if this book makes one thing clear, it is that golden eras do not last forever.

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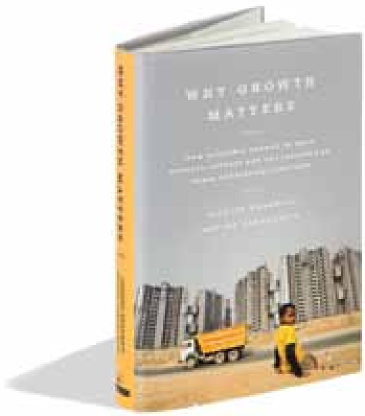
The World's Largest Debate Club



Jagdish Bhagwati and Arvind Panagariya

Why Growth Matters

How Economic Growth in India Reduced Poverty and the Lessons for Other Developing Countries

PublicAffairs, New York, 2013, 304 pp., $28.99 (cloth).

Over the past few decades, India's development story has garnered increasing attention. Following independence, but especially in the 1960s and 1970s, restrictions on foreign trade and capital flows and measures to raise government oversight of, and involvement in, the economy were ratcheted up. The Indian government nationalized banks, coal mines, and insurance and oil companies; created a strict regulatory environment, reining in large companies and favoring small-scale enterprises; tightened labor market regulation; and curtailed foreign investment.

Growth gradually ground to a near halt, until this tightly controlled and closed economy began to loosen and open up in the 1980s. The process accelerated dramatically after a balance of payments crisis in 1991. Since then, India has become a fast-growing economy with world-class corporations and increasingly important global connections.

This story led to debate—in the world's largest democracy it seems almost everything leads to debate—over whether those reforms actually fueled growth, whether growth reduced poverty and income inequality, and whether the lives of the poor improved. These questions matter. India still has hundreds of millions of poor people by any count: What does India's success tell us about which policies make their lives better?

In *Why Growth Matters,* Jagdish Bhagwati and Arvind Panagariya forcefully defend the past two decades of reform, dismantling step-by-step various myths about Indian economic and social policy from independence to the present day, and issue a call for additional reforms to bolster growth and further improve the lives of Indians.

Start with the myths about Indian growth. Were the 1991 reforms, which among other things dismantled industrial licensing and opened India to foreign trade and capital flows, the reason growth accelerated? Have these reforms widened income inequality and led to a new Gilded Age? Bhagwati and Panagariya cite extensive evidence supporting their claim that it is the 1991 reforms, rather than earlier, more minor reforms, that underlie India's accelerated growth and that these reforms have led to less poverty in India—without a significant increase in income inequality.

The authors go on to address the frequent claim that social progress in India, especially in health and nutrition, lags that of other countries. They dig deeply into studies that either ignore India's initial conditions or define various social indicators in a way that may make India look worse than comparator countries. The overall thrust of these claims is convincing: certainly, the 1991 reforms ushered in a new period of optimism and macroeconomic stability. A lower percentage of the Indian population is poor, and a higher percentage literate, than at any time in the past. These are indisputable. Other points—such as denial that the 1991 reforms led to increased corruption—are stated clearly and convincingly. Still others, however, such as those on malnutrition and infant mortality, are set forth with equally stentorian certainty but somewhat less convincing evidence.

Bhagwati and Panagariya also make a valuable contribution in presenting a reform agenda to extend India's recent growth record and make it more inclusive. The authors usefully divide progrowth reforms into two tracks: those that support growth immediately—for example, less regulation and more investment in infrastructure—and those aimed at more effective and inclusive growth—such as better elementary education and implementation of social programs.

Although the list of reforms is familiar to many people who follow India—the need for broader access to higher education and better roads is clear—the authors go a step further and lay out clearly and insightfully the specific difficulties that could arise if these reforms are implemented in an Indian context. Conditional cash transfers, which have been quite successful in Latin America and have been mooted in the Indian context, should be undertaken with care, given India's challenging governance environment.

Similarly, expanding higher education is an important goal, but the reasons such expansion has not already taken place—ranging from limited funds to the need to confront the entrenched interests of market occupants in skilled fields—are sometimes counterintuitive, and the discussion of how to address these roadblocks is useful.

Those unfamiliar with India and its complicated federal system will find some of this discussion—and the debates over India's pre-1985 economic policy and source data for household survey–based research—arcane. But for those who have followed India's recent growth story, *Why Growth Matters* is a useful summary of both the history of economic reform in India and of the controversies these reforms have generated, as well as a detailed and practical explication of what is necessary for the future.

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