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FOREIGN FINANCIAL INSTITUTIONS
&
NATIONAL FINANCIAL SYSTEMS

An Introduction to the Conference Proceedings

Manfred Pohl

Founder and Deputy Chairman of EABH e. V.

The interconnectedness of the world economy is the outcome of a long economic process in which commerce, trade, financial services and technology have interacted in mutually dependant relationships specific to a particular time and space. Globalisation, alas, is often defined as the shrinking of time and space made possible by modern technologies, which increasingly connect the world, particularly the global economy. The role of multinational financial institutions in the process of globalisation is an important aspect of this interconnection and yet it is often examined in such broad brush strokes that the detailed histories of individual actors, institutions, and complex relationships associated with particular times and places are marginalised or even overseen. Viewing financial history in this detailed manner reveals the real life challenges and complexities associated with cross-border banking, including the reasons and motivations underlying financial institutions' investment in foreign jurisdictions, as well as their failures and successes along the way.

This edited volume provides an insightful contribution to this aspect of the history of financial globalisation by focusing, in general, on: the reasons, motivations and roles that financial institutions' have played as cross-border agents; their reception in foreign jurisdictions including

regulatory responses and domestic banking developments; and the complexity of their evolving relationships with other institutional actors over time and space. Scholarly contributions to these topics cover a wide range of modern financial history and jurisdictions, stretching from early nineteenth century to the interwar period (1918–1939) until the fall of Berlin Wall (1989). Each scholarly contribution is concerned with understanding the interrelation of financial actors, trends and other variables associated with the activities of financial institutions at a particular time in a foreign jurisdiction on the basis of archival and other historical records.

The volume originates from the proceedings of an international conference entitled ‘Foreign Financial Institutions and National Financial Systems’, which took place in Warsaw, Poland from 7–8 June, 2013. The conference as well as the 15 chapter contributions contained herein were organised by the European Association for Banking and Financial History (EABH) e.V. in cooperation with the National Bank of Poland, the Kronenberg Foundation and the National Bank of Poland Foundation.

The volume aptly begins with several contributions which examine the complex relationship between European trade and finance, sometimes focusing on multinational institutions in foreign jurisdictions, and at other times concerned with domestic financial activities and commercial developments that shaped the behaviour and activities of foreign financial institutions. The first contribution by Hubert Bonin, entitled ‘French Bankers and Economic Patriotism in the Chinese Port Cities’, examines French financial participation in Far Eastern trade and commerce as a bridgehead for other French state, industrial and business interests in several Chinese concessions (Tianjin, Shanghai, Canton, Wuhan, etc. and colonies (Hong Kong). Although French financial institutions were meant to serve as ‘conduits of outflows and inflows’ to the French homeland, French banks active in these regions became embedded in local business life over time, altering their initial commercial strategies to take advantage of their hard earned networks of business interests. Chapter two addresses

PREFACE

a topic no less interesting and yet is relatively unexamined, namely the role of finance in the transatlantic slave trade. In a piece entitled 'Making Money: Cotton, Slavery and Finance Across the Atlantic 1815–1837', Kathryn Boodry is concerned with the way in which finance played an essential role in developing America's most important export commodity at the time, cotton, and how it helped to fuel the Atlantic slave trade and thus support the industrialising economies of the United States and Britain in the nineteenth century. Another contribution by Miguel A. López-Morell addresses the interrelationship of European trade and finance in the nineteenth century on the basis of investment activity of the Rothschild House in Spain. The article shows the importance of this family's investments to the Spanish economy including its principal industrial sectors as well as its contribution to economic development at large.

The next group of contributions all involve Poland, Polish bankers and Polish financial institutions and yet each work highlights the connections between finance, macro-economy and the histories of individuals who steered financial institutions through the tumultuous interwar period. The first contribution from Wojciech Morawski entitled 'Foreign Capital in Polish Banking 1918–1939' deals with foreign direct investment in Polish banking until the end of the Second World War. Detailing the macro-economic conditions of that period in Poland, the contribution examines the ways in which these influenced the influx and withdrawal of foreign capital, with the final liquidation of foreign investment in privately owned banks taking place in the spring of 1946. The second related contribution from this group, 'The Determinants of Foreign Banking Activity in Poland During the Interwar Period' by Cecylia Leszczyńska, examines factors that compelled foreign financial institutions to invest in interwar Poland by considering the role of risk conditions (capital controls, host country conditions), political connections and foreign direct investment. Similar to the preceding contribution Leszczyńska's article is concerned with macroeconomic conditions, regulatory interventions and their effect

on foreign financial activity. Guido Montanari's article entitled 'A Banker from Poland: Exploring Josef Toeplitz's International Connections through His Correspondence' takes a different approach to examining the relationships and activities of banks active in Poland and throughout Europe in general. The contribution's focus on the international banker known as Jozef Toeplitz provides a close-up view of this banker's strategic banking decisions in a particularly difficult business environment. Finally, Jerzy Łazor's article entitled 'Control and Regulation of Capital Flows between Poland and Palestine in the Interwar Period' examines the role of capital in the economic relations between Poland and Palestine. Based on the emigration of Polish Jews to Palestine in the interwar period the article examines the way in which capital and emigration interacted to shape the evolution of these states' relations.

In the next group of papers Piet Geljon and Ton de Graaf chart the histories of three Dutch financial institutions' overseas banking activities in 'Dutch Banking in Overseas Territories: Different Ways of Entry and Exit'. Initially focusing on the opportunities of local banking environments, the contribution shows that the emergence and growth of multinational financial institutions forever changed the nature of overseas banking, as well as the composition of financial institutions. Next, Adrian Tschoegl applies an interesting methodological construct to view financial institutions as part of a banking ecology in which the conditions conducive to financial institutions' entry into a particular market change through competition and reform so that these same institutions eventually sell their stakes to local banks and investors. Tschoegl's intriguing hypothesis is presented in 'Ecological Succession in Foreign Ownership in National Banking Systems'. Ashok Kapoor's 'Foreign Banks in India: Establishment, Operations and Challenges as Reflected from the Records of the Reserve Bank of India' also depicts an evolutionary history of banking by examining the origin and development of modern banking in India from the late eighteenth and early nineteenth centuries. Kapoor's contribution evidences a wholesale

change of attitudes and restrictive regulatory approaches toward foreign banks in India to a positive view of such institutions as mutually beneficial, even helpful to creating a healthy and transparent financial system.

The next group of papers focuses on the reasons for cross-border financial activities and their influence on domestic banking systems. Witold Koziński, in 'Reasons for Financial Institutions to Cross Borders: Drawing in Polish Experience' hypothesises that foreign banks enter specific areas of business where they have a comparative advantage and substantiates this by showing that mostly large, internationally active financial institutions enter the Polish market. Peter Haiss and Reinhard Schwaiger analyse the role of Austrian banks during the Austrian-Hungarian Dual Monarchy (1867–1918) in 'History Compared: Austrian Banks' Internationalisation during the Monarchy and After the Fall of the Iron Curtain' and compare it with banks' activities after the fall of the Iron Curtain (1989). The paper shows that historically, Austrian banks tended to pursue a 'follow the client' strategy, mainly driven by industrial firms which had relocated along a newly created railway network, whereas modern banks are more proactively engaged in retail markets. Enrico Berbenni's contribution places especial focus on the relevance of space to banking activities: in particular, his 'Border Effects on Local Banking Systems: the Swiss Italian Frontier between the Two World Wars (1914–45)' shows how political borders not only separate but connect different socio-economic and institutional systems, endowing these spaces with multidimensional meaning. And, finally, Thibaud Giddey's work, 'The Regulation of Foreign Banks in Switzerland (1956–72)' also focuses on the importance of space in the context of the Swiss financial centre. Giddey's work illustrates the evolutionary nature of the Swiss regulatory approach to foreign financial institutions.

The final two papers deal with the experiences of insurance institutions in overseas financial activities. The first by Ingrid Elferink concerns the foreign activities of a Dutch fire insurer known as De Nederlanden

van 1845, which began opening overseas agencies in 1857, and 30 years later totalled over 400 representations. The aim of this global strategy as set out in 'Insurance Abroad and Communication with the Home Front: 1850–1940' was, in fact, to compensate losses in domestic markets. And the final contribution entitled 'Opportunities in the Asia-Pacific Region for Canadian Life Insurance Companies in the Early 1990s' by Joseph Martin may provide an instructive conclusion for contemporary financial pursuits in that his paper's focus concerns the Canadian Life and Health Association's (CLHA) pursuit of insurance opportunities in the Asia Pacific region in the aftermath of deregulation.

These contributions provide a wonderful array of perspectives and histories of overseas financial activity and each comprises important lessons and trends which continue to resonate and impact contemporary bankers and policymakers. It is my hope that this volume will also encourage spirited discussion and debate and, most importantly, provide a lasting contribution to the objective of documenting, analysing and learning from the history of banking and finance.

Experiences of European Banking in the
Context of the Development of International
Trade in the 19th and 20th Century



FRENCH BANKERS AND ECONOMIC PATRIOTISM IN THE CHINESE PORT CITIES (1880s–1930s)

HUBERT BONIN

Abstract

The French state, industrialists and the business communities of French port cities considered the French communities involved in Far Eastern trade as a bulwark for French productions, services and financial investments in the bridgeheads established little by little in several concessions (Tianjin, Shanghai, Canton, Wuhan, etc.) or colonies (Hong Kong). The successive banks active in the area (Comptoir national d'escompte de Paris, Banque de l'Indochine, Banque russo-chinoise, Banque industrielle de Chine, etc.) intended to serve as a form of leverage for French outflows and inflows. But they became more and more embedded in the business life of these port-cities, under the pressure of competition and the necessity of finding out sources of operations and profits so as to mutualise their means and to amortise employed capital (ROCE). Therefore, their profile became mixed, spurring the interests of 'local' business communities in France to the 'global' scope of the Chinese economy, and weaving networks among 'local' trade houses in China to fuel their 'global' developments.

Thus the main questions could be: Were French banks promoting French companies in Chinese port-cities or acting as globalised business partners? How did they manage to tackle the interests of French firms in the host country/port cities, and to become positive intermediaries in favour of Chinese business firms? To what extent do the interests of Banque de l'Indochine as a firm establish a balance between both demands, those of economic patriotism and those of local embeddedness, along with what is today called a 'multidomestic strategy'? This paper will ascertain the connections established among the business communities of the port-cities, and the kinds of autonomous strategies used to prospect these markets. It

will also gauge the shaping of a new 'culture of risk management' in such 'imperial' off-shoots, thus fostering a reshaping of the overall corporate culture of the firm.

Introduction

The French communities of interest involved in Far Eastern trade were expected by the French state, industrialists and business communities of the French port-cities committed to overseas trade to support French production, services and financial investments in the bridgeheads established in several concessions (Tianjin, Shanghai, Canton, Wuhan, etc.) or colony (Hong Kong). The succession of banks active in the area (Comptoir national d'escompte de Paris, Banque de l'Indochine, Banque russo-chinoise, Banque industrielle de Chine, etc.) were meant to serve as conduits of French outflows and inflows. But, under the pressure of competition and the need of finding new sources of operations and profits, the need for the mutualisation of their means and amortisation of capital employed (ROCE), they became more and more embedded in the business life of these port-cities. They began to assume a mixed profile, spurring the interests of the 'local' business communities in France at the 'global' level of the Chinese economy, and weaving networks among 'local' trading houses in China to fuel their 'global' development.

The main issue is: did French banks promote French companies in the Chinese port-cities, or did they act more as globalised business partners? How did they manage to tackle the interests of French firms in the host country and its port-cities and become positive intermediaries in favour of Chinese business firms? We intend to determine how far the interests of Banque de l'Indochine as a firm tended to establish a balance between both demands: those of economic patriotism and those of local embeddedness, along what is called today a 'multidomestic strategy'. Such an approach will allow us to determine the connections established between the business

communities of the port-cities, and the building of autonomous strategies to prospect these markets. Our text will, of course, gauge the formation of a new 'culture of risk management' in such 'imperial' off-shoots, thus fostering a reshaping of the overall corporate culture of the firm.

We will use direct archival records and hope that this case-study on Banque de l'Indochine will broaden the scope set out by Frank King regarding HSBC and Banque industrielle de Chine,¹ the studies by some Japanese colleagues on the role played by the Yokohama Specie Bank and the book retracing Citibank's history in China.

I. The Emergence of a French Banking Strategy in China

Throughout South East Asian and Chinese commercial flows, it was the British and Japanese banks which prevailed by scale and strength over those of the French. Nevertheless, the latter continued to try and loosen the hold of their competitors, to play a greater part in the Asian money market and to follow the development of trade, whether local, or in joining the Pacific hubs or those linking Asia and Europe. Three axes of action can be defined: supporting trade between the Far East and Europe; propping up the half political, half financial penetration in China, especially against the United Kingdom – a penetration which was to strengthen the size and range of the Paris financial hub; and taking part in the trade between China and North America. The competitiveness of French banks was tested at every commercial and money market all along the Chinese coast which had been opened to western traders and bankers and where they could broaden the scope of their portfolio of skills through the acquisition of the specific commercial and financial know-how required for dealing

1 F. King, 'Sino-French Banque industrielle de Chine between 1900–1922', in: P. Hertner (ed.), *Finance and Modernization: A Transnational and Transcontinental Perspective for the Nineteenth and Twentieth Centuries* (Farnham 2008).

with Chinese customers, Asian traders or European firms active there. This process demanded the consolidation of their ability to master the particular risks created by extending their reach in such new business areas against a background of stiff competition, with foreign firms scrambling to get footholds in the North-Chinese and Hebei markets.²

In fact, French banks active in Asia had not targeted China because they had to first nurture the business fostered by the development of French firms in Indochina from the 1860s–1880s after the two-stage conquest of the peninsula. The Indochinese commercial business itself opened the doors to the Hong Kong market (for rice exports). But French traders gradually penetrated deeper into Chinese markets to get high-value materials (silk) and to establish bridgeheads for the export of consumer goods (textiles, machines, etc.),³ particularly through Hong Kong and the Guangzhou (Canton) coast. Banks accompanied the move with the opening of branches. A second area, the Centre-West, joined Haiphong harbour via the newly completed Yunnan railway,⁴ and led French businessmen to hope that it would become a key outlet, able to short-circuit British predominance on the Yangze basin,⁵ all the more because of the

2 See A. Feuerwerker, *The Foreign Establishment in China in the Early Twentieth Century* (Michigan 1976).

3 L. Gueneau, *Lyon et le commerce de la soie* (Lyon 1932). J. Laffey, 'Les racines de l'impérialisme français en Extrême-Orient. À propos des thèses de J.-F. Cady', *Revue d'histoire moderne et contemporaine*, April–June 1969. J.-F. Cady, *The Roots of French Imperialism in Eastern Asia* (New York 1954). J. Laffey, *French Imperialism and the Lyon Mission to China* (Cornell 1966). C. Fivel-Démoré, 'The Hong Kong & Shanghai Bank in Lyon, 1881–1954. Busy, but too discreet', in: F. King (ed.), *Eastern Banking* (London 1983), pp. 467–516. H. Brenier, *La mission lyonnaise d'exploration commerciale en Chine, 1895–1897* (Lyon 1898).

4 M. Bruguière, 'Le chemin de fer du Yunnan. Paul Doumer et la politique d'intervention française en Chine (1889–1902)', first published 1963 in the *Revue d'histoire diplomatique*, republished in: M. Bruguière, *Pour une renaissance de l'histoire financière, xviiiè–xxe siècles* (Paris 1992), p. 84.

5 E.W. Edwards, 'British policy in China, 1913–1914. Rivalry with France in the Yangtze valley', *Journal of Oriental Studies*, no. 40 (1977), pp. 20–36. E.W. Edwards, 'The origins of British financial cooperation with France in China, 1903–1906', *English Historical Review*, no. 86 (April 1971), pp. 285–317.

amplification of commercial relations with the East owing to the opening of the Suez Canal in 1869.⁶

A 'Chinese strategy' took shape in the 1890s within French diplomatic and business circles.⁷ They longed for a powerful banking arm there, able to counter the weight and influence of British trading firms in China and especially,⁸ the banking hegemony exerted by the Hong Kong & Shanghai Bank (HSBC) and Standard Chartered.⁹ Several banks drew up schemes of their Asian deployment, but a spirit of cooperation prevailed in favour of building a single entity capable of challenging the British leaders and their competitors from Japan (Yokohama Specie Bank,¹⁰ in charge of financing foreign trade) and Germany (Deutsch-Asiatisch Bank, linked to Deutsche Bank).¹¹ In fact, several countries lagging behind British influence had also thought of promoting a single banking firm which would represent the interests of its country in China and its environs: Deutsch-Asiatische Bank, the Russian-Chinese Bank (with a few French interests) and Banque sino-belge from Brussels are examples.

6 H. Bonin, *History of the Suez Canal Company, 1858–1960. Between Controversy and Utility* (Geneva 2010). H. Bonin, 'Suez canal', in: J. Zumerchik & S. Danver (eds), *Seas and Waterways of the World. An Encyclopedia of History, Uses, and Issues* (2 volumes) (Santa Barbara 2009), pp. 257–270.

7 N. Tixier, 'La Chine dans la stratégie impériale : le rôle du Quai d'Orsay et de ses agents', in: H. Bonin, C. Hodeir & J.-F. Klein (eds.), *Lesprit économique impérial (1830–1970). Groupes de pression & réseaux du patronat colonial en France & dans l'empire* (Paris 2008), pp. 65–84. And, about the origins of the role of the consuls: J. Fredet, *Quand la Chine s'ouvrait. Charles de Montigny consul de France* (Paris 1953).

8 See J. Osterhammel, 'British Business in China, 1860s–1950s', in: R.T.P. Davenport & G. Jones (eds.), *British Business in Asia since 1860* (Cambridge 1989), pp. 189–227. R. Bickers, *Britain in China: Community, Culture and Colonialism, 1900–1949* (Manchester/New York 1999).

9 E. King, *The History of the Hong Kong and Shanghai Banking Corporation. Volume 1. The Hong Kong Bank in Late Imperial China, 1864–1902: On an Even Kneel* (Cambridge 1987). G. Jones, *British Multinational Banking, 1830–1990* (Oxford 1993).

10 K. Ishii, 'Japanese foreign trade and the Yokohama Specie Bank, 1880–1913', in: O. Checkland, S. Nishimura, and N. Tamaki (eds.), *Pacific Banking, 1859–1959. East Meets West* (London/New York 1994), pp. 1–23.

11 M. Akagawa, 'German banks in East Asia. The Deutsche Bank (1870–1875) and the Deutsch-Asiatische Bank (1889–1913)', *Keio Business Review*, The Society of Business and Commerce, Keio University, no. 45–1 (2009), pp. 1–20.

A first stage of the process was animated by a bank created as early as 1848, Comptoir d'escompte de Paris. It defined a strategy which melded national growth with support for traders, especially at the import-export hubs and ports in order to stimulate the spirit of enterprise after the conclusion of the free trade treaties.¹² It decided to settle in Shanghai as early as 1860 and set up about ten branches in the Eastern countries: in Yokohama (1867), Hong Kong, Calcutta, Bombay, Madras and Pondicherry, and Cochinchina. Comptoir d'escompte de Paris was 'the French Bank' in the Orient, especially when it strengthened its Chinese settlement in 1886/1887 with the opening of branches in Tien Tsin, Fou Tcheou and Hankow. But Comptoir d'escompte de Paris faced a major crisis in Paris in 1889 and collapsed, and its successor, Comptoir national d'escompte de Paris (CNEP), focused its activities in Egypt, India and Australia.

The French state was thus committed to luring bankers in to take the relay along the Sea of China: it asked Banque de l'Indochine,¹³ which had been the issuing and commercial bank of southern and central Indochina (Cochinchina and Annam) since 1875 and of northern Indochina (Tonkin) from 1888, to change its scope. In November 1897, it balanced the renewal of its issuing concession in Indochina for 30 years against the deployment of the bank in China and in South-East Asia through the opening of branches. Banque de l'Indochine had to bear the French flag at key commercial markets, in Hong Kong, Canton and Shanghai of course, but also in northern China. After Banque de Paris et des Pays-Bas, Crédit industriel et commercial, Comptoir d'escompte de Paris and the Haute Banque (the Parisian merchant banks) had godfathered the creation of Banque de

12 H. Bonin, 'Le Comptoir national d'escompte de Paris, une banque impériale (1848-1940)', *Revue française d'histoire d'outre-mer*, tome 78 (1991), no. 293, pp. 477-497.

13 M. Meuleau, *Des pionniers en Extrême-Orient. Histoire de la Banque de l'Indochine (1875-1975)* (Paris 1990). Let us precise that, without this very book, this text would have considerably suffered from a lack of materials, which explains our gratefulness towards Marc Meuleau. Y. Gonjo, *The History of the Banque de l'Indochine (1875-1939): French Imperialism in the Far East* (Tokyo 1985), thesis in Japanese, translated into French by Comité pour l'histoire économique et financière de la France (Paris 1993).

l'Indochine in 1875, other big Paris deposit banks (Société générale in 1887 and Crédit lyonnais in 1896) joined the equity and its board, relying on their daughter or sister banks to represent the French business community in China.

'They saw that the Far East French colonies required an autonomous banking institution which would be the vanguard and representative of French High Finance in Asia, gathering major affairs and transmitting them to its Parisian partners, to which it procured a flow of profitable operations, like the credit issued through acceptances or FOREX operations. Multiplying banking institutions in Asia would weaken the French position there in the face of the British who knew how to mix diplomacy and finance and found strong colonial banks like HSBC or Chartered.'¹⁴

Meanwhile, CNEP had been weakened by the resignation of its German and Swiss managers in Asia who joined British or German banks there, its crash of 1889 and the economic, monetary (with the acute depreciation of silver) and military (Sino-Japanese war) turmoil in the Far East during the first half of the 1890s. It decided therefore to close its branch in Yokohama in 1893 and those of Tianjin and Fou Tcheou in 1899. For some time, the whole banking strategy in China had to be borne by Banque de l'Indochine, which inherited CNEP's Hong Kong branch in 1894,¹⁵ settled in Shanghai in July 1898 and in Singapore in 1905.¹⁶ Geopolitical events dictated such a move because China was forced into granting a series of newer, harsh concessions to 'the Powers', having to lease more harbours, to dedicate more tax revenues to the Boxers indemnity as pledges against bonds and even accept the presence of troops to guarantee the completion

14 M. Meuleau, *Banque de l'Indochine*, p. 145.

15 H. Bonin, 'French banking in Hong Kong: From the 1860s to the 1950s', in: S. Nishimura, T. Suzuki & R. Michie (eds.), *The Origins of International Banking in Asia. The Nineteenth and Twentieth Centuries* (Oxford 2012), pp. 124–144.

16 H. Bonin, 'The French banks in the Pacific area (1860–1945)', in: O. Checkland, S. Nishimura & N. Tamaki (eds.), *Pacific Banking (1859–1959). East Meets West* (London/New York 1994), pp. 61–74.

of the agreements – even as Chinese nationalists denounced them as ‘unequal agreements’. The balance of power was not in favour of China and the installation of Banque de l’Indochine in the northern cities was in fact part of this ‘imperialist’ system linking geopolitical pressure and business penetration;¹⁷ part of the strategy of ‘*impérialisme à la française*’ and promoting ‘*la France impériale*’ beyond mere colonial deployment.¹⁸

At the same time, French interests in Asia started being promoted by another bank, Banque russo-chinoise,¹⁹ which, in 1896, associated some banks from Paris, with two-thirds of the capital subscribed in France, Belgium and Russia – especially Banque internationale de St. Petersburg – in order to get a share in the development of Manchuria and northern China. This development was stimulated by the opening of the Transsiberian railway and the trans-Manchurian railroad, for the construction of which Banque russo-chinoise constituted Compagnie des chemins de fer de l’Est chinois in 1896 (Eastern Chinese Railways). But the purpose was larger as Banque russo-chinoise intended to become the spearhead of the penetration of French and Russian interests in the Chinese regions located north of the Yang Ze Kiang. It acquired CNEP’s Hankow/Wuhan and Tientsin/Tianjin branches in 1895 and settled in Beijing in order to be close to the financial authorities, especially for loans intended for the payment of the war indemnity to Japan, other loans and treasury advances: it led the negotiations for the financing of the Shansi railway in 1902–1903 and negotiated its FRF 40 million bonds on the Paris stock market.

However, Banque russo-chinoise soon escaped French influence as its German and Russian managers seemed to only favour Russian interests and did not promote French banks’ business with the Chinese

17 See F. King, ‘Extra-regional banks and investment in China’, in: R. Cameron & V. Bovykin (eds.), *International Banking, 1870–1914* (Oxford 1991).

18 J. Bouvier, R. Girault & J. Thobie, *L’impérialisme à la française, 1914–1940* (Paris 1986).

19 R. Qusted, *The Russo-Chinese Bank* (Birmingham, Slavonic monographs, n°2, 1977). K. Yago, ‘The Russo-Chinese Bank (1896–1910): An international bank in Russia and Asia’, in: S. Nishimura, T. Suzuki, & R. Michie (eds.), *The Origins of International Banking in Asia. The Nineteenth and Twentieth Centuries* (Oxford 2012), pp. 145–165.

government. In fact, the latter called British and German banks when it looked for subscriptions to the last portion of the indemnity it had to pay to the Powers in 1905, having intervened during the Boxers war. This choice aroused strong discontent amongst the French authorities. Banque russo-chinoise ended up competing against Banque de l'Indochine in Southern China and opened a branch in Hong Kong in 1904. This managerial dissent, coupled with the inability of Russian interests to exert strong pressure on China after Russia's military defeat to Japan in 1905, excluded Banque russo-chinoise from playing any part in the great French financial strategy in China. Moreover, when Banque russo-chinoise was merged with the Russian Banque du Nord to create the Banque russo-asiatique in 1910,²⁰ it rejoined the sphere of influence of French banks and its successor devoted itself mainly to its Russian and Manchurian business and, in spite of the desires of its managers in China, did not project itself significantly southwards.

This development emphasised the Banque de l'Indochine's mission of a double strategy of reinforcement of its commercial implantation in South China and of breakthroughs in the centre and north. An agreement with the French state on 16 May 1900 confirmed this move. It included a change to its statutes in order to adapt them to the practices in Chinese markets and an increase in its capital. The bank thus opened branches in Hankow and Canton in 1902, in Tianjin in February 1907 and in Beijing in April 1907. This program was soon crowned with success, as these branches, equipped with the comprador system, using an intermediary with the Chinese community, gathered a wide clientele of local traders and bankers for short term advances on commodities (opium, raw cotton, raw silk, tea), industrial products (cotton and silk fabric), gold and silver. However, Banque de l'Indochine limited its operations to short term loans, currency exchange operations and to participation in the issuing of

²⁰ See H. Bonin, *La Société générale en Russie (Histoire des activités financières et bancaires de la Société générale en Russie dans les années 1880–1917)* (Paris 1994 and 2005).

securities subscribed abroad. It refused to get involved in the construction of a branch network in the Chinese provinces and in the direct financing of local business, then considered as entailing high risks and financial immobilisations; although the granting of credit to trading houses and even to local bankers does imply the indirect financing of indigenous merchants.

Chinese affairs provided Banque de l'Indochine with 27 per cent of its total operations in 1905 and 33 per cent in 1910,²¹ with advances to local customers, European firms like Compagnie française de tramways et d'éclairage électrique de Shanghai, public works companies, real estate developers, the Franco-Belgian Crédit foncier d'Extrême-Orient, the transfer of public monies between Indochina and metropolitan France, currency exchange operations, and the trading of remittances and bills, particularly in Shanghai, which had become 'the heart of the circuits of Banque de l'Indochine, the centre of its network.'²² Beyond its clientele of European firms it had acquired, and thanks to the reform of its statutes in 1900 which allowed it to be engaged in loans lacking the usual collaterals and credentials, it developed an outstanding capacity for risk assessment of credit operations with Asian bankers and large merchants.

'By their knowledge of Chinese affairs and their know-how in FOREX techniques that allowed them to rapidly transfer the millions subscribed by French savings or the redemptions of the Chinese government, the agents of Banque de l'Indochine brought an organisation and a range of abilities that were necessary to the success of large affairs. We may affirm that never before had 'the French Bank' so deserved its nickname overseas.'²³

This assumes what Michel Bruguière called 'flag imperialism,' even though a partnership between French and Belgian businessmen (Banque

21 See M. Meuleau, *Banque de l'Indochine*, p. 238.

22 Ibid.

23 Ibid.

d'outre-mer, Banque sino-belge, linked to Société générale de Belgique) was maintained for some Chinese financial and railway businesses.

II. From Imperialism to Economic Patriotism

This background served as a basis for implementing a concrete strategy for the deployment of banking activities to promote French enterprises in China. It consisted of going well beyond the issues of a simple 'imperialism'²⁴ and the relationships of geopolitical and financial dependence as, ultimately, it could get only a few opportunities of any real business or orders for French firms. We have found that the financing of the Peking-Hankow railroad in the 1890s was accompanied by massive orders for the Belgian industry.²⁵ And so, experts suggested that the bank orient itself resolutely towards directly promoting French capitalism and driving a wedge between the competing banking, commercial and industrial powers.

We must determine the Banque de l'Indochine's, and eventually its French colleagues' field of intervention regarding the promotion of French national interests. Economic patriotism²⁶ grew at the turn of the century: letting the market self-regulate would leave the field open to foreign competitors and hinder French firms from developing their internationalisation

24 D.K. Fieldhouse, *The Economics of Empire, 1830–1914* (Ithaca 1973). D.K. Fieldhouse, *The Theory of Capitalist Imperialism* (London 1967). D.K. Fieldhouse, '“Imperialism”: An historiographical revision', *Economic History Review*, no 14 (1961), pp. 187–209. R. Koerner & G.D. Schmidt, *Imperialism. The Story and Significance of a Political Word, 1940–1960* (Cambridge 1964). J.-F. Cady, *The Roots of French Imperialism in Eastern Asia* (Ithaca 1954). J.F. Laffey, 'Les racines de l'impérialisme français en Extrême-Orient. À propos des thèses de J.-F. Cady', *Revue d'histoire moderne et contemporaine*, tome xvi (April–June 1969), pp. 282–299.

25 G. Kurgan-Van Hentenryk, *Léopold II. et les groupes financiers belges en Chine* (Brussels 1972). G. Kurgan-Van Hentenryk, 'Un aspect de l'exportation des capitaux en Chine : les entreprises franco-belges, 1896–1914', in: M. Lévy-Leboyer (ed.), *La position internationale de la France. Aspects économiques et financiers, xixe-xxe siècles* (Paris 1977).

26 See B. Clift and C. Woll, 'The revival of economic patriotism. Part 2: The genealogy of economic patriotism', in: G. Morgan & R. Whitley (eds.), *Capitalisms & Capitalism in the Twenty-First Century* (Oxford 2012), pp. 70–89.

and share of global money flows at a time when protectionism added to the difficulties of entering foreign markets. A strategy of economic patriotism would entail the mobilisation of all national forces towards the growth of commercial power and the development of exportable products by showing a heightened reactivity and aggression. Economic nationalism did not consist in any policy of ‘withdrawal’, sheltered by protectionism, which was toned down in the years 1890–1910, or the famous ‘imperial withdrawal’ from the colonial ‘preserves’. It consisted in stimulating the spirit of enterprise within companies so that they could be more aggressive in the markets, which were beginning to turn into ‘open economies’ such as China and Latin America.²⁷ The involvement of the political (renegotiating the concession in Indochina and asking the bank to deploy in Chinese port-cities) and diplomatic (asking consulates to collect information and support the expatriate members of the French business communities in these cities) powers also formed a part of this economic patriotism.

These issues covered a still larger dimension: the fact that a major portion of Franco-Chinese trade consisted of imports from China, especially the silk trade. Consequently, banks needed to enter the heart of these East-West commercial flows and prevent their rivals from making hay. It must be noted that HSBC had even established a subsidiary at Lyon, the French silk capital, in open defiance of French bankers. This meant convincing the French merchant houses that were active in China to patronise Banque de l’Indochine and to remain loyal to it in order to benefit from its services (FOREX, means of payment) and loans (seasonal credit, documentary credit, warrants) for their imports from China.

III. Managing the Trade between Indochina and China

27 See H. Bonin, ‘Les vertus de l’économie ouverte?’, in: B. Blancheton & H. Bonin (eds.), *La croissance en économie ouverte (xviii–xxie siècles). Hommages à Jean-Charles Asselain* (Brussels 2009), pp. 13–42.

The first intervention, in Asia itself, was in the trade financing market between Indochina and China, mainly in the export of Indochinese rice to Hong Kong (which had increased sharply) and, on a lesser scale, in the import of specific Chinese consumer goods for the local population (including the Chinese community). Here, too, one had to loosen the grip of the two British banks in South East Asia (HSBC, Chartered), which had long financed intra-Asian trade.

Banque de l'Indochine had to work from its Hong Kong base, linking its information network with its Indochinese subsidiaries to its presence within the Chinese business community in Hong Kong. It had to try and capture an increasing share of banking operations induced by the trade between Indochina and China, mainly for imports but also, more and more, for exports. In fact, Chinese business houses began to export regular consumer goods adapted to the local lifestyle, thus opening a niche for Banque de l'Indochine. The important role played by the trade between Indochina and China is well reflected by the volume of trade passing through the port of Canton at the beginning of the 1930s: the development of French economic patriotism helped the French colonial space in South East Asia (see Table 2).

The Banque de l'Indochine's branch in Hong Kong joined the fray of French interests in South-East Asia along two main commercial axes: the first connecting Indochina to Hong Kong and the second, Guangzhu and Southwest China to Hong Kong. The Hong Kong branch became a hub for favouring the relationship between Hong Kong and Indochina when

Table 1 – Trade between China and Indochina (thousands francs)			
	Imports by Indochina	Exports from Indochina	Total
In 1906	12,982	10,750	23,732
In 1907	15,073	37,697	52,769
<i>Source: Charles Augier et Angel Marvaud, La politique douanière de la France dans ses rapports avec celle des autres États (Paris 1911), p. 337</i>			

	Imports		Exports	
	1930	1931	1930	1931
Total	51,162	56,212	60,367	61,811
From or to Hong Kong	47,032	51,867	59,622	60,571
From or to Japan (with Formosa)	2,406	1,830	25.7	61.3
From or to the Dutch Indies	654	616	13	3.6
<i>From or to Indochina</i>	<i>651</i>	<i>1,329</i>	<i>75</i>	<i>66.3</i>
<i>From or to France</i>	<i>/</i>	<i>5.8</i>	<i>/</i>	<i>12</i>
From or to the USA	/	36.2	/	110.5
From or to Macao	297.6	376.1	631.3	893.9
From or to the British Indies	119.8	132.3	/	4.5
From or to UK	/	6.8	/	52.8
From or to Singapore	/	3	/	33.8
<i>Source: the Banque de l'Indochine archives, reports, letters and outcome, second half of 1931.</i>				

this latter emerged as a somewhat prosperous country, able to export commodities.²⁸ Its very first mission was to serve traders in Indochina who, Banque de l'Indochine argued, lacked the Hong Kong branch's information and competence capital and convinced them in the 1890s to use the branch instead of trying to manage their surplus funds in Hong Kong through their own investments:

'Up to now, for their [of the Chinese traders in Haiphong] shipments of goods to Hong Kong and those which they received, exporters and importers agreed to clearing their operations, and the balance was sold to Hong Kong in cash. This caused them difficulties, delays, and

28 P. Morlat, *Indochine années vingt: le balcon de la France sur le Pacifique. Une page de l'histoire, de France en Extrême-Orient, 1918–1928* (Paris 2001). See also: P. Brocheux & D. Hémy, *Indochine, la colonisation ambiguë, 1858–1954* (Paris 1994, reedition 2001). I. Nordlund, 'Rice production in colonial Vietnam, 1900–1930', in: I. Nordlund (et alii, eds.), *Rice Societies: Asian Problems and Prospects* (London 1986).

thus losses in interest. I showed them the advantages of using Banque de l'Indochine for these operations, and they understood very well.²⁹

Generally speaking, Hong Kong became a key hub for Indochinese exports, especially as rice plants in Saigon-Cholon were in the hands of Chinese manufacturers and traders.

Indochinese traders exported huge amounts of rice to China, generally through Hong Kong, though some of the cargoes were delivered to the coast ports without transiting through Hong Kong. Saigon emerged as the key port exporting rice to Hong Kong (541,000 tonnes in 1890), while Haïphong asserted itself as new source of trade as soon as it was equipped with a modern port (in the 1890s) and rice cultivation continued in Tonkin: with rice exports to Hong Kong growing to reach 60,000 tonnes in 1892. Indochina remained the main supplier to the Hong Kong market in the 1920s/30s. Chinese merchants purchased rice in Saigon, Bangkok and Burma, and sold it to Hong Kong traders, who selected, mixed, and stored them, before selling them to export houses (to China, Japan or elsewhere), thus opening opportunities to several stages of credit financing in which Banque de l'Indochine took a small part in Hong Kong – its main involvement being in Indochina.

A special line (with two ships) joined Indochina and Hong Kong in the first decade of the twentieth century; it was managed from its inception in 1907 by Compagnie française des Indes & de l'Extrême-Orient, itself created in

1905	20%
1907	25%
1907	50%
1909	15%
1911–1913	25 to 30%
1919–1921	35%
1923–1924	60%

²⁹ Letter from the Banque de l'Indochine Saigon director, 4 March 1889, in: M. Meuleau, p. 130.

³⁰ P. Caron, 'Le riz', *L'illustration économique et financière*, special issue *L'Indochine*, no. 15 (1925), pp. 40–41.

1903 by the Combarieu family.³¹ A special shipping line between Haiphong and Hong Kong was adjudicated in 1910 (to East Asiatic shipping). Hong Kong banks were used to finance loans to Saigon traders exporting rice to Hong Kong (and often to Japan), and Banque de l'Indochine joined HSBC and Bank of China in this business. Gradually, it enlarged its market share. Chinese rice merchants in Saigon-Cholon gathered packs of documentary credits on Hong Kong, and the payments by Hong Kong importers fuelled the dispersal of cash, which was used there.

Meanwhile, the coal trade opened doors to important credits: the Charbonnages du Tonkin, a Franco-British colliery company, sold coal in Hong Kong and became a client of the Banque de l'Indochine's branch

Imports to Hong Kong	5,570,000	
From Indochina	2,855,000	51.3%
From Siam	2,216,000	39.8
From Burma	474,000	8.5
Exports from Hong Kong	4,488,000	
North China	784,000	
Middle China	152,000	
South China	2,646,000	
Macao	152,000	
Philippines	90,000	
Japan	347,000	
South America	77,000	
USA	37,000	

there from the start. Houses in Hong Kong were financed by Banque de l'Indochine to trade in Tonkin coal. But the large dimensions of this trade explain why companies preferred HSBC as their banker in Hong Kong instead of Banque de l'Indochine, which complained about such an attitude.³³

Trade on goods was also financed by the Banque de l'Indochine's branch, especially as some of its clients in Indochina intensified their operations with Hong Kong: the

31 Letter from the branch manager, 5 May 1907.

32 Report on the rice market in Hong Kong, 25 May 1931.

33 *Ibid.*, 29 December 1925, about Charbonnages du Tonkin, which left its funds by HSBC because its suppliers had accounts in this bank.

	Total	To Hong Kong	Hong Kong's share of the total amount	To China (either through Hong Kong or directly)	To metropolitan France
1929	1,256,887	379,454	30.2%	64,490	188,044
1930	1,058,410	310,991	29.4	190,320	203,610
1931	961,206	330,823	34.4	48,682	292,044
1932	1,191,649	451,217	37.9	63,351	408,271
1933	1,220,988	492,177	10.3	1,831	533,958
1934	1,275,539	343,313	26.9	100,491	698,738
1935	1,718,013	437,372	25.5	369,938	348,563
1936	1,711,775	161,074	9.4	6,933	995,277
1937	1,548,358	290,182	17.7	102,878	674,487
1938	1,077,637	140,173	13	17,940	562,944
1939	1,680,822	162,212	9.7	78,148	461,035

Union commerciale indochinoise et africaine (UCIA) opened an office in Hong Kong in 1907 for import-export wholesale trading. A comprehensive assessment of such flows seems impossible, but the Hong Kong branch showed its usefulness and efficiency on several occasions – for example when the French Descours & Cabaud company (from Lyon) sent tyres to the Europe Asia Trading company in Indochina with a discount from Banque de l'Indochine in Hong Kong.³⁴ The trading house Optorg – diversifying out from its age-old activities in Russia – moved to Hong Kong and Shanghai in 1923 and began the import and trade of goods (mainly wool cloth, but also spirits, champagne and pharmaceuticals) which it delivered against promissory notes.³⁵ The Banque de l'Indochine Hong Kong became its leverage in Asia. It collected its remittances in Hong

³⁴ Ibid., 26 March 1924.

³⁵ Ibid., 20 November 1924.

Table 5. Indochina's commercial partners ³⁷ in 1924 (FRF million)		
From/to	Import to Indochina	Export from Indochina
Metropolitan France	712	346
Hong Kong	247	743
China	129	121
Singapore	49	153
Dutch Indies	62	74
British Indies	62	?
Philippines	?	124

Kong, fuelled exchange contracts (FRF 982,000 in 1931), and carried a large portfolio of bills drawn on Chinese clients (\$82,000 on I.P. Hang Fong in 1931) for goods stored in the name of the bank pending sales.³⁶ But generally speaking, imports from Hong Kong were inferior to exports from Indochina to Hong Kong; this explains the cash to be used as treasury deposits or short-term investments on the Hong Kong markets, or even to purchase bills of exchange to be remitted in London or Paris by the circuit of Banque de l'Indochine in these marketplaces.

IV. A Growing Concern: Supporting French Exports to China

'Chinese imports are ten times bigger than our exports [...]. Our exports to China are spread over a rather large number of articles, most of which are of insignificant value in themselves. Only the silk cloth and ribbons merit being mentioned as they attain to some

³⁶ Ibid., 23 February 1931.

³⁷ P. Morlat, *Indochine années vingt*, op.cit., p. 3.

respectable figure. After them come the wines, cotton and wool cloth, watches and jewelry, machines, etc.³⁸

Therefore, a form of economic patriotism would consist in promoting French produce in China, and the banks should play a pivotal role, in the manner of their Anglo-Saxon rivals!³⁹

It is true that French firms had captive markets within the concessions: regular equipment for the troops stationed there and meeting the daily requirements of expatriates working in the administration, service and commercial enterprises or Catholic missions. They brought in modest though regular inflows (especially for the medium-high range consumer goods: wines and spirits; clothing, jewelry, perfumes, stationery, books, etc.). At the same time, Chinese outlets were yet to be conquered. But the country was not inclined favourably towards French products, which did not seem to have any competitive advantages. In fact, the United Kingdom, Germany, Japan and even Belgium – if we think of the Pekin-Hankow/Wuhan railroad – had already established themselves solidly (railroads, arms, harbour facilities),⁴⁰ while the United States began making inroads in 1910/1920. Capital goods played only a small part of French manufactured products exported to China. It was then that the triptych ‘diplomacy-industry-bank’ as defined by historian Jacques Thobie and used by Jean Bouvier and René Girault,⁴¹ was deployed in this geographic region – just as it had been earlier during the Ottoman empire,

38 C. Augier and A. Marraud, *La politique douanière de la France dans ses rapports avec celle des autres États* (Paris 1911), p. 337.

39 See, as a case study: C. Davis, ‘Financing imperialism: British and American bankers as vectors of imperial expansion in China, 1908–1920’, *Business History Review*, no. 56–2 (1982), pp. 236–264.

40 See R. Lee, ‘French finance and railway construction in northern China, 1895–1905’, in: R. Roth and G. Dinshoh (eds.), *Across the Borders. Financing the World’s Railways in the Nineteenth and Twentieth Centuries* (London 2008), pp. 241–254. R. Lee, *France and the exploitation of China, 1885–1901. A Study in Economic Imperialism* (Hong Kong 1989). R. Roth & G. Dinshoh (eds.), *Across the Borders. Financing the World’s Railways in the Nineteenth and Twentieth Centuries* (Abingdon 2008).

41 J. Thobie, *La France impériale, 1880–1914* (Paris 1982). J. Thobie, *La France, l’Europe et l’Est méditerranéen depuis deux siècles. Économie, finance, diplomatie* (Istanbul 2007). J. Thobie, *Intérêts et impérialisme français dans l’Empire ottoman (1895–1914)* (Paris 1977).

followed by Central and oriental Europe and sometimes, in Latin America. French diplomats (at the embassy, but more often from the consulates, who were cultured and often dynamic) were constantly mobilised from Paris to collect information on the development and modernisation plans of cities (orders for transportation facilities, electricity production),⁴² harbour development plans (orders for public works), new arms for the army, etc., in a foreshadowing of economic intelligence gathering. French Chambers of Commerce in city-ports and industrial federations at home and abroad completed these information gathering networks, while the managers of the bank subsidiaries in China often acted as middlemen at the heart of local business communities.

Capital Goods at Stake

In a movement of cooperation between enterprises, the French business community explored the markets for electro-technical (small power stations, often for tramways or lighting), harbour and automobile equipment, for building sites as part of real estate development, factory equipment (sugar factory, flour-mill, etc.). The Fives-Lille equipment manufacturing company exported three 115,000 hp electric turbines to the Sungari power station in Manchukuo in the 1930s. If we focus on the north-eastern area, in the mid-1920s, Banque de l'Indochine partnered a French group which wanted to bag public orders for telecommunications equipment. The group was known as Société française des téléphones interurbains (SFTI). It had installed the networks in Tianjin, Harbin and Mukden (in Manchuria). It had moved its headquarters from Harbin to Tianjin in 1925 because, from being an Anglo-Russian company, it had turned into a French one in September 1924, even though it kept links

42 See N. Tixier, 'La Chine dans la stratégie impériale: le rôle du Quai d'Orsay et de ses agents', in: H. Bonin, C. Hodeir & J.-F. Klein (eds.), *L'esprit économique impérial (1830-1970). Groupes de pression & réseaux du patronat colonial en France & dans l'empire* (Paris 2008), pp. 65-84.

with the British Far Eastern company, a supplier to the Chinese Eastern Railway. Its purpose was to expand its activities from Manchuria to the broader north-eastern areas of China. It won the contract for the telephone and wireless link between Tianjin and Shanghai for the Tianjin-Pukow railway (Chinese Eastern Railway). Though it issued a loan to finance this investment, it needed bank credits to finance its purchases in Europe and the US (copper, equipment), in Manchuria (wood poles) and for its day to day operations in China as a representative of French telecommunications firms, with advances of G\$ 148,000, £11,000 and taels 10,000 in 1926.⁴³ Such an opportunity seemed relevant to Banque de l'Indochine.⁴⁴ It was modestly involved in a major agreement between European, Chinese banks and Sfti in the summer of 1926 to provide big advances pledged against seven years of revenues from the network to be set up, but Banque de l'Indochine provided it with advances pending the first instalment of credit – with the equipment pledged in a warehouse. Part of the equipment was ordered in France from Câbles de Lyon and part in the UK from Siemens UK.⁴⁵ Another contract took place in 1927: the Far Eastern Bank financed (through a G\$ 175,000 documentary credit and a global G\$ 400,000 advance) the telecommunications equipment at Mukden (exchange centre and 3,000 automatic units).⁴⁶

The group enlarged its scope and its subsidiary, *Le Matériel technique*, could offer almost anything to customers: eleven Potez 25 with Lorraine engines were sold to the Szechuen government in 1932. Though transported by boat to Haiphong and assembled there, military troubles suspended the completion of the operation, which was co-financed by Banque de l'Indochine through confirmed credits. It also considered the prospect of operations with the Tchengtai railway, which had kept some

43 Ibid., June 1926.

44 Ibid., 15 July 1926.

45 Ibid., 26 August 1926.

46 Ibid., 27 October 1927. But the Banque de l'Indochine was not directly involved.

French engineers and managers throughout the interwar period despite its sinisation, because it had been built and managed (in Shihkiachwang) by Frenchmen in the 1900s. Le Matériel technique succeeded in selling new equipment (from French firms Daydé and Comptoir sidérurgique de France) in 1933 for FRF 20 million and later, FRF 29 million. A credit package was set up by the Banque de l'Indochine's branch, even though the Paris office itself was involved in some millions,⁴⁷ against the deposit of part of the funds by the Chinese ministry in a Chinese account as a guarantee.⁴⁸ The operation took shape in 1934–1935.

Anyway, the fragmentation of Chinese power and networks of influence resulted in massive graft: for example, the telephone contract required G\$ 237,000 against a total amount of G\$ 859,000. 'No state operation could be concluded in China without considerable 'squeezes' given to help in getting the contracts signed. This explains why big German firms (Siemens, Carlovitz, Arnhold, Karber) had won the monopoly of large industrial firms in the country before the war. Far from changing, the system has been greatly amplified by the colossal appetite of the present politicians who are primarily interested in concluding such operations. Large orders for planes, trucks, railway equipment, etc. are brokered only via such a system. We have to accept such constraints and shut out eyes if we wish to work in this country.'⁴⁹

We do not have any systematic reviews of this development in the export of manufactured goods, only glimpses from the archives. Still, we can clearly detect a collective entrepreneurial dynamism which nevertheless remained modest in size in the face of Japanese investments in textiles and clothing, especially in the cotton industry, and within the Shanghai economic space. Because of these limits, the French economic offensive could not open major outlets for structured finance or supplier credit

47 Ibid., 19 September 1933.

48 Ibid., 25 January 1934, 10 February 1934, 15 February 1934.

49 Ibid., 9 February 1927.

operations which could have greatly benefited Banque de l'Indochine and the Parisian interbank pools upstream. These were all only individual cases succeeding one another, far from the 'economic system' that was established between France and the USSR in 1960–1980, for example.⁵⁰

Armaments at Stake

A less pacific trade in armaments was also developed owing to the fragmentation of military and political power. In the 1920s, several branches of Banque de l'Indochine and its Parisian headquarters served as levers for processing arms orders from warlords who, either in agreement with the central government which entrusted them with the mission of building regional arsenals, or autonomously, had acquired from Europe armoured vehicles, artillery, munitions and even airplanes. This Chinese rearmament drive also benefited French firms from time to time.

In 1929, the Banque de l'Indochine's branch became involved in the sale of armaments by French (and Belgian) companies: as the orders from the Guangdong authorities grew in size, so did FOREX activities and cash transfers (repayment in Europe of the receipts paid by Chinese clients), offering good returns through commissions. On one side, Banque de l'Indochine practiced normal banking: the import of airplane engines for the Guangdong air force in 1930 resulted in a fat bill of exchange (FRF 833,000), to be discounted. Similarly, when the house of Pinguet acted as an intermediary for selling armaments to the local warlord, another bill of exchange (£ 16,000) drawn on the Reuter-Brockmann house was discounted by the bank, with a collateral in cash for 75 per cent.⁵¹ Another service concerned the provision of FOREX facilities, as it was the case in

50 H. Bonin, 'Business interests versus geopolitics: The case of the Siberian pipeline in the 1980s', *Business History*, volume 49, no. 2 (March 2007), pp. 235–254. H. Bonin, 'L'émergence de la coopération industrielle, bancaire et commerciale franco-soviétique dans les années 1960', in: M. Vaisse (ed.), *De Gaulle et la Russie* (Paris 2006), pp. 229–252.

51 *Ibid.*, 14 December 1930.

1931 for an order of armaments, thanks to the Banque de l'Indochine's FOREX capabilities.⁵² The total amount overseen by the bank in the first half of 1932 attained US\$ 760,000.⁵³

For the major orders, Banque de l'Indochine assumed no risk at all, except the 'risk of execution':⁵⁴ for example, in 1932, the two brokers handling armaments deliveries, Ott and Krebs, had to fuel cash upstream on a current account in Europe as an actual guarantee.⁵⁵ The bank partnered larger operations in 1932: the sale of armaments by the French firms Schneider and Hotchkiss (and also consultancy to the Belgian firm, Herstal). E. Ott, a Swiss heading the Industrial Export Co., acted as an intermediary in South China for the 'Groupe Chine', an association of French exporters into China, picking up contracts and following them until completion. In 1932, he oversaw the purchase of 200 Hotchkiss machine guns by the First Army Corps for US\$ 183,457, with a guarantee by the Canton government and collateral on the modern cement plant of Sai Tsun, opened in 1932.⁵⁶

On 22 February 1933, another contract for 260 Brandt mortars, 39,000 shells and ammunition worth gold-USD 624,999 was signed, with the last instalment made on 27 March 1934. In parallel, Henri Krebs, head of the Augsburg house in Basel since 1921, and the representative in Canton of the Belgian Fabrique d'Herstal from 1931, also used Banque de l'Indochine as a financial lever, with loans of US\$ 150,000 in 1933 for the import of armaments.⁵⁷ All in all, the armament business varied depending on the Guangdong authorities and the rhythm of war, locally or to the north (in support of the Nanking offensives against the guerrillas or the

⁵² *Ibid.*, second half of 1931, 8 April 1932.

⁵³ *Ibid.*, first half of 1932, 27 October 1932.

⁵⁴ *The Banque de l'Indochine archives*, DES 13/4, Reports from the Canton branch to the Paris headquarters, 21 February 1934.

⁵⁵ *Ibid.*, 15 February 1932.

⁵⁶ *Ibid.*, 19 September 1932.

⁵⁷ *Ibid.*, 5 May 1933.

Japanese). The Banque de l'Indochine's branch oversaw sales of armaments of US\$ 769,000 in 1932, and US\$ 226,000 in the first half of 1933. The fees earned on them made for half of the profits of the branch during the second half of 1933. 'The arms business has gone up to FRF 6,826 million. The lion's share of this amount goes to the Groupe Chine, which has been, for the entire period, our branch's best client.'⁵⁸

Even though it faced competition from the Bank of Kwangsi in Hong Kong for FOREX fees linked to the import of armaments (in 1934), the Canton branch acquired a relevant portfolio of skills as a factor of 'differentiation' and profit, thus proving its efficiency: 'The transfer of funds pertaining to the preceding contracts (Schneider, Hotchkiss, Brandt, etc.) were accomplished with regularity. On the whole, these contracts will very soon be completely settled.'⁵⁹ This fuelled the flow of cash into the silk business: 'For us the arms business is a major source of revenue and it allows us, during normal times, to quickly cover our silk paper.'⁶⁰ Such expertise opened up several opportunities. Negotiations began in 1934 regarding a big contract (FRF 85 to 100 million): Banque de l'Indochine (in France and in Guangdong) as an active intermediary and the Groupe Chine (a coalition of French firms) had to face a British coalition of HSBC and Jardine Matheson,⁶¹ because its manager John Craven was also on the Board of Vickers. Six French firms, led by Brandt, were involved: Schneider (40 million), Hotchkiss (20 million), Renault (ten million), Brandt (ten million), Sauter-Harlé (four million), and Somua (one million). On the Chinese side the government of Kwantung/Guangdong and Marshal Chan Chai Tong/Tchang Tchai Tong, with the Bank of Canton (based in Hong Kong) as guarantor were present. After seven months of negotiations, the

58 *The Banque de l'Indochine archives*, 323 DES 36/2, Letters and reports, first half of 1933.

59 *The Banque de l'Indochine archives*, DES 13/4, Reports from the Canton branch to the Paris headquarters, 1 January 1934.

60 *Ibid.*, 27 April 1933.

61 About this hong, see: M. Keswick (ed.), *The Thistle and the Jade. Jardine & Matheson* (London 1982).

financial contract was signed in summer 1934 by the head of the Banque de l'Indochine's branch in Canton, Jean Juge, and the Marshal's representatives. But it lasted only a few months due to the lack of money on the Chinese side. The bank guaranteed the delivery of military equipment against treasury bills from the Guangdong government (themselves pledged by taxes on tobacco and wine) and exchange bills on the bank's order, to be drawn in 60 months.⁶²

Schneider, the big French manufacturer of heavy armaments,⁶³ was again involved in such a deal in July 1935, this time for three batteries of four canons, light canons, and ammunition. Payment instalments were scheduled for 1935–1938, once again based on taxes on wines and tobacco as collateral for promissory notes issued to cover the loan. Banque de l'Indochine acted as the agent for the transfer – with a one per cent-fee, for its guarantee for the embarkation of the equipment in France, thus as a kind of comptroller for the completion of the operation.⁶⁴ Deliveries commenced in April 1936, cash was picked up by the Canton branch on behalf of the Groupe Chine, just as new contracts were signed in March–May 1936 for more canons, 75-type batteries, mortars, shells, etc. These orders amounted to around FRF 78 million in August 1936, with 33.7 million paid by the government against a value of 10.4 million for equipment already delivered – which could reinsure the bank despite a change of power in Canton.⁶⁵ During only the first half of 1936, the armament sales overseen by Banque de l'Indochine attained FRF 24 million of a total of 32 million. The coup of August 1936 suspended the process, but the new power eventually confirmed the contract, albeit imposing more 'grey' payments and smaller fees. A final operation took

62 *The Banque de l'Indochine archives*, DES 13/4, Reports from the Canton branch to the Paris headquarters, 21 June 1934.

63 See T. de la Broise & F. Torres, *Schneider, l'histoire en force* (Paris 1996).

64 *The Banque de l'Indochine archives*, DES 13/4, Reports from the Canton branch to the Paris headquarters, 15 July 1935.

65 *Ibid.*, 14 August 1936.

place in 1936, when the Banque de l'Indochine provided the trading house of Feld & Co. with a guarantee (£ 58,000) for the delivery of 10,000 Mauser guns ordered from the Belgian Fonderie nationale in the spring of 1938. It also managed the transfer of the first two instalments (US\$ 7,650) by the Kwangsi government – the other ones still pending in 1938. When the general crisis paralysed normal business in the Guangdong area, the sale of armaments became one of the key sources of revenue for the branch, under the account 'interests & fees.'⁶⁶

After Banque de l'Indochine had proven its talent in the field of armament contracts, it tried to extend its reach to the import of equipment. While China still faced political and military tensions, its actual economic development was gradually gathering momentum. This explains the negotiations of 1935 between the Guangdong authorities and the Schneider group, in this case with its Czechoslovakian sister company, Skoda. It concerned the delivery of a big power plant for supplying energy to a paper mill at a cost of HK\$ 209,000 in 35 months. Guarantees were to be brought by Zevnostenska Banka and Anglo-Czekoslovenska Banka, but Jean Laurent, head of the Banque de l'Indochine's General Inspection and supervisor of its Asian activities, fought hard to introduce his bank into the pool, and succeeded in getting the Banque de l'Indochine's Canton branch a HK\$ 86,000 loan to help seal the contract. Unfortunately, the project fell through. Skoda endeavoured to reach other agreements (for five sugar plants, etc.), while Banque de l'Indochine took part in a few other Czechoslovakian exports to Guangdong in the mid-1930s. The launch of the Three-Year Industrial Plan in 1934/35 opened the doors to new opportunities, but nothing much can be said from the archives available in Paris regarding the Canton banks' involvement.

Meanwhile, in Tianjin, the Hei Lung Kiang government placed an order for a hundred machine guns on the French firm of Hotchkiss and Banque

⁶⁶ *The Banque de l'Indochine archives*, 323 DES 36/2, Letters and reports, first half of 1937, 18 October 1937.

de l'Indochine brought its local guarantee (US\$ 80,000) while the Paris office opened a confirmed credit (US\$ 78,000).⁶⁷ But the development of such business was hindered by military and political developments in China and the disturbing stand taken by the French government, which refused to give a public guarantee for credit insurance to the suppliers because it required that the Chinese loan of 1902 be repaid in gold francs and not in current francs. This paralysed exports.

V. The French Government's Support of the Import of Chinese Products

We must also look at one of the aims of the French government at the turn of the twentieth century: an increasing share of the imports from China was to be financed by French banks, especially Banque de l'Indochine.

Banque de l'Indochine as the Banker for the Silk Trade

The silk trade was at the core of these east-west flows. A business community grew between the subsidiaries or branches of Lyon silk trading houses in Guangdong and Hong Kong. An entire credit chain was formed: from the collection points along the riverbanks to storage in the port-city, between Canton and Hong Kong, and between Asia and Europe, with flurries of bills of exchange, discount and warranty, followed by documentary credit and FOREX operations, often with a clearing stage in the city (by the Banque de l'Indochine's London branch) and banking facilities in French ports, and at Lyon by the mainland Banque de l'Indochine itself – with an entire chain of commissions and interest revenues. It is clear that henceforth HSBC's power had been successfully contained in these markets: fed

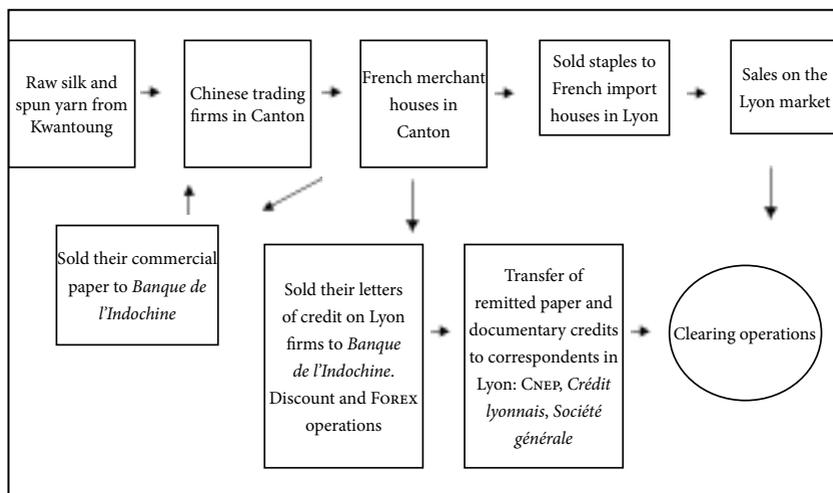
⁶⁷ Ibid., 23 July 1930.

by liquidity from its Paris headquarters or the seasonal availability from its Hong Kong and Shanghai subsidiaries, Banque de l'Indochine became a key player in the silk trade. Thus, a growing share of the profits it generated entered the coffers of a bank flying the French flag.

It asserted itself as a leveraging force at the service of the silk trade between China and France. Apart from Lebanon and Japan, China had become a key supplier of raw silk, mainly because it was cheaper and because French silk production had been badly hit by disease. French trading houses had settled in Canton because the port was the outlet for silk producers from several districts.⁶⁸ Together, they tackled a huge amount of silk trade, with the total estimated at 25 million francs in 1905. Two leaders, R. Chauvin and E. Pasquet, competed mainly with the British Jardine Matheson, and the German, Arnhold Karberg. They were joined by some rapidly growing competitors (Générale des soies, Gerin & Drevard, Meurer frères, Boyer Mazet, Albert & Wullschleger, Th. Varenne, etc.). Warehouses lodged silk, either by merchant intermediaries, or at the Banque de l'Indochine's own godown, well separated from other goods for fear of infection. The bank offered a classical range of credit, and first loans pledged against silk balls or cloth piled in the godowns. The trading houses thus welcomed the introduction of its local branch which saved them from having to use Hong Kong brokers (with a 1/8 per cent commission) and banks, as well as sending a constant stream of telegrams, which led to significant cost cuttings.

The branch was inserted into the chain of trade and credit linking Canton to Europe: transportation; inventories in Marseille and Lyon; and pending sales to French merchants and (weaving) industrialists. This fuelled the remittance of bills of exchange, with the risk on credit (documentary credits) and foreign exchange (FOREX), which was granted autonomy from the Hong Kong branch in April 1910. The Banque de l'Indochine's branch thus accomplished the mission entrusted to it: French

68 L. Gueneau, *Lyon et le commerce de la soie* (Lyon 1932).



trading houses and the Lyon market could now avail themselves of an efficient platform to get information, connections, credit, FOREX, international clearing, and cash transfers. No doubt, they could have found similar facilities elsewhere too, in Hong Kong and from British banks, but the fighting spirit and the growing skills of the Banque de l'Indochine's branch undoubtedly eased their *modus operandi* in the region and contributed to the French competitive edge. This led to a partial transfer of activity from Hong Kong to Canton, reinforcing the rise of the latter as a key silk port-city.

In the 1920s, the Banque de l'Indochine's branch increased its commitment to silk trade banking. Taking full advantage of the rebirth of commerce and its own portfolio of skills and connections, it turned itself into a major player in the port-city's silk trade. Over the first quarter of 1923, it financed three-quarters of all silk balls sent to Lyon.⁶⁹ In France, artificial silk (rayon) began replacing natural silk in the mid-1920s, forcing merchant houses to redefine their business model. They had to demand higher quality raw silks to be delivered to high-class weavers and luxury houses in Lyon. The

⁶⁹ The manager of the Banque de l'Indochine's branch to Paris headquarters, 3 December 1923.

Kwantung/Guangdong constituency and its traditional spinning mills had to redeploy, causing more trouble: Chinese bankers became wary of their credits to such customers, and sifted them carefully.⁷⁰

Another point was the Banque de l'Indochine's focus on French houses because, during the 1921–1924 crisis, British houses had depended heavily on advances from British banks, which afterwards demanded that they remain loyal and not go to their French competitors.⁷¹ The Banque de l'Indochine's key advantage lay in its permanent funds (allocated by its mother company) which allowed it to grant increasing amounts as loans on silk balls, which in turn allowed its merchant clients to repay their suppliers without long deadlines. It was a traditional clientele with a renewed profile, because a few houses withdrew or even disappeared. Apart from a bunch of small and medium-sized merchants, the leaders provided banks with large amounts of business. They included Canton Silk & Co., South China Trading Co., Madier-Ribet, Comptoir franco-chinois, Central Produce & Co., Hogg & Co., J. Cassa, Gérin-Drevard and Boyer-Mazet (whose building was adjacent to that of Banque de l'Indochine).

Banque de l'Indochine as a Companion to French Trading Houses

Banque de l'Indochine began to partner with an ever-increasing number of French trading houses in every port-city's concession, houses which were scrambling to get a share of Chinese exports. In Tianjin, where the French presence was scarce because of the might of British and American competitors, there were about 34 French trading houses against a total of 625 in the mid-1920s. The only major company active there was the international wholesale commission trader Olivier, with bases in Paris, London and

⁷⁰ Ibid., 22 December 1927.

⁷¹ Report on the second term of 1927 by the manager of Banque de l'Indochine branch.

Milan, and offices and warehouses in Tianjin. Even though Olivier faced a constant financial crunch, the branch financed its Tianjin activities from the 1920s. It required guarantees on inventories stored in a special godown dedicated to goods pledged against its 'packing credits', that is, advances on merchandise transiting through the warehouses. Despite Olivier's failure in March 1922, it restarted its operations and remained a faithful customer to Banque de l'Indochine in Tianjin. It exported basic (wool, walnuts) as well as high-value 'exotic' goods: goat beards, horsetails, bristles (pork hair), animal casings, stumps (drawings on special paper), carpets, furs, straw braids, egg albumine, etc., often sold in New York. Despite the constant support from Banque de l'Indochine in Paris (its house banker) and in Tianjin, the complaint was that Olivier also used other banks to finance its exports – for example, the current overdraft advances were shared: 43 per cent for Banque de l'Indochine; 42 per cent for HSBC; and 12 per cent for Banque industrielle de Chine. But it favoured a sound division of risks and Banque de l'Indochine remained the key banker with two-thirds of the 1.5 million taëls borrowed by Olivier through packing credits in 1924–1925.

Olivier remained a key customer of the Banque de l'Indochine's branch throughout the 1930s, with large confirmed and irrevocable credits:

'It is a credit of pure trust which we grant to Olivier, and we are well aware of the danger of such facilities. But, should we operate differently, we would have to renounce this business and leave it to our competitors. Neither the house of Olivier nor the others would accept leaving their goods piled up in customs godowns costing high rates when they own massive commercial assets including vast warehouses.'⁷²

At the same time, banks could not precisely determine the value of its pledge in these warehouses. The Banque de l'Indochine's commitments

72 Ibid., 13 June 1932.

to Olivier reached US\$89,000 in 1933 (US\$48,000 on Europe; US\$41,000 on the US), against US\$109,000 by HSBC and US\$68,000 by City Bank.⁷³

‘Tianjin is mainly an exporting hub and almost all the exported goods need long and delicate manipulations in the exporters’ warehouses, outside any kind of proper monitoring by banks. If we stopped opening overdrafts in trust without actual collateral guarantee, our part would dwindle there. Our clientele is already very small and this situation has a notable effect on our FOREX operations which lack counterparts. In contrast to us, British and American banks are helped in this policy by the large number of houses from their own countries.’⁷⁴

VI. Regaining Decisive Roles for Financing International Trade

Having said that, promoting such forms of economic patriotism could be rather disappointing and vain: in fact, Franco-Chinese trade remained rather modest (see Table 6)! And France’s role in Tianjin remained small (see Table 7).

Whatever the levers of its growth, especially in the silk trade, the prosperity of the commercial banking network built by Banque de l’Indochine in China could no longer depend solely on these activities – it needed to diversify. Franco-Chinese trade could no longer remain the only basis for growth: a second base was built when Banque de l’Indochine entered the trade between China and other countries such as the United States. The first target was international trade itself – whether with French firms which were stakeholders (the priority) or whether with foreign firms as

73 Ibid., 14 August 1933. On 27 January 1937, the shares of the global \$547,000 credit were: 197,000 for the Banque de l’Indochine, 150,000 for HSBC, 125,000 for Banque belge pour l’étranger (the successor of Banque sino-belge), and 75,000 for City Bank. The archives of the house of Olivier completely disappeared when the firm left active history in the 1960s/70s.

74 Ibid., 4 March 1936.

Table 6 – France’s major Asian commercial partners at the start of the twentieth century				
(million francs)				
	Exports in 1900	Imports in 1900	Exports in 1913	Imports in 1913
Indochina	57	37	104	108
China	34	177	48	298
Japan	34	77	32	175
British Indies	32	185	82	466
China’s share of total French trade	0,62%	2,3%	0,6%	0,3%
Total French trade	5,522	5,989	8,091	9,836

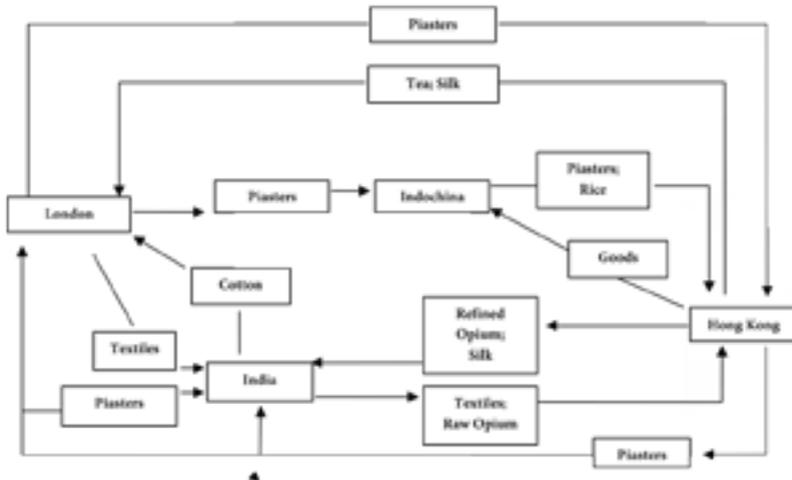
clients. Foreign banks could no longer be allowed to have a free hand, especially the British entities. The monovalent strategy of economic patriotism needed to be replaced by an autonomous economic model as practiced by Banque de l’Indochine: serving the interests of both French firms and its own.⁷⁵ The French bank deployed within multiple business communities and along multiple commercial axes.

Table 7 – Exports from Tianjin in 1936 (million \$)	
Total exports	110
Exports to Japan	24
of which cotton	15
Exports other than Japan	86
Exports to UK & dominions	19
Exports to USA	44
Exports to France	3
Exports to Germany, Belgium, the Netherlands, Italy and Western Europe	20
France’s share of the exports excluding to Japan	3,5%

⁷⁵ H. Bonin, 'Les banquiers français en Chine (1860–1950) : Shanghai et Hong Kong, relais d’un impérialisme bancaire ou plates-formes douanières multiformes?', in: L. Cesari & D. Varaschin (eds.), *Les relations franco-chinoises au vingtième siècle et leurs antécédents* (Arras 2003), p. 157–172.

Participating in Intercontinental FOREX and Payment Flows

The first challenge was managing FOREX and payment transfers. As the London money market was the hub of global compensation, French banks had to use their bases there to control a growing part of the trade between Asia and Europe which often passed via the London money market, the hub of global clearing operations.⁷⁶ Thus, they had to strengthen their presence in London, Hong Kong and Shanghai. In the Far East, French and British banks were both competitors and co-operators as they had to share payment, FOREX and refinancing means via complementary bodies



⁷⁶ See P. Cottrell, 'Connections and new opportunities: London as an international financial centre, 1914–1958', in: Y. Cassis & E. Bussière (eds.), *London and Paris as International Financial Centres in the Twentieth Century* (Oxford 2005), pp. 153–182. H. Bonin, 'The challenged competitiveness of the Paris banking and finance markets, 1914–1958', in: Y. Cassis & E. Bussière (eds.), *London and Paris as International Financial Centres in the Twentieth Century* (Oxford 2005), pp. 183–204. Y. Cassis, *Capitals of Capital. A History of International Financial Centers, 1780–2005* (Cambridge 2006). Y. Cassis, 'Les places de Londres et de Paris au début du xxe siècle. Quelques réflexions comparatives', in: O. Feiertag and I. Lespinet-Moret (eds.), *L'économie faite homme. Hommage à Alain Plessis* (Geneva 2010), pp. 487–501. H. Bonin, *La Société générale en Grande-Bretagne (1871–1996)* (Paris 1996).

and axes of flow which simplified the flow of goods,⁷⁷ commodities and money involving the Banque de l'Indochine's Hong Kong branch.⁷⁸

New Scope for Silk Trading: A Port City on Two International Legs

The resurgence of the silk trade was based on new connections. While European outlets retained their momentum, the US market opened up a whole new dimension for Chinese exports when the US economy began to mature from the start of the twentieth century, with the growth of the luxury industry centred around New York. During the 1923 season, silk exports from Canton to the US attained 47,342 units as against 18,298 to Europe and Lyon.⁷⁹ One of the Banque de l'Indochine's best clients, the General Silk Importing Co. shared its silk exports equally between Lyon and New York in 1928. An approximate balance was reached in the years 1926 and 1928 when 23,239 and 18,005 balls respectively left Canton for the USA, and 20,316 and 17,625 for Europe. Between May 1926 and December 1927, Gérin-Drevard, the biggest French firm there, sold 3,096 balls to Lyon and 5,895 to the US, Arnhold 909 and 4,320, and the entire business, 45,634 and 55,792 respectively.

French banks had to evolve in parallel: as an offshoot of French interests along the Pearl Rivers, they could not but join the growing China-US connections, where the port city was strongly involved, thus changing its scope from Asia-Europe to Asia-US business. But such developments required its insertion into a new 'financial system', with FOREX operations no

⁷⁷ E.W. Edwards, 'The origins of British financial co-operation with France in China, 1906-1961', *English Historical Review*, lxxxvi (1971), pp. 285-317. E.W. Edwards, 'British policy in China, 1913-1914. Rivalry with France in the Yangtze Valley', *Journal of Oriental Studies*, 40 (1977), pp. 20-36. E.W. Edwards, *British Diplomacy and Finance in China, 1855-1914* (Oxford 1987).

⁷⁸ This scheme is inspired from the one presented by M. Meuleau, *Banque de l'Indochine*, p. 159.

⁷⁹ *Ibid.*, 3 December 1923.

	Towards Lyon		Towards USA		Towards Italy
	May 1928– April 1929	May– December 1929	May 1928– April 1929	May– December 1929	May 1928– April 1929
Export of raw silk balls	21,773	15,079	26,927	34,061	
Silk waste products	21,084		21,825		6,817
<i>Source: report from the Banque de L'Indochine's Canton manager for the first and second terms of 1929.</i>					

longer linked to the French franc and the British pound (through the Hong Kong dollar or the Chinese-Mexican silver dollar), but to the US dollar. Far from the stature of Shanghai and Hong Kong, Canton had to diversify its banking modus operandi. Massive FOREX contracts had to be set up, with maturities up to one year or more. Apart from volumes and maturities, the Banque de l'Indochine branch could not act on its own because of its lack of correspondents in New York – and it faced stiff competition from National City Bank, which even managed to lure French houses with better interest conditions.

French transatlantic interests moved rapidly forward in the immediate post-war period and led, in 1919, to the foundation of the French American Banking Corporation, a federated initiative by the two banks which were the most involved in non-European international operations, CNEP and Banque de l'Indochine. This common affiliate became the Banque de l'Indochine's Canton branch's correspondent in 1920 – with a security deposit of US\$500,000 made by Banque de l'Indochine Paris in the name of its Canton offshoot.⁸⁰ Trading houses exporting to the US could now transfer their letters of credit and trading documents (for documentary credit), and rely on that platform to clear the banking operations with their US counterparts. The bills ('silk paper') arrived in New York and were

⁸⁰ The manager of the Banque de l'Indochine's branch to Paris headquarters, 23 April 1920.

paid for in cash or, pending their repayment, were rediscounted locally for a few months (three to four). Acceptance operations complemented the process,⁸¹ with about a final 0.5 per cent profit margin.

In the first half of 1928, the branch purchased commercial paper from the USA worth US\$2,063 million, for French (Madier-Ribet, Gérin-Drevar, etc.), British (Arnhold, T.E. Griffith, Mac Neary, etc.) and Japanese (Mitsui Bussan Kaisha) houses. Operations completed in US\$ by the branch rose significantly: from the first (4,538 million) and second (5,874 million) halves of 1928 to the first half of 1929 (8,529 million): it 'walked on two legs' – Lyon and New York. A precise breakdown of the silk credit activities of the branch for the first half of 1925 shows the Banque de l'Indochine's involvement on both international markets, financing about a fifth of Canton's total silk exports. The evolution of the branch thus epitomised the port city's three-fold dimension, with operations with France, London and New York and the whole range of FOREX and clearing markets in their wake. The branch even commenced purchasing credit papers on London and New York issued in Canton by trading houses, whether they were its customers or not: it wagered on pure FOREX operations, without any direct link to its own clients' operations.

Conclusion: Was the Strategy of Economic Patriotism

Successful? From an Imperial Bank to an International Bank?

The aims of 'economic patriotism' set at the turn of the twentieth century and retained by the French commercial and industrial business communities in Paris and every port-city were not achieved. French industrial and commercial influence was not strong enough to fight against the British, Japanese, American or even German (after World War I) 'economic war machines'. Chinese interest in French products proved limited, with no

81 'Acceptance by an American company of remittances on irrevocable confirmed credit drawn by Gérin Drevar on a few banks of the New York clearing houses', *Ibidem*, 26 January 1931.

decisive relative advantages. In fact, French firms seemed to have targeted other geo-economic regions such as Central Europe, their colonial empire and the United States.

Nevertheless, a part of the objective was well and truly achieved. A succession of large orders for capital goods and arms concretely benefited French industrial exports. More importantly, a 'French system' took shape in South West China which helped take advantage of the silk trade. The most decisive aspect was the insertion of French banks – mainly Banque de l'Indochine, but also its partners and correspondents in France and London and, for the CNEP, in the United States – in the internationalised Chinese commercial system. By flexing its Asian arm, Banque de l'Indochine and the Parisian market succeeded in nibbling some market share at the heart of payment, FOREX and finance flows between China and Europe on one hand and between China and the United States on the other.

Such a process led to a re-balancing of the Banque de l'Indochine's activities. It was an 'imperial bank' at the heart of the colonial system in Indochina, and an internationalised bank, acting within the core exchanges of China with Europe and North-America. It contributed significantly in changing its strategic nature and business model and considerably broadening its portfolio of globalised skills. Through the diversification of its geographical basis in Asia and particularly in China, and thanks to the enrichment of its 'tools box' and its portfolio of skills, the bank decidedly and positively met to the expectations of the state, the experts of Asian economics and the chambers of commerce, as well as the business communities involved in overseas trade.

It has therefore seized on one of the banners of French economic patriotism in a few important port-cities in China – even if the results might seem tiny in terms of the overall economic competitiveness of the French economy and its balance of exchanges. And the strict definition of 'economic patriotism' had to be broadened: in parallel with the bilateral exchanges of trade and bills between France (and Indochina)

and China, the bank helpfully fostered the very 'internationalisation' of French banking, trade and economy, on an Asian-European level and more and more too on an Asian-American level. Moreover, its co-affiliate, French-American Banking Corporation, was a beacon of such an involvement in trans-Pacific exchanges. More than the competitiveness of the mainland platform, what was at stake, in fact, was the competitiveness of French firms and banks on a globalised field, which could not but entice arguments about the meaning of economic patriotism for a country involved in an 'open economy'.

MAKING MONEY: COTTON, SLAVERY AND FINANCE ACROSS THE ATLANTIC 1815–1837

KATHRYN BOODRY

Abstract

In the nineteenth century cotton was the primary export item produced by the United States for a global market. As early as 1815 the United States was the largest producer and Great Britain the largest consumer of cotton.¹ The commodity proved deeply important to economic development and industrialisation in both countries. Given the importance of cotton to both Britain and the United States the vital role of slave labour in the production and sale of this crop is noteworthy for its contribution to self-sustaining economic growth across the Atlantic world. The role played by slavery in sustained economic development seems worthy of our consideration. Additionally, and especially in terms of this conference, the role played by British credit in allowing this system to function is equally important. An exploration of cotton bridges the worlds of finance, and slavery and makes clear how one facilitated the expansion of the other across the nineteenth-century Atlantic. The Atlantic market in cotton is testament to the vital role played by an Atlantic hinterland in European, and specifically British self-sustaining economic growth.² This system of production required land, labour and, just as critically, capital.

Agricultural, commercial and industrial expansion was facilitated by the proliferation of banks capitalised with money flowing from London and

¹ See D.C. North, *The Economic Growth of the United States 1790–1860* (New York 1966), p. 10.

² See K. Pomeranz, *The Great Divergence: China, Europe and The Making Of The Modern Economy* (Princeton 2001).

New York into the South. In the North, canal building and the rise of New York as the preeminent American port stimulated commercial activity and established it as a vital economic and financial hub.³ Much of this commercial activity in the city revolved around cotton, which assumed an increasingly important position as the most profitable export article for the young nation, and as a raw material that fueled the textile mills of Lancashire.⁴ As Friedrich Engels noted, ‘England and the United States are bound together by a single thread of cotton, which, weak and fragile as it may appear, is, nevertheless, stronger than an iron cable.’⁵ But this common thread was not only woven from a raw fibre but also from increasingly sophisticated ways of providing credit. The provision of capital, through advances, consignments and the proliferation of banks across the southern United States cleared the way for mills to be constructed, mules to spin, ships to alight from busy ports and for planters to purchase the slaves, land and goods that allowed them to focus exclusively on the harvesting of agricultural commodities for commercial sale. In short, the economic world that cotton made was one reliant on credit. The pivotal role of finance is one that has too often been elided in the creation of the cotton kingdom.

Slavery and finance, for some reason, are rarely discussed in conjunction with one another, even when we make allowances on occasion for wide-ranging discussions that might bring together things like labour and capital. Yet slaves played a vital role in the shaping of this larger financial world: they planted and harvested the labour-intensive crops that were

3 On the development of New York as the premier commercial port and financial centre of the United States in the nineteenth century see R.G. Albion, *The Rise of New York Port, 1815–1860* (Hamden 1961).

4 On the vital role played by the fibre in Lancashire see D. Farnie, ‘The Fibre That Changed the World: The Cotton Industry in International Perspective 1600–1990’, in: M. Rose (ed.), *The Lancashire Cotton Industry: A History Since 1700*, (Preston 1996). On the pivotal importance of cotton to American economic development see D.C. North, *The Economic Growth of the United States 1790–1860* (New York 1966).

5 Quoted in B. Schoen, *The Fragile Fabric of Union: Cotton, Federal Politics and the Global Origins of the Civil War* (Baltimore 2009), p. 225.

eagerly purchased in European markets. In essence, they produced the commodities upon which the entire system was based. With advances like the development of Cartwright's water loom in 1785, more efficient carding machinery and eventually Eli Whitney's cotton gin in 1793, cotton became increasingly important to both the United States and Britain.⁶ The cotton gin allowed short-staple cotton to be produced more efficiently. Since short-staple cotton could grow in areas where Sea Island cotton did not fare well this allowed for an increase in acreage planted, and correspondingly, of slavery in the American south.⁷ This cotton, planted and picked by slaves, in turn contributed to the development of credit and finance across the nineteenth-century Atlantic world linking slavery and finance together with one supporting the other. This nascent financial world was deeply dependent upon their labour. By the same token, the maintenance of the institution of slavery was contingent upon the streams of credit provided by banks in London and merchants in Manchester. These funds allowed plantation owners to pay their operating costs over the course of a year and to purchase necessary equipment supplies, slaves and land. Thus, although US slavery became increasingly regional in the nineteenth century, the fruits of slave labour were savoured nationally, and indeed, internationally.

In everything from the purchasing of slaves and supplies to run the plantations to the sending of harvested crops to market plantation agriculture was dependent on both coerced labour and frequent infusions of money to keep things running smoothly. What happened on plantations in Georgia, Louisiana, Alabama and Mississippi contributed directly to economic development and growth in places like New York, Massachusetts

6 See A. Lakwete, *Inventing The Cotton Gin: Machine and Myth in Antebellum America* (Baltimore 2005).

7 Rothman points out, additionally, how the Louisiana Purchase contributed to this expansion, even though Jefferson had felt that this increase in land would lead to a gradual fading away of the institution as more independent farmers settled in the region. See also Thomas Jefferson, 'Notes On The State of Virginia', in: M. Peterson (ed), *Thomas Jefferson: Writings* (New York 1984).

and Rhode Island. Southern planters, and Americans generally, did not have access to large amounts of cash, or capital, in the first half of the nineteenth century.⁸ Correspondingly, planters in the South simply were not interested in ploughing funds into manufacturing or the development of infrastructure in spite of anger and resentment at what was widely perceived as exploitation by the North. The majority of planters spent money on slaves and land. This behaviour was noted at the time: ‘to sell cotton in order to buy negroes – to make more cotton to buy more negroes ‘ad infinitum,’ is the aim and direct tendency of all the operations of the thorough going cotton planter; his soul is wrapped up in the pursuit.’⁹ The planter would spend profits, potential profits and future profits in this relentless quest for more slaves, and more land, to grow more cotton.¹⁰ Often this did result in increased profits but even in off years this enhanced a planter’s social status, at least in the southern United States.

In the period from 1815–37 British merchant banks found productive deployment of capital in the Americas and all were eager to increase investments in American markets, and specifically, in the cotton trade. This in turn influenced their development, growth and the evolution of business practices across the Atlantic as Anglo-American finance became increasingly integrated. In my paper, I will examine the development of this nascent Anglo-American financial world, demonstrating how it supported the plantation system in the United States while simultaneously contributing to the development of an increasingly sophisticated Atlantic financial system and the growth of British banks. In this era, from 1815–37 these firms metaphorically ‘made money’ through consignments on cotton, the expansion of banks and banking through the American South

8 See Clarke, *The Roots of Rural Capitalism*.

9 J.H. Ingraham, *The Southwest By A Yankee*, (New York, 1835), p. 91.

10 See H.D. Woodman, *King Cotton and His Retainers: Financing and Marketing the Cotton Crop of the South, 1800–1925* (Columbia 1990), pp. 131–8. For a more critical consideration of planter fantasies and the relentless motivations to buy slaves with a focus on the market itself see W. Johnson, *Soul by Soul: Life in an Antebellum Slave Market* (Cambridge 2001).

and the increase in the circulation of discount paper. Their involvement with cotton effectively increased the money supply and easy money fed increased speculation, in turn encouraging all parties towards increasingly leveraged positions. The result of all this money coursing through the American economy was the creation of periods of exuberance and mania followed by panic, resulting eventually in the panic of 1837, one of the largest in American history. The investment of these British and Anglo-American houses in the early American Republic transformed the United States and British economies as well as the financial practices across the Atlantic world. Many elements of the trade in cotton carried over from earlier colonial trade in tobacco and indigo, both of which held market share before cotton became a viable American crop at the beginning of the nineteenth century.

In the eighteenth century the majority of cotton planted was short-staple cotton, a temperamental crop grown primarily in the Sea Islands of South Carolina. Long-staple cotton, a heartier crop, could grow in a wider region but the tightness of the boll and concentration of the seeds meant that, previous to the invention of the cotton gin, this type of cotton was not really cost-effective to harvest. Thus, cotton production was effectively limited to a very narrow region of the United States. The transformation of the American landscape, and economy, through cotton production occurred through a series of unrelated events that coalesced to create the cotton kingdom. Technological advances in the production of cotton, the opening of the Deep South through the Louisiana Purchase and the development of a domestic slave trade resulted in a dramatic shift away from Jefferson's vision of an agrarian republic where slavery faded away. Instead, the Louisiana Purchase resulted in a second life for the peculiar institution and the development of a domestic slave trade that moved slaves out of Virginia and the Chesapeake and into the Deep South.¹¹ With advances like the development of Cartwright's water loom in 1785,

11 W. Johnson, *Soul By Soul*.

more efficient carding machinery and eventually Eli Whitney's cotton gin in 1793, cotton became increasingly important to both the United States and Britain.¹² The cotton gin allowed short-staple cotton to be produced more efficiently. Since short-staple cotton could grow in areas where Sea Island or long-staple cotton did not fare well, this allowed for an increase in acreage planted with cotton and the insatiably hungry mills were seemingly capable of keeping up with every increase in American production.¹³ This cotton, planted and picked by slaves, in turn contributed to the development of credit and finance across the nineteenth-century Atlantic world, linking slavery and finance together with one supporting the other. This nascent financial world was deeply dependent upon their labour. By the same token, the maintenance of the institution of slavery was contingent upon the streams of credit provided by banks in London and merchants in Manchester and Liverpool. These funds allowed plantation owners to pay their operating costs over the course of a year and to purchase necessary equipment, supplies, slaves and land.

In the 1790s a decline in the price of cotton, tobacco and indigo, and crop infestations in turn made both articles more problematic and less profitable to cultivate. At the same time cotton reached 25 cents per pound in 1791 and rose as high as 44 cents per pound in 1798.¹⁴ Clearly, even at this early date the conditions for a cotton boom were favourable, leading one Louisiana planter to remark in 1799 'we are all in cotton now'.¹⁵ By 1803, at the time of the Louisiana Purchase, intimations of a future radically different from Jefferson's vision of an agrarian republic were present. Cotton was already viewed as a lucrative crop and in conjunction

12 Lakwete, *Inventing the Cotton Gin*.

13 Rothman, *Slave Country*. Rothman points out, additionally, how the Louisiana Purchase contributed to this expansion, even though Jefferson had felt that this increase in land would lead to a gradual fading away of the institution as more independent farmers settled in the region. See also: Jefferson, 'Notes On The State of Virginia'.

14 Rothman, *Slave Country*, p. 47.

15 Quoted in Rothman, *Slave Country*, p. 48.

with all the newly discovered technological innovations planters saw additional appeal. These planters had land and labour that could be deployed at will and the right kind of soil to deal in the article. The Manchester mills had become partial to a particular variety of upland cotton that happened to grow fantastically well in the Deep South, making this land incredibly valuable indeed. In 1803, the United States produced 45 per cent of the cotton consumed in British markets and this market share continued to expand throughout the antebellum period. These changes encouraged and facilitated both the expansion of plantation slavery and finance in the United States. The growth of cotton as an item produced commercially for sale in an international marketplace resulted in a marked increase in the demand for credit and bills of exchange. The Jeffersonian vision of a nation of farmers producing a surplus for sale in distant markets but not farming commercially gave way to the establishment of large plantations growing crops, primarily cotton, for sale in an international market and facilitated by a radical expansion of the money supply through the provision of various types of credit. Although the influx of capital was large, and very welcome in the South, it did militate against regional development and the growth of domestic industries in much of the plantation South.

Trade in cotton in the early nineteenth century accelerated rapidly from the proverbial ten bags arriving in Liverpool in 1803 that were met with disbelief by a customs agent suspicious that the United States could produce the crop. A few early merchant-manufacturers traded in cotton along with making purchases for their own mills, supplying other spinners further inland, in the Manchester region and Scotland.¹⁶ As trade in cotton grew, more agents were attracted to transactions in the article and business was increasingly conducted through agents located in Liverpool, New York and the southern port cities of New Orleans, Natchez, Augusta and Savannah.

¹⁶ The firm of McConnel and Kennedy had extensive involvement in the trade in cotton, especially Sea Island cotton in the early nineteenth century and made numerous purchases for shipment to Glasgow and Paisley. See the papers of McConnel & Kennedy and McConnel & Co., 1715–1888, John Rylands University Library, Manchester, GB133 MCK.

The war of 1812 disrupted the trade and left the United States adrift financially. The Bank of the United States was not re-chartered during the conflict and the country resorted to direct taxation and attempts to raise funds through bond issues with little success. At the close of the conflict the Browns returned to the trade in cotton and, more pivotally, the offering of consignments with renewed zeal. The chartering of the second bank in 1816 brought greater stability with the bank sometimes assuming some of the functions of a central bank. With the backing of a line of credit from Baring Brothers, the bank did direct capital flows and with an open line of credit to draw on, injected liquidity into American markets. Occasionally this liquidity was aimed squarely into cotton to shore up prices, much to the chagrin of European financiers who viewed this as an overstepping of boundaries by Biddle.

More vitally, with the return to peace the taps of easy capital flowed once again, leading to an era of immense financial expansion with exuberance and euphoria giving way to manic investing through 1826. British merchant bankers had abundant motivation to expand their operations in American markets in the 1820s: between 1820 and 1830 over a third of American exports went to Britain, and more than 40 per cent of American imports were British. A remarkable 80 per cent of the cotton in Lancashire came from the southern United States.¹⁷ Further, because of a marked expansion in trade across the Americas, a relative dearth of investment opportunities in England and the use of British sterling as a global currency, British capital became an export item in the 1820s. London had become 'the money meter of the world'. Houses that failed to invest in the Americas stagnated.¹⁸ To wit, for the house of Baring this was a period of negligible growth. They were still regarded as a stable, prosperous and

17 L.H. Jenks, *The Migration of British Capital to 1875* (New York/London 1927).

18 Kindleberger, *A Financial History of Western Europe* (Oxford 1993), p. 216. On Barings in the 1820s see R.W. Hidy, *The House of Baring in American Trade and Finance: English Merchant Bankers at Work, 1763–1861* (Cambridge 1949) and Austin, *Baring Brothers and the Birth of Modern Finance* (London 2007).

well-capitalised firm, but comparatively speaking they had lost ground. They returned to United States markets with renewed energy in the late 1820s, appointing Thomas Wren Ward their American agent in 1828. Yet in 1830, still seeking a foothold, the firm was losing ground to its main competitors. The combined resources of the five Rothschild houses amounted to ten times the capitalisation of the once preeminent British financial house. Barings held a relatively modest £492,803, (\$2,500,000 in American dollars) to the Rothschilds' excess of £4,330,433.¹⁹ The combined capital of the Brown houses in Baltimore, New York, Philadelphia, and Liverpool stood at \$3,230,000.²⁰

As more cotton was planted and sold, speculation in the article increased as well, with frenzied buying from 1824–26 driving the commodity to excessive heights and resulting in a corresponding crash in price later in 1826. Prices fell by a third in the autumn of 1826 and many Liverpool houses involved in the American trade suspended payments, including Peter Pole and Company, one of the larger Liverpool cotton houses. Five London houses were pulled down in their wake. The frenzied monetary expansion of the early 1820s was over. This crash, unlike the panic of 1837, had far greater effects in England than the United States, and resulted in a bullion drain and a 20 per cent drop in specie. A fortunate discovery of crates of overlooked notes at the Bank of England eased pressures in the British economy when the bank did not take decisive action to stabilise firms domestically, yet the damage was done. With this panic, many English merchant-manufacturers, who had previously been active in cotton operations, pulled out of American markets, leaving the field open for larger merchant bankers eager to invest their capital in ventures that offered more potential for profit than was available in England or Europe.

19 See N. Ferguson, *The House of Rothschild*, 1st American edn. (New York 1998), p. 164. On the capitalisation of the house of Baring see Hidy, *The House of Baring and Austin; Baring Brothers*, p. 28.

20 See E.J. Perkins, *Financing Anglo-American Trade: The House of Brown, 1800–1860* (Cambridge 1975), p. 19.

Given the conditions in Europe many Anglo-American houses were eager to invest in the United States, especially in cotton, in spite of the risks.

Many merchant bankers invested heavily in regional banks. Aside from providing an open line of credit to the Bank of the United States, Barings had extensive involvement with the plantation banks established in New Orleans. Rothschild had a large interest in the New Orleans canal bank. The Browns, however, pursued a different path and eventually other banks followed their lead. After the war of 1812 they focused increasingly on the consignment of cotton shipments to Liverpool. In due course, other houses followed suit, but the Browns set the pace and established business precedents. They also seemed to see earlier the most profitable directions in which to venture, often arriving first to tie up the majority of business for themselves. On occasion they did ship cotton on joint account with southern merchants and purchased cotton on their own account. This usually happened when they desired to give their ships some weight if they came up light. The firm realised early that consignments and a focus on the provision of credit and financial services allowed them to profit from the cotton trade, while radically reducing the risk of loss. Since the Browns never actually owned consigned cotton, price fluctuations were less of a concern. Likewise, they developed a system of consigning cotton that became the standard: they retained the bill of lading on all shipments of consigned cotton until it was sold and they were paid. By 1820 the house was the second largest recipient of cotton consignments in Liverpool.²¹

In conjunction with increased attention to consignments the Browns moved heavily in the 1820s towards the issuing of letters of credit. In this business they did very well, in no small measure because by 1826 their acceptances were passing 'in Manchester as cash with as much freedom as [...] any other banker in the place which cannot be said of

²¹ See Perkins, *Financing Anglo-American Trade*, p. 24.

any other Liverpool house.²² Their involvement in the extension of credit to merchants on both sides of the Atlantic continued to increase and they became thoroughly involved in these transactions as well as in the issuing and acceptance of bills of exchange. Other houses followed in due course, and these various credit mechanisms contributed to an effective expansion of the money supply coursing through this Atlantic system, which fuelled speculation in cotton, banks and other investments in the United States. Since the United States lacked an effective central bank to check much of the speculative activity, private merchant banks had much more influence in the financial affairs of the early Republic. In these markets the Browns' activity appears more speculative but, as Perkins notes, they obviously felt very much in control of the flows in the market, especially after the demise of the second Bank of the United States. They effectively managed these markets in much the same way a central bank might have but for their own ends, sending money through various regions of the United States in conjunction with the seasonal needs for capital in the North, South and western United States.²³

Generally, advances on cotton ranged between two-thirds to three-quarters of the value of the crop on the local market. An advance of 75 or 80 per cent would be risky even when cotton was priced lower.²⁴ To consider offering an advance over that amount with prices already running inordinately high would be foolish, yet planters found creditors willing to indulge them again and again. William Bowen, the Browns' trusted agent

22 New York Historical Society (NYHS) Brown Bros & Co. NY to Benjamin Story, New Orleans, 5 Apr. 1826.

23 See Killick, "The Operations of Alexander Brown and Sons in the Deep South."

24 On advances on cotton see Perkins, *Financing Anglo-American Trade*, pp. 94–6. Also Woodman, *King Cotton and His Retainers*, pp. 34–5. Simply put, an advance on cotton meant that the firm to which the article was consigned would provide the consignor with a portion of the anticipated sale price in advance. The consignor, whether he was a planter, factor, merchant, or broker did not have to wait until sale for money – partial payment was made immediately. Upon the eventual sale of the article fees and commissions would be deducted before the final remittance on sold goods was made to the consignor. In addition, factors often carried costs and made advances to planters on crops still in the fields, a more informal type of credit that allowed plantations to bring crops to harvest. See Woodman, *King Cotton and His Retainers*, p. 35.

in the South, reflected later in a letter to Joseph Shipley, a partner in the Liverpool house: 'it seems as if the cotton trade was never to be governed by the same commonsense rules that prevail in other commercial transactions, there seems to be a charm in the great southern staple that leads people out of their sober senses.'²⁵ Throughout the early 1830s the price of cotton increased steadily as the United States economy expanded. From 1834 to 1836 the price of cotton rocketed skyward, bolstered in part by access to easier credit in the southern United States. By 1835 there were close to 700 banks operating in the American South, and over the course of the decade another 200 would open their doors for business with a total capital that exceeded \$358 million.²⁶ Large advances on crops became common and the price of cotton rose in markets in New York and Liverpool. As cotton continued to rise in price and became more widely available banking practices, most notably credit mechanisms, were increasingly developed in accordance with the dictates of the commercial production and marketing of the commodity. Cotton not only served as security for advances; when specie was scarce it also served as a reserve for the issue of notes, and as collateral for the issuing of stock by property or plantation banks.²⁷ However they were ultimately financed, whether privately or capitalised by states, property banks sold bonds to planters, who paid for their stock with mortgages on their estates for up to two-thirds of their market value. The banks, or in some cases, states, then issued bonds backed by this mortgage pool and typically sold them for working capital in the money markets of the northeast, or in London.²⁸ Subscribing planters could then borrow from the fund thus created, pledging their

25 NYHS Brown Brothers Harriman Records, MS 78 William Bowen, letter to Joseph Shipley, 25 Nov. 1845.

26 Schweikart, *Banking In The American South*, pp. 48–49.

27 Cf. Neu, 'J.B. Moussier and the Property Banks of Louisiana'; Hidy, 'The Union Bank of Louisiana Loan, 1832'; and Schweikart, *Banking In The American South*.

28 It is worth noting that Barings offered the bonds issued by the Union Bank of Louisiana on the markets in London and in cooperation with Hope & Co. on markets in Amsterdam.

crops as security.²⁹ So long as commodity prices held reasonably steady – and this was the key – the land bank system in the South provided capital and credit to a region chronically short of both. Cotton planters needed it and the banks provided one way they could convert cotton into cash, often employing British and northern capital to do so.

This type of reckless speculation characterised the business throughout the antebellum period. Investment in cotton, and American operations generally, was widely understood to be risky. As N.M. Rothschild & Sons noted in a letter to Alphonse de Rothschild, the son of James, the head of the Paris house, during his American travels:

‘you will find while living among the Americans, that they are too fast in many more ways than with their horses. We have noticed [...] that upon getting our orders + credits in America they had a notion they were ‘great guns’ + that they could not do things on too large a scale or draw too largely on our capital.’³⁰

Quite frequently, advances were made on cotton for the convenience of the planter or agent and to provide an incentive to use the services of a particular firm. The lack of sense in both their granting and acceptance had pronounced repercussions. In the 1830s demand for cotton was often high and firms were more forthcoming to secure business. Agents and factors frequently offered advances backed by larger merchant-banking houses. The amount of the advance was important; too large an advance often meant a ‘reclamation’ on the shipper when the advance was secured with cotton. In cases where advances had not been secured or plain and simply had been beyond the planter’s capacity to meet the debt, firms had to suspend payment. S.L. Josephs & Sons, the New York agent of the Rothschilds until 1837, are but one example. They became over-involved

29 Cf. Schweikart, *Banking In The American South*; Neu, ‘J.B. Moussier and the Property Banks of Louisiana’; Hidy, ‘The Union Bank of Louisiana Loan, 1832’; Jenks, *British Capital*; Austin, *Baring Brothers*, pp. 32–6 and Kilbourne, *Slavery Agriculture and Financial Markets*.

30 *The Rothschild Archive*, London (RAL) 58/1/224, letter from N.M. Rothschild & Sons to Alphonse de Rothschild, 27 Dec. 1848.

in mortgages on real property in the South and were compelled to suspend payment in March 1837. As they explained the situation to the Rothschild London house, they were taken down by the fall of associates in the South:

‘The unexpected suspension of Mssrs Hermann Briggs + Co. of New Orleans carrying with them Mssrs. Tho. Barrett + Co. and Mssrs Saint Germann + Co. [...] for all of whom we are under acceptances to an amount exceeding two millions of dollars in the aggregate making it impossible for us to continue our own payments. [...] This unfortunate occurrence has, as you may imagine, given a severe blow to our credit + we shall no doubt experience for some time considerable difficulty[...].’³¹

Invariably firms did what they could to avoid a loss, but at times prudence seemed to take a back seat to greed. Often, when planters were unable to pay, the end result was a loss of slaves or the entire plantation for the planter and a highly resented lock-up of funds for the imprudent creditor.

In January 1837 the price of cotton began to decline, right at the height of the season. The timing of the fall in prices was particularly troubling given that the tumble commenced as cotton was coming to market, consignments and advances often already made. From January to May the price of cotton declined by 18.5 per cent in New Orleans. By April, cotton prices were 30 per cent lower than a year previously, a catastrophic decline following a boom period from 1832 to 1837, where cotton prices had consistently risen between January and April. Shippers from New Orleans lost 18 per cent on cargoes to New York and 15 per cent on those destined for Liverpool. For many firms involved in the speculative frenzy, already over-extended from bloated advances, the losses were unsustainable.³² Financial houses, agents and factors began to fall like dominoes as all actors began calling in debts, creating a shortage of money.

31 RAL XI/38/159B, letter from Mssrs Josephs to N. M. Rothschild & Sons, 19 Mar. 1837.

32 For cotton prices see S. W. Bruchey, (ed), *Cotton and the Growth of The American Economy, 1790-1860*; Sources and Readings, *The Forces in American Economic Growth Series* (New York 1967), Table 3-P.

According to Charles Kindleberger and, by extension, Hyman Minsky, bubbles have a general form; they are not unique or necessarily historically specific and have common characteristics. Bubbles generally form in reaction to some type of displacement or shock. This can be a political event, bumper harvest, financial success, or an unanticipated change in monetary policies. I would also suggest that the surprising surge of employable cash into a system, very much like what occurred in the United States from 1826 forward as British investors sought to effectively employ their capital, is an apt example. This displacement creates a boom, with investment and productivity increasing. The boom is fed with an expansion of credit that enlarges the total money supply, whether in the form of bank notes or credit mechanisms. In the southern United States banks opened and were capitalised with European funds, cotton and, occasionally, slaves. At this point, numerous European firms were eager to enter the cotton trade either by granting credits, negotiating exchange or buying cotton outright. The eagerness of Anglo-American firms to employ their capital profitably, in conjunction with the opening of numerous southern banks, resulted in a large influx of capital into the American South. It is indicative of the sheer volume of money passing through the South that two of the most active branches of the Bank of the United States were located respectively in New Orleans and Natchez, Louisiana before 1837.³³ The end result was that money flowed and credit was widely available. Kindleberger specifically notes that money supply can be increased through an expansion of the existing system of banks, the development of new credit instruments

33 Hidy, *The House of Baring*, p. 180.

and the increase in availability of personal credit outside of banks. In the cotton belt, all three occurred and drove the inflation of cotton prices.³⁴

By 1835, some actors in American markets, notably Thomas Ward Wren and Joshua Bates, the American agent for Barings and a partner in the London house respectively, had noted the formation of what we would call a bubble and anticipated a decline in cotton prices. Ward in particular spotted trouble and in a letter to Joshua Bates voiced agreement with his dour assessment of American markets. 'If your views of cotton are correct, business must be lessened considerably. [...] we are now on top of a wave. It requires care in descending.'³⁵ Ward also noted that the competition was fierce and that this created chaos in the markets because '[...] there is very little calculation to be made on what others are willing to do.'³⁶ The frantic activity and abundance of easy credit in southern markets contributed to rising cotton prices, along with advances. Like Barings, the Browns stepped back quickly. Although both firms missed claiming a share of the profits in 1836, they also avoided the catastrophic losses of the following year. Alexander Brown & Sons held their ground going into the 1836–7 season stating, 'as regards cotton we have made up our minds to do nothing in it this season except to put a few hundred bales in our ships to give them a start in freight.'³⁷ They further made clear they were not willing to advance over three-quarters or four-fifths of the present value of cotton, in spite of higher advances offered elsewhere. Yet money

34 Cf. Kilbourne, *Slavery Agriculture and Financial Markets*; Schweikart, *Banking In The American South*; Perkins, *Financing Anglo-American Trade*, and Austin, *Baring Brothers and the Birth of Modern Finance* on the expansion of banks and development of financial instruments like cotton as currency, discount paper, bills etc. On credit supplied outside the banking system see Kilbourne, *Slavery Agriculture and Financial Markets*, and E. David, 'In Pursuit of Their Livelihood: Credit and Debt Relations Among Natchez Planters in the 1820s', in: S. Delfino, M. Gillespie, L.M. Kyriakouides (eds.), *Southern Society and its Transformations, 1790–1860* (Columbia 2011), pp. 217–249.

35 *National Archives of Canada*, Baring Papers, Thomas Wren Ward, letter to Joshua Bates, 10 Oct. 1835.

36 *Ibid.*

37 Cited in Perkins, *Financing Anglo-American Trade*, p. 99. See also Bruchey (ed.), *Cotton and The Growth of The American Economy*.

continued to course through the American markets, and because of the amount of credit already extended and sundry bills moving through the system, the money supply effectively expanded.

The expansion of money fuels euphoria and the manic purchasing of certain articles, like tech stocks and real estate at the dawn of the twenty-first century, and cotton in the 1830s. As firms and individual actors see others making money from purchases and sales they also enter the market. Eventually, the allure of easy money pulls in even those who would normally have no such involvement, and a market that might still have been governed by some modicum of rationality becomes manic. As more people are pulled into the frenzy a larger and larger group seeks to profit without understanding the mechanisms of the market in the article, or the fundamentals of exchange. Obviously this generates chaos, as individuals follow the herd and begin to act en masse. As the speculative boom grows, interest rates, the velocity of circulation and prices continue to rise and eventually the smart money moves out as insiders cash in and take their profits. At the height of the market, this appears as hesitation. Hot money moves on while newcomers buy in. This leads to an uneasy period of financial distress as some firms and actors begin to contemplate the possibility that they may fail to meet their obligations. For many actors in the financial world of early 1837 the dawning realisation that people were moving away from cotton with prices beginning to fall resulted in the dumping of cotton and discount paper quickly in an attempt to get hold of cash. This race to get out became a stampede and firms failed on both sides of the Atlantic as everyone called in debts in vain attempts to meet their own liabilities.³⁸

In 1837, this led to the fall of virtually all the key players in the southern cotton market and the suspension of quite a few larger New York firms.

38 C. Kindleberger, *Manias, Panics and Crashes: A History of Financial Crises*, Fifth Edition (Hoboken 2005), pp. 38–90. See also, C. Kindleberger, *A Financial History of Western Europe* (London 2006), pp. 264–280.

Prices fell and suspensions were widespread as it became clear there was simply not enough cash to cover all the debt. Minsky called this a state of revulsion as this creates a panic, which feeds on itself. In the end, most panics that have had any type of successful resolution have found some form of cash to ease the liquidation of assets before the bottom falls out. In 1837, the Bank of England intervened with an emergency loan to the Browns which saved the firm and quelled the panic on one side of the Atlantic. But on American shores the picture was a different one, with no central bank or effective lender of last resort on hand to tame the markets and ease distress.³⁹

The panic of 1837 proved to be one of the worst financial panics in American history and resulted in large-scale alterations to the American financial landscape. After the panic the Browns moved decisively out of cotton and focused on packet shipping and discount paper. In fact, they monopolised this business in the American South. They found a way to make money on cotton while avoiding any direct involvement with the article. Baring Brothers and Rothschild stepped into the wake, with Barings eventually buying up a substantial share of cotton outright to ship to their Liverpool branch and Rothschild purchasing fair amounts through 1848. For many Anglo-American firms, their operations in cotton gave them knowledge of markets, connections and capital that provided the base for their further development and expansion. Barings left the trade in the 1840s and specialised in the marketing of American loans on European markets; their experience in cotton and property banks allowed them to determine the relative strength of financial institutions throughout the country. The Rothschilds moved into gold shipped from California. Each firm chose a different area of specialisation. This was determined by the presence of other firms in the market, the unique expertise they gained

³⁹ On the loan to the Browns and the negotiations by Shipley with the Bank of England see Brown, *100 Years of Merchant Banking, and Perkins, Financing Anglo-American Trade*.

in their American operations and in what cities they had placed agents or opened offices.

Many merchant-banking houses in this era became entangled in cotton's various threads. For the most part, these ensnarements proved profitable, although occasionally disconcerting given that involvement with cotton entailed involvement with slavery as well. Although the contradictions and conflicts that came of this blending of disparate systems would not be made explicit until much later, trade in cotton often meant not only financial exposure but an uncomfortable association with an institution which many of these firms found troubling. N.M. Rothschild provided the funds necessary to carry forward the Abolition Act of 1833, and both the Paris and London houses refused reimbursement in land and slaves in later years. Likewise, Barings also steadfastly refused compensation on bad debts with land and slaves.⁴⁰ The Browns voiced anti-slavery sentiments yet found themselves the reluctant owners of operating plantations in the American South, acquired when consignments went sour.⁴¹ Nevertheless, all of these firms actively traded in commodities produced with slave labour. The fact of the matter is that in the nineteenth century, involvement in the American trade, whether in goods produced for commercial sale, or in financial instruments like bonds, meant involvement in some fashion with slave labour.

It is important that we acknowledge the pivotal role played by slavery in the development of both the American economy as well as that of a larger Atlantic world. As one historian has noted, 'freedom, capitalism, and democracy appear as synergistic forces flowing from the inherent logic of the American Revolution. Capitalism in the early Republic is so strongly associated with democracy and freedom that its relationship to unfree

40 See Austin, *Baring Brothers*.

41 J.R. Killick, 'The Cotton Operations of Alexander Brown and Sons in the Deep South, 1820–1860', in: *The Journal of Southern History*, Vol. 43, No. 2 (May 1977), p. 187. The records for these plantations were carried by the New Orleans office and are now on file at the Library of Congress.

labour stands unexplored, unmentioned, and ultimately unfathomed.⁴² This presumptive equation of capitalism with democracy and freedom has obscured our ability to understand the reality of antebellum America as well as the early American Republic. We distort American history, Atlantic history and the history of capitalism by not looking directly at these relationships and their ramifications. Cotton would never, ever, have become king with free labour or ready cash. Whether ‘the economic history of the United States simply makes no sense without slavery and coerced labour as central components’ is debatable, but we have an obligation to grapple with the issue and endeavor to understand more fully all the elements and people that contributed to the growth of the American, as well as the global, economic system.⁴³

Coerced labour and the sale of people as chattels has played a profound role in the economic development of the United States as well as Europe.⁴⁴ This earlier trade in people facilitated the development of financial instruments that in turn eased the completion of these transactions; transactions that, not coincidentally, were also reliant on forms of credit.⁴⁵ Arguments

42 S. Rockman, ‘The Unfree Origins of American Capitalism’, in: Cathy Matson (ed.), *The Economy of Early America: Historical Perspectives and New Directions* (Pennsylvania 2006), p. 316.

43 Rockman, *Unfree Origins of American Capitalism*, p. 319.

44 See E. Williams, *Capitalism and Slavery* (Chapel Hill 1994). Scholars who have examined the profitability of slavery to Britain include S. Engerman, ‘The Slave Trade: A Comment on the Williams Thesis’, *Business History Review*, 46, 4 (1974); J.E. Inikori, *Slavery and the Rise of Capitalism, Elsa Goveia Memorial Lecture*; 1993 (Mona 1993); J.E. Inikori, *Africans and the Industrial Revolution in England: A Study in International Trade and Economic Development*, (Cambridge 2002); J. E. Inikori and S. L. Engerman, *The Atlantic Slave Trade: Effects on Economies, Societies, and Peoples in Africa, the Americas, and Europe* (Durham 1992); J.C. Miller, *Way of Death: Merchant Capitalism and the Angolan Slave Trade, 1730–1830*, (Madison, 1988). Work that has examined, and contested, the decline in the profitability of slavery include R. Anstey, *The Atlantic Slave Trade and British Abolition, 1760–1810*, (Humanities Press 1975); Howard Temperley, ‘Capitalism, Slavery and Ideology’, in *Past & Present: A Journal of History Studies*, 75, (1977), pp. 94–118; R. Fogel and S. Engerman, *Time on the Cross: The Economics of American Negro Slavery* (Boston 1974); J. Inikori and S. Engerman, ‘Gainers and Losers in the Atlantic Slave Trade’, in: Inikori and Engerman (eds.), *The Atlantic Slave Trade: Effects on Economies, Societies and Peoples in Africa, The Americas and Europe* (Durham 1992), pp. 1–24, and D.B. Davis, *The Problem of Slavery in The Age of Revolution*, especially pp. 150–164.

45 See Carl Wennerlind, *Casualties of Credit: the English Financial Revolution, 1620–1720* (Cambridge 2011).

have been made that the slave trade, and the employment of unfree labour retarded rather than facilitated economic growth, but that is questionable given the enduring nature of these predatory economic relationships.⁴⁶ In the light of the central role of coerced labour in the contemporary manufacture of discount clothing, computer equipment and electronics, the prevalence of global trafficking in people and of contemporary forms of slavery the issue of the relationship between slavery and capitalism is still a vital one and worthy of our sustained attention.

Just as vitally, the pivotal role played by finance and capital in the growth and maintenance of plantation slavery all too often receives short shrift both from historians and economists. Part of the appeal of slave labour was that it was wageless labour, but just as importantly this was labour deployable at will.⁴⁷ This guaranteed crops came to market, sugar was harvested before it spoiled and cotton before it fell victim to capricious winds or rain. All of this was made possible with credit, which benefited both debtor and creditor. Plantation slavery assured weary creditors that workers would be in the fields picking cotton when it was necessary to bring in the crop. This reduced risk and made plantation slavery worth the cost: to financiers and creditors the purchase of all those slaves went beyond status and the satisfaction of a planter's soul. The labour force that could be deployed at will guaranteed the harvest and gave a risky venture a bit of consistency. Although many of these larger banking houses preferred not to wield the lash directly, they nevertheless profited from their involvement with plantations slavery. After 1837 all of these houses saw

46 Some historians that have disagreed with Williams: Anstey, *The Atlantic Slave Trade*; S. Engerman, 'The Slave Trade: A Comment on The Williams Thesis', *Business History Review*, 46, 4 (1972) and S. Drescher, *Econocide: British Slavery in The Era of Abolition* (Pittsburgh 1977). For rebuttals to Engerman and others disputing Williams' thesis see H. Beckles, 'Down But Not Out: Eric Williams' Capitalism and Slavery After Nearly Forty Years of Criticism', *Bulletin of Eastern Caribbean Affairs*, 8 (1982), pp. 29–36; B.L. Solow, 'Caribbean Slavery and British Growth: The Eric Williams Hypothesis', *Journal of Development Economics*, 17 (1985), pp. 99–115; Inikori, *Slavery and the Rise of Capitalism*; Inikori, *Africans and the Industrial Revolution*.

47 See G. Wright, *The Political Economy of the Cotton South: Households, Markets and Wealth in the Nineteenth Century* (New York 1978).

opportunity and made further and extensive investment in cotton through 1848, at which point all deployed the profits and knowledge gained into less risky ventures. Nevertheless, they learned lessons from cotton that they deployed to distinct advantage long after the demise of plantation slavery in the United States.

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ROTHSCHILD INVESTMENTS IN SPAIN 1856–1930

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Abstract

This paper deals with the investments of the Rothschild House in Spain from 1856 to 1930. In this period, this merchantbank was responsible for a significant portion of private investments in Spain, which were concentrated in the most strategic sectors. This paper has four main objectives: Firstly, to define their chronology, the intensity they had and the sectors they affected; secondly, to quantify their importance and the weight they had in the Spanish economy; thirdly, to outline the steps taken by the Rothschilds to achieve success in each of their businesses; and, finally, to analyse their contribution to Spanish economic growth.

I.

This work attempts to study the investments by the House of Rothschild in Spain during the first half of the nineteenth century and the first third of the twentieth century from a double perspective: on the one hand, it attempts to describe and analyse the different investment projects developed, barely known in general; on the other, it endeavours to contemplate the ways in which the activities these companies carried out affected Spanish economic development. The role that this House played in the development of mining, industry and railways in Spain in those years will also be discussed, confirming or rejecting the hypotheses by renowned authors, with the inclusion of new literature.

The debate on the suitability of foreign investment in the development of the economy has a long tradition in political and intellectual circles in Spain. During the first half of the twentieth century, the nationalist movements exerted huge pressure against every kind of foreign capital.¹ Joan Sardá's pioneering work afforded a new approach to the problem from a very much more analytical and detached perspective as compared to the rest. It dwelt on the consequences of foreign capital inflows as regards the stability of the Spanish balance of payments, in an unbiased way.² Some decades later, and after other empirical works had been compiled,³ Gabriel Tortella added some analytical elements to those of Sardá.⁴ Tortella would study in depth the first massive investments in banking and railways, which took place between 1856 and 1864. According to him, it was not as fruitful as expected nor did it create in the Spanish economy the same effects it had in the rest of the European economies. His descriptive hypothesis explained that railway legislation was negative for the development of the economy, granting the import of railway material too easily, without giving the emerging iron and steel industries a chance. Railway lines were built, so to speak, at the expense of industrial growth.

Jordi Nadal contested Tortella's second statement,⁵ arguing that most of the capital invested in railways came from foreign investors who had never thought of investing their money in the weak Spanish industry. However, he agreed with the rest of the assertions made by Tortella and introduced a new element in the discussion: that of 'indirect incentives' for foreign

1 Especially outstanding is the role played by the *Revista Nacional de Economía*, which enjoyed the support of the public at large, and some extreme critical writings like those by Sevillano, *España... ¿De quién? Ingleses, franceses y alemanes en este país* (Madrid 1936), prior to the Franco era, helping to demonize foreign investment.

2 J. Sardá, *La política Monetaria y las fluctuaciones de la economía española en el siglo XIX* (Barcelona 1948, reed. 1970).

3 M. Campillo, *Las inversiones extranjeras en España*; and Anes, 'Las inversiones extranjeras en España (1850-1950)' (Madrid 1963).

4 G. Tortella, *Banking, Railroads, and Industry in Spain, 1829-1874* (New York 1977).

5 J. Nadal, *El fracaso de la revolución industrial en España* (Barcelona 1975).

investments, which foreign investors, who were in a position of superiority over successive Spanish governments, sought, requested and continuously obtained. This was the case of railways (1855), banking (1856) and mining (1868) legislation. Further, Some concessions to specific investors were made, as was the case in the surrender of the mercury monopoly in Almadén to the Rothschilds in 1835.⁶ These measures were allegedly taken to reduce the risks of foreign capital, not to protect the interests of the national economy, which would be one of the main axes of his theory concerning the failure of the industrial revolution in Spain.⁷

Following this argument, there are many authors who have insisted that the excessive weight of foreign interests in the economy had much to do with the internal demand of the Spanish market. According to this hypothesis, the profits from national production were unrealistic in light of the attitude of the mining industrial sector. Its tendency toward exports affected the way in which the railway lines or the financial structures were designed. These investments generated small economic earnings, as net profits went abroad, without producing major reinvestments.⁸ Therefore, a substantial portion of foreign investments meant a lost chance for development.

Given this data, as early as in the 1980s, other authors⁹ blamed Spanish economic underdevelopment on the country's reluctance to increase

6 The Rothschilds took advantage of the subsequent contracts with the Spanish government to guarantee the sales contracts in the Almadén production, which, together with the mines in Idria, allowed them to monopolise the world supply of mercury for more than ninety years.

7 These theses of Nadal's have been unquestionable from the point of view of many authors who still quote this concept, among others, F. Comín, *Hacienda y economía en la España contemporánea* (Madrid 1988), pp. 372–373, 429, and J.L. García Delgado and J.C. Jiménez, 'El proceso de modernización económica' (Madrid 1999) p. 14.

8 See main literature in J. Muñoz, J.A. Hierro, and J.M. Martín, *Involución y autarquía, La economía española entre 1890 y 1914* (Madrid 2000), charter 1.

9 Mainly, S. Coll, 'El sector Minero', *Información Comercial Española*, no 623 (1985); L. Prados de la Escosura, *De Imperio a nación: crecimiento y atraso económico en España (1780–1930)* (Madrid 1988), and P. Fraile, *Industrialización y grupos de presión. La economía política de la protección en España (1900–1950)* (Madrid 1991).

farming exports and industrial capacity,¹⁰ and the ever-existing mediocrity of the corporate sector in Spain.¹¹ That is to say, development problems had a purely internal origin.

The nub of the argument between the two schools lies in pinpointing the factors that actually delayed Spanish contemporary economic growth. For this second group of authors, the argument concerning the negative outcomes of the exporting sectors is out of line, since these were the ones that really pushed the economy forward. In fact, for these authors, that very reluctance towards business development prevented a speedy convergence with world economic powers. Thus, they accuse the former authors of supporting nationalistic political budgets, as they firmly safeguarded markets from strong foreign competition. This position gave rise to the protectionist period in 1891, which worsened in 1920 and later in the Franco era. Consequently, from this standpoint, Spain was plagued by a problem of supply during the twentieth century, which had very much to do with the incapacity of the Spanish corporate class to join forces with a competitive, open market philosophy. Hence, foreign capital would not have been a hindrance, but, rather, an essential incentive for economic growth.¹²

The present work sets off to give answers to some of the somewhat paradoxical questions raised by the phenomenon of foreign investment, from the point of view of one of its major investors: the Rothschild group. This specific case is particularly interesting, not only because it was played out in the sphere of public economy, but also in that of private enterprise, during an age that embraces most of contemporary history. However, it is

10 Already stated by W.A. Lewis, *Growth and Fluctuations, 1870–1913* (London 1978), and other Anglo-Saxon authors.

11 G. Tortella, *El desarrollo de la España contemporánea. Historia Económica de los Siglos XIX y XX*. (Madrid 1994).

12 Prados, *De Imperio a nación*, pp. 190–197. Tortella himself (*El desarrollo de la España contemporánea*, pp. 128–134) goes back on his initial theories and acknowledges the income generated by the entry of foreign capital. Gómez Mendoza, *Ferrocarriles y cambio económico* (Madrid 1982) and *Ferrocarril, industria y mercado* (Madrid 1989) contributed new data to confirm the railway industry as an opportunity for development in Spain.

important to point out that this paper restricts its area to the output investments, excluding any financial investment of the House of Rothschild with the Spanish Government, as well as the businesses derived from that such as the massive sales of gold and silver or of mercury in Almadén.

Therefore, we will proceed to identify the time in which the main capital entries at the initiative of the Rothschild House took place; their intensity and the sectors they affected. Next, we will quantify the consequence of these investments, the influence they had regarding the business fabric of the Spanish market, as well as the foreign investments as a whole during each period. Then, we will go into the patterns of behaviour and means used by the Rothschild House to attain success in each and every one of their businesses. Finally, the profitability they achieved and the aftermath of this phenomenon in the actual growth of the contemporary Spanish economy will be considered, both generally and by sector.

II.

By 1856 the House of Rothschild had been immersed in dealings within the Spanish economy for two decades, although its first activities in the country hark back to the financing of the Wellington army during the Spanish War of Independence. The turning point is the setting up in Madrid of an agency in 1835, managed by Daniel Weisweiler and Ignacio Bauer, which was to become one of the most active financial institutions in the Spanish capital. This was the basis of a solid financial relationship with the Spanish government, to whom it granted numerous loans, and would engage with in important dealings in the area of foreign debt.¹³

13 M.A. López-Morell, 'El papel de los Rothschild en las finanzas públicas españolas durante el siglo XIX,' *Revista de Historia Económica*, no. 3 (2004), pp. 597–636; J. Fontana, *La revolución liberal. Política y hacienda en 1833–1845* (Madrid 1977); V. Martín, *Los Rothschild y las minas de Almadén: el servicio de la deuda pública española y la comercialización del mercurio de Almadén* (Madrid 1980); and A. Otazu, *Los Rothschild y sus socios españoles (1820–1850)* (Madrid 1987).

All these years were devoted mainly to the negotiation of public finance, with the exception of some contracts for the re-export of tobacco and others with lead foundries in Almería and Murcia, which enabled the family to control around 22 per cent of Spanish lead exports in 1860.¹⁴ However, this figure was the pinnacle of a process that was bound for decline on account of the price war waged by the British suppliers.

The House of Rothschild was not even interested in developing railway projects in Spain, despite James Rothschild's experience in the area in France and the repeated suggestions that it do so by the entrepreneur José Salamanca.¹⁵ However, in November 1855, the Pereire brothers gave the Spanish government 14.3 million French francs in advance,¹⁶ as an anticipatory token of appreciation for a formal commodity loan,¹⁷ and a railway company: The Caminos de Hierro del Norte de España (hereafter Norte). In short, the Pereires pursued the feud, which had started in 1852 with the Rothschilds, when they created the Credit Mobilier in Paris. The Credit Mobilier was regarded as the first modern investment bank with shares, and a large railway company, Grand Central, in partnership with Count Auguste de Morny. This project was exported to Europe as a whole. The idea was to acquire the most important railway lines, and so to monopolise the merchant bank business under the Rothschild family's leadership, which had existed since the end of the Napoleonic wars.¹⁸

14 A. Calavera, 'La Casa Rothschild, Madrid y la Habana y operaciones financieras y tabaco', *Arbor*, (1991), pp. 181–196.; Otazu, *Los Rothschild y sus socios españoles*, pp. 145–146 and 170–186; and B. Gille, *Histoire de la Maison Rothschild*, Vol. 2 (Geneva/Paris 1967), pp. 548–551.

15 López-Morell, 'Salamanca y la construcción del ferrocarril de Aranjuez', in: M. Benegas, M.J. Matilla and F. Polo (eds.), *Ferrocarril y Madrid. Historia de un progreso* (Madrid 2002), pp. 13–44

16 A. Broder, *Le rôle des intérêts étrangers dans la croissance économique de l'Espagne: 1815–1913. Etat, entreprise et histoire*. PhD thesis (University Paris X 1979), pp. 646–647.

17 See Sánchez-Albornoz, *España hace un siglo*, chapter 6; and Tortella, *Banking, railroads, and industry in Spain, 1829–1874*, on the Pereires' investments in Spain.

18 For the feud between Rothschilds and Pereires see Bouvier, *Les Rothschild*, Chapter 8; Cameron, *France and the economic development of Europe*, chapter 7; and Ferguson, *The World Bankers*, chapters 18 and 19.

For the Rothschild family, the arrival of the Pereire brothers in Spain was an all-out attack on one of their most exclusive investment territories. Just as they had done in Austria with the Kreditanstalt, they instructed their agents in Madrid to create an identical institution to that of the Pereires, which would be called the Sociedad Española Mercantil e Industrial (hereafter SEMI), set up on 15 January 1856, with an initial capital of 76 million pesetas.¹⁹ Next, they bought the only long railway line in construction in Spain at that moment from Salamanca, the Madrid–Alicante, and a short line to Toledo, to which was to be added the Madrid–Zaragoza line. Surprisingly enough, their partners in this enterprise were Auguste Morny himself and three directors of the Paris Grand Central: Benoît Chatelus, Gustave Delahante and Leopold Lehon, although James de Rothschild took great care in getting the exclusive rights to the business, divesting them of management powers in the company and any exclusive rights in the construction of the future railways²⁰ known as the Cía de Ferrocarriles de Madrid a Zaragoza y a Alicante (hereafter MZA).²¹ The MZA was incorporated in Madrid with the assets bought on 10 January 1857. The company boasted of an initial capital of 114 million French francs, divided into 240,000 shares with a nominal value of 500 French francs. Of these, SEMI took 64,000 shares and the Rothschilds 66,000 directly, which meant the straight control of 51.7 per cent of the share total for the family, a little more than estimated at the beginning. The rest was divided up amongst the partners of Central.²²

Between 1857 and 1864, the Rothschild House provided cover for every share and bond issue of MZA on the Paris Stock Exchange. This was not easy, despite the prestige of the company promoters, since the Paris market was suffering from a crisis that would lead Grand Central to ultimately

19 SEMI, company documents 1856; *Bank of Spain Archive*, Secretary, doc. no. 3820.

20 López-Morell, *La Casa Rothschild en España* (Madrid 2005), chapter 4.

21 Notary proceedings of the creation of MZA. *French Finance Ministry Archive* (hereafter FFMA), B-31200 and Tedde, 'las compañías ferroviarias en España', pp. 21–22.

22 Notary proceedings of the creation MZA, FFMA, B-31200.

collapse.²³ The problems that the stock exchange had were coupled with a bureaucratic one, as it took the treasury almost a year to authorise the quote of MZA shares,²⁴ even though the Rothschilds sold most of the securities within their own client portfolios.

At the same time, MZA swiftly started to build their lines and went about purchasing others, so as to stymie any plan that the Pereire brothers might have. They did this by getting access from Madrid to the South, so as to isolate the Pereire brothers from their Seville-Cordoba line, which could not be incorporated into the northern line when MZA bought the rights of the Manzanares-Cordoba line at an exorbitant price. This was a decision that the board had to justify to their shareholders later in light of the strategic importance of the company's expansion plans towards the South.²⁵ However, they failed in their attempt to connect with France, because of the Spanish government's refusal of a line parallel to that allowed to Norte in the west of the Pyrenees.²⁶

This, however, was not the Rothschild's main problem. The crisis in the middle of the 1860s led to the failure of their expectations that the railway sector in Spain would fail as had happened in the rest of Europe. From 1864 to 1870 MZA, like other companies, desperately issued 390 million French francs in stocks on the French market, which plummeted dramatically as its interests, loans and overhead kept growing. The Rothschild family had to fund the company in advance so as to cover its subsequent deficits. Therefore, from 1865 onward, they lent amounts to the company

23 Letter from James de Rothschild to Weisweiller and Bauer dtd 15-9-1856. *Archives Rothschild Paris*, Centre des Archives du Monde Du Travail (hereafter ARP), 132AQ728.

24 The authorisation was not issued until 1-1-1858. *FFMA*, B-31200.

25 This line, with 243.6 km did not connect any capital city and was extremely costly; hence, the government offered a 71.1 per cent subsidy of the estimated cost. MZA reduced the aid by 83 per cent to get control of the line against other 13 other bids, MZA Memories 1861; Tedde, 'Las compañías ferroviarias', pp. 21-22.

26 Letter from Weisweiller and Bauer to James Rothschild dtd 14-11-1858. *ARP* 132AQ6163.

of over 25 million French francs. In April 1870 the family ceased lending when the figure reached 42,754,000 French francs.²⁷

Overall, the first years of the MZA could be regarded as a fiasco, but it is also true that the Rothschilds had already gotten most of their private investment in the company back, and that their operative plans had worked quite successfully. Their lines, starting from Madrid towards three cardinal points, almost doubled those of Norte in 1864 (1,163 km, compared to 663 km). The first goal set for the company was, accordingly, seen as having been achieved.

In any case, the revolution years in Spain (1868–1874) meant a small recess for MZA, which stopped the expansion of its lines sharply and started to settle, while it waited for better economic opportunities.

III.

From 1875–1880, the Rothschild group shifted its economic sights in Spain, turning them around as they made medium and long term investments in mining and industrial companies, and recovering their railway activity. The factors that motivated this new strategy are varied, although the most important was the generational change in the family of bankers. James Rothschild had died in 1869 and, in 1879, Lionel, the second leader of the London House, passed away too. Their heirs reconsidered the situation and thought that the time had come to switch to other activities, now that the family held enough resources to finance other businesses. In this state of affairs, the Rothschild House started to consider mining businesses, a sector in which they had already worked through the elaboration and marketing of precious metals, including copper, lead and oil. These enterprises could not really be regarded, at least at their outset, as businesses in a strict sense. They were rather an attempt to open up new lines of

²⁷ Gille, *Histoire de la Maison Rothschild*, vol. 2, pp. 530–531.

business, in an attempt to adapt to the new modern economic conception of industry and global markets. Nevertheless, from another perspective, this process could be interpreted as a milestone in a new learning development stage during which the Rothschilds matured towards the control of production bases, profiting even further from their speculation on the London Metal Exchange at a time when there was a sharp increase in the international demand for primary products.

The MZA experience was slightly different, from the moment that there was actual control over a company that they had created, financed and structured. However, the family's interests had focused on the somewhat speculative profits earned from the construction of the lines. From then on, circumstances would start to change, as a consequence of the new management requirements of the finished networks, and the arrival of new competition factors on the Spanish railway map.²⁸

Indeed, the railway business started to become unsteady again when the government granted the *Compañía de Ferrocarriles de Badajoz* a direct link to Madrid, parallel to that of MZA, in 1875.²⁹ The decision was very risky for MZA, as this company was sponsored by the building company, Parent&Shaken, and the French *Credit Industriel et Commercial*. The company was able to join its lines with those of the businessmen, Jorge Loring Oyarzabal and Joaquín de la Gándara, who were in the process of creating a network connecting all the main cities in Andalusia.³⁰ Both lines, stemming from the Córdoba–Almorchón–Bélmez link, would establish a new axis in connecting Madrid with the South, to the detriment of the MZA lines.

28 Apart from this, MZA had succeeded in changing its accounts in 1871, due to some subsidies by the state and the improvement of its earnings. Letter from Bauer to James Rothschild, *Rothschild's Archives, London* (hereinafter RAL), XI/109/107. MZA started to pay dividends again in 1873.

29 Letter from Bauer to Rothschild dated 5-12-1875, RAL, XI/109/121.

30 On 30 May 1877, Loring and Gándara created the *Compañía de los Ferrocarriles Andaluces*, which started a 700 km line, with the support of Paribas, Stern, the Camondo brothers and Duclerc. P. Tedde, 'Las compañías ferroviarias en España (1855–1935)'; in: M. Artola (ed.), *Los Ferrocarriles en España 1844–1943* (Madrid 1978), pp. 9–355.

In the following months, as an answer to the Badajoz Company, MZA bought the Cordoba–Seville and the Seville–Huelva concessions.³¹ The Compañía de Badajoz could not have been very convinced that, once the Madrid line was opened, they would be capable of competing with MZA.³² Therefore, they started to have talks with them and an agreement was reached to consolidate their lines in May 1880.³³

In the north of Spain, the struggle by MZA to go on and consolidate their link with France centred on their disputes with Norte, which had enjoyed a railway monopoly in the north-west of the country since they had merged with the Saragossa–Pamplona–Barcelona company in 1878.³⁴

However, in the middle of the 1880s, the main independent company in Catalonia, the Ferrocarriles de Tarragona a Barcelona y Francia, the result of the merger of more than ten small railway companies in the suburbs of Barcelona, decided to merge with the company Ferrocarriles Directos de Madrid y Zaragoza y Barcelona, with the aim of breaking Norte's commercial monopoly to the south of the Ebro river. The emerging company would be called Nueva Compañía de los Ferrocarriles de Tarragona a Barcelona y Francia (hereinafter TBF), and would be the only important company in Spain with a majority of national capital, even if it did have substantial financial losses. In spite of this, in the spring of 1888 the company started to conclude their link with Saragossa, which failed and obliged them to negotiate the incorporation of their assets with Norte in 1890, so as to avoid having to wind up.³⁵

Alarmed by the possibility of isolation of their Saragossa, the management of MZA decided to play their trump card and submitted a second bid

31 Tedde, 'Las compañías ferroviarias en España', pp. 54–55, and letters from Bauer to the Rothschild, dated 22-10-1875, 24-11-1875, 31-10-1876, 01-12-1876, 27-01-1877, 26-07-1877, 31-08-1877, 9-10-1877 and 2-11-1877 and 2-6-1878, *RAL*, XI/109/121, 123, 124 and 125.

32 Letter from Bauer 27-12-1878, *RAL*, XI/110/10.

33 MZA report to shareholders, 1880, pp. 14–21.

34 Cameron, *France and the Economic Development of Europe* (Princeton 1961), p. 253.

35 Pascual, *Los caminos de la era industrial* (Barcelona 1999), pp. 439–455.

to TBF, which offered its shareholders facilities to cash in all their devalued bonds and a ten million pesetas credit. This would enable the company to end its connection to Saragossa. The company's board could do little to defend Norte's original bid in the midst of an argument that brought back the biased atmosphere of Catalonian politicians and entrepreneurs against Norte's high rates. This factor was decisive in the triumph of MZA, which, moreover, suited everyone's interests better.³⁶

Table 1 – MZA takeovers, 1875–1898.

Date of acquisition	Line	km. of line	Transfers to stakeholders		
			MZA shares	MZA bonds	Cash
24–7–1875	Córdoba – Sevilla	131	38,000	34,000 (a)	900,000 fr.
13–10–1877	Sevilla – Huelva	110	28,000	56,000	–
8–4–1880	Madrid – Ciudad Real	166	50,000	100,000 (b)	5,500,000 fr.
	Ciudad Real – Badajoz	342			
	Almorchón – Bélmez	64			
	Aljucén – Cáceres*	66			
27–6–1881	Mérida – Sevilla	202	–	87,522	580,834 ptas.
14–9–1884	Aranjuez–Cuenca	152	–	–	12,500,000 ptas.
2–5–1891	Valladolid–Ariza	255	–	100,000 (c)	–
15–5–1891 1–1–1898	Red Catalana (TBF)	723	141,006	97,500 (d)	30,000,000 ptas. (on credit)
<p>*Not built</p> <p>(a) To be added to 49,426 bonds at 3% of the Córdoba–Seville, with a nominal value of ESP 11,738.</p> <p>(b) To be added to 63,634 bonds at 5% of the Badajoz, with a nominal value of ESP 31,817,000.</p> <p>(c) To finance this line, MZA issued 100.000 securities at 5%, which gave returns of ESP 43,825,950 .</p> <p>(d) To be added to 500,275 bonds in 1899, with a nominal value of ESP 141,121,788, a legacy from TBF. Series B, of 97,500 bonds of ESP 500, was issued in 1899 by MZA so as to finance their Catalonian network.</p> <p>Source: <i>Financial History report of MZA (19–9–1918)</i>. <i>Fundación Ferrocarriles Españoles Archive, MZA, Secretary, Box 215, and Tedde, 'Las compañías ferroviarias en España', pp. 66–80.</i></p>					

³⁶ Pascual, *Los caminos de la era industrial*, pp. 454–458.

TBF was able to end its connection with Saragossa on 1 July 1894, but its income was not high enough to give MZA the 30 million pesetas loan, not to mention the seven million pesetas in interest. This event drove TBF into receivership and allowed MZA to cheapen the terms for the 1891 agreement to close TBF's takeover on the first day of 1898.³⁷

With the eventual merger of TBF the Rothschilds finally achieved their direct connection with France, finishing, after 42 years, their project of a railway line from the north to the south of the peninsula. The cost and profitability of the partial transactions themselves were never tested, but it is clear that the takeover of TBF helped to increase dramatically the number of travellers and commodities transported, as can be seen in Graph 1. Cameron remarks that the MZA strategy was wrong, especially in the South, as the company competed excessively, instead of letting entrepreneurs run the risks.³⁸ According to him, the result was a disproportionate debt that had negative repercussions on the MZA balance. However, the result for the Rothschild family was positive, as they never lost the lucrative, operative and financial control of the largest company in the country; a railway that was 3,650 kilometres long, connected the main cities and provided employment for more than 15,000 employees in 1900.³⁹ It was one of the biggest in Europe, with no losses until well into the twentieth century. This was quite a success, considering the disappointing scenario of the Spanish railway companies in Spain in the nineteenth century.

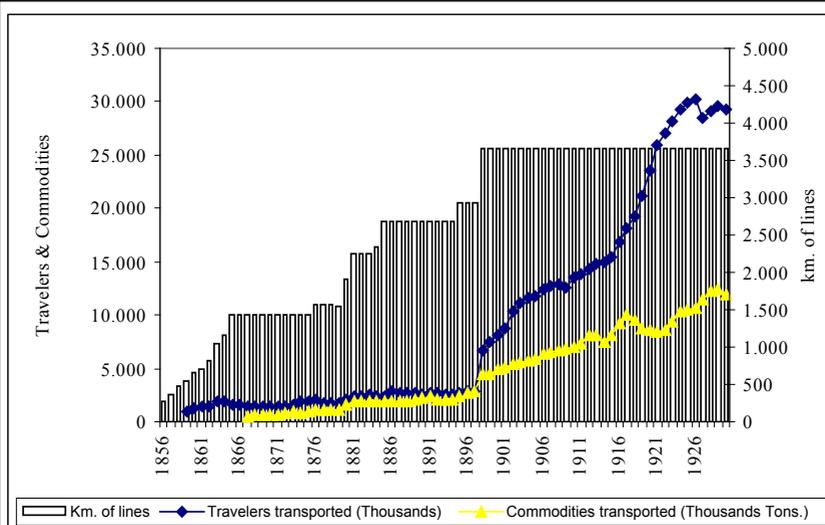
On the other hand, as stated above, the Rothschild family set a new investment strategy in motion, focused on the industrial mining sector, either through direct control of the manufacturing companies, or through the promotion of specific companies.

37 Pascual, *Los caminos de la era industrial*, pp. 461–478.

38 Cameron, *France and the Economic Development of Europe*, p. 253.

39 Ballesteros and Martínez Vara, 'Evolución del empleo en el sector ferroviario español, 1893–1935'.

Graph 1 – Development of the progress of the MZA railway line, commodities and number of travellers transported, 1856–1930.



Source: Anes, *Relación entre el ferrocarril y la economía española*, p. 487–490, Gómez Mendoza, *Transporte y Comunicaciones*; and Tortella, *Banking, railroads, and industry in Spain*.

The first initiative was created with the establishment of the Deutsch & Cie. oil-refining company, created in 1879 as the outcome of an agreement between the Rothschild House in Paris and Alexandre Deutsch de la Meurthe, who had been a pioneer in introducing the processing of oil in France and Europe.⁴⁰ The agreement of the Rothschilds with de la Meurthe was exclusive to Spain, but soon there was a second agreement with the building of a refinery of sizeable dimensions in Fiume, which was managed from the Sté de la Raffinerie d’Huiles de Fiume, with the headquarters being in Vienna.⁴¹ With these antecedents, the Rothschilds started to carry out investments in new oil beds in the Caspian sea, which gave rise to

⁴⁰ Turgan, *Les grandes usines* (Paris, 1865–1885), vol. 15, pp. 6–7.

⁴¹ RAL, Rfam. FD/5.

the creation of the *Sté Anonyme Commerciale et industrielle de Naphte Caspienne et de la Mer Noire*, better known as BNITO, through which they would supply the Deutsch facilities in France, Spain and Austria. This generated a net of oil distribution on a European scale in the Caspian sea.⁴²

In Spain, the new company operated as a limited partnership under the name of *Deutsch & Cía*, for a period of seven years from 1 January 1880. The Rothschild family would invest the capital, three million French francs, and Deutsch would be in charge of the production management. The bankers, however, kept the rights to the financial control of the company and 50 per cent of the net profits, apart from five per cent interest for capital invested, as well as the right to control operations.⁴³

The company assigned the Scottish firm A. and F. Craig & Co the task of constructing three refinery plants in Santander, Seville and Alicante. These facilities were intended to cover the markets in the north of Spain, Andalucía–Extremadura–Madrid and the Mediterranean regions, and to combine their sales with a net of deposits and warehouses which extended as far as Madrid, Bilbao, Saragossa, Gijón, La Coruña, Vigo, Cádiz, Málaga, Almería, Garrucha, Cartagena and Valencia.⁴⁴

The partnership contract was extended in 1887 and 1897, until 1911, maintaining the basis of the first agreement, except for the equity amount, which was halved.⁴⁵ In those times Deutsch & Cie. had consolidated itself as one of the main refining companies in the country, with a relevant group of five industrial establishments, including the three original ones, and two more in Badalona and El Ferrol. This was completed by an establishment in Philadelphia for the management and warehousing of crude

42 Chandler, *Escale and Escope* (Cambridge 1990), pp. 721–722; McKay, ‘The House of Rothschild as a multinational’ (Paris/London 1986); Ferguson, *The World Bankers* (London 1998), p. 880. An agreement in 1891 between the Rothschilds and Marcus Samuel, for the output of the BNITO at the east of the Suez Canal, was the origin of the Shell Transport & Trading Co.

43 Copy of the memorandum of association, dated 31-12-1879, ARP, 131AQ354.

44 Letter from Weil to the Rothschild House in Paris, dated 12-12-1879, ARP 132AQ 6209; Turgan, *Les grandes usines*, vol. 15, p. 16; and Teresa Tortella, *Una guía de fuentes*, p. 77.

45 Copy of the company extension contracts, dated 4-3-1887 and 9-10-2-1897, ARP, 131AQ354.

purchases.⁴⁶ These facilities allowed them to cope with up to 29 per cent of the national output of refined oil.

After the setting up of Deutsch & Cie., the Sociedad Minera y Metalúrgica Peñarroya (hereafter Peñarroya) was founded in 1881, as a result of a partnership between the Rothschild family and the promoters of the Compagnie Houillère et Métallurgique in Bélmez, almost all of whom had been members of the Compañía de Badajoz after its merger with MZA. The new entity, owned both by the Rothschild group and the owners of the Houillère, with 50 per cent each, received all the lead assets from the former, including the mines and foundry they had in Peñarroya. It also included some leasing contracts for the mines of the businessman, Huelin, which the Rothschilds had received from the settlement of a mortgage payment default.⁴⁷

It was soon clear that the lead business was much more profitable than that of coal. From the foundation of Peñarroya until 1889, subsequent improvements in technology enabled the first foundry to grow spectacularly, increasing production from 3,070 tonnes of lead to 12,180 tonnes. The same year the factory could not possibly deal with all the minerals it received and plans were made to expand the plant. The growth was such that the managers of Peñarroya and Compagnie Houillère agreed that a merger would be more effective in promoting the metallurgic side of the business. The union was materialised in 1893 through a takeover that recognised the superiority of the Peñarroya assets over those of the Houillère with a 2:3 and 1:3 ratio difference. New capital of ten million French francs was invested.

By 1900 Peñarroya had doubled its refining capacity again. This growth was even more valuable inasmuch as it was produced in a context where prices were bottoming out and competition was increasingly threatened by American lead producers. From that year on, the company decided

⁴⁶ Reports of the financial years 1896 to 1900 of Deutsch & Cie., *ARP*, 132AQ139.

⁴⁷ *ARP*, 132AQ116.

to alternate between takeovers or buying assets from their competitors, as well as creating subsidiaries with their usual suppliers. Little by little, they purchased more than 100 coal mines in Belmez, justifying the convenience to reduce costs through economies of scale. The management of Peñarroya quickly decided to increase the supplies of lead by adapting better to their rising needs of transformation. Thus, the subsidiaries Nueva Sociedad de Minas del Horcajo (1902) and Sociedad Minera de Villanueva del Duque (1903) – which would become famous in the future as the most profitable company involved in lead exploitation in the country – came to life. In 1907 the Cía. Industrial Minera de Linares was created. The Sté des Anciennes Etablissements Sopwith took a 50 per cent stake, as did the Cía. Minera de Villagutierrez, after an agreement with La Mancha Syndicated Ltd. Another two subsidiaries, the Sociedad de Piritas de Sevilla and the Sociedad Española de Tejidos Industriales searched, however, for other objectives: the first emerged as a means to ensure the supply of sulphur for their recent line of production of superphosphates, and the second to manufacture the bags for the distribution of those products.⁴⁸

However, the great push forward would come from the takeover in 1912 of the Sociedad Escombreras Bleyberg. Through this operation, Penarroya would buy out, in one blow, the foundry in Cartagena, a zinc factory in Bleyberg, Belgium; 42 mines in Murcia and 62 stakes in other companies, among which was the Charbonnages company in Puertollano. The company had taken a huge step forward in its industrial capacity. However, the next year it beat its own record, acquiring the Sté. des Produits Chimiques de Marseille l'Estaque, which possessed a chemical product company and a lead foundry in Marseille; as well as all the assets belonging to the Figueroa family, consisting of the St Luis factory in Linares, which was prepared for a 20,000 tonnes output in lead, and that of St Ignacio in Cartagena. Three

48 López-Morell, 'Peñarroya, un modelo de corporación minero-industrial' (2003).

lead transformers in Marseille, Barcelona and Lisbon, and another share packet in Charbonnages were also acquired.⁴⁹

All these takeovers were closed by matching capital expansions in Peñarroya, which compensated the owners of the annexed companies with shares of their own. In 1914 the company's equity was 24,375,000 French francs after share swaps and extraordinary issues.

At this point, the company would follow the same patterns of asset expansion, increasing transformation capacity and ensuring supply. A difference was to be made, though: the company favoured the creation of subsidiaries, rather than takeovers. This took place both in Spain, the refuge of many a company in times of crisis during the 1920s (when international raw materials markets collapsed and crises were the norm), and in the rest of the Mediterranean. The list of companies taken over or created in those years by Peñarroya totalled 48 in the group. Amongst all of them, the one with the highest repercussions in Spain in the coming years would be the Sociedad. Minero Metalúrgica Zapata–Portmán functioned as the basis of Peñarroya in acquiring most of the concessions in the Cartagena–La Union mountain range in 1947, and from which it would reactivate its transactions in the 1950s.⁵⁰

Therefore, we find a mature entity at the beginning of the 1930s, reckoned as the first industrial company by assets in Spain, with a higher capacity for the manufacturing of lead than the rest of the country as a whole. This was achieved by virtue of the process of international expansion as described above. It was also the first coal supplier in Spain and had stakes in more than 30 healthy companies, possessed a relevant industrial heritage in four continents, and had turned, in conclusion, into a veritable multinational corporation.

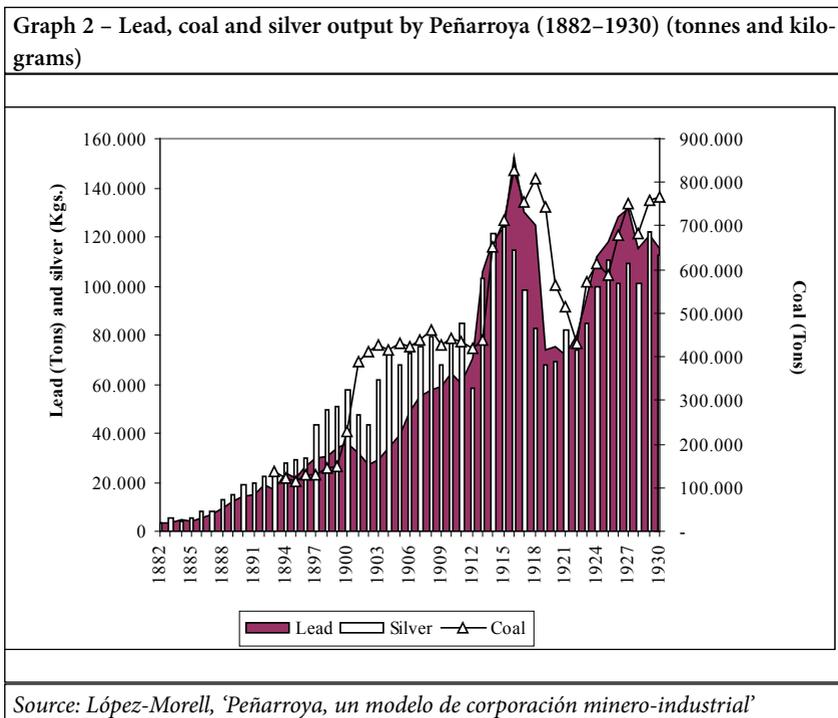
The case of Rio Tinto Co. Ltd was different, as this company emerged as a mining empire when, in 1873, an international consortium led by the

⁴⁹ Ibid.

⁵⁰ Ibid.

banker Hugh Matheson acquired the Rio Tinto mining bed after paying out 3,850,000 pounds sterling to the Spanish Government. The first managers of Rio Tinto set up the necessary infrastructure for modern production around the mining bed: they built the railway, a big quay in Huelva and an open cash system to permit high-scale manpower. The mine turned into one of the most important mining exploitations in the world in just a short time, although it would not reach its profit goals during the first two decades of its history.⁵¹

The Rothschild family, which had taken no part in setting it up, eventually gained control of the company in 1895. It all started when the family



51 Avery, *Not on Queen's Victoria Birthday. The Story of the Rio Tinto Mines* (London 1974); and C. Harvey, *The Rio Tinto Company. An Economic History of a Leading International Mining Concern, 1873–1954* (Cornwall 1981).

took advantage of the world crisis of the copper monopoly, established by H. Secretan between 1887 and 1889. The Rothschild family acquired a substantial package of shares of Rio Tinto and thus dominated the AGM.⁵²

The Rothschild family did not hurry to take control of the management of Rio Tinto and waited for the departure of the founding partners, positioning their own pawns on the board and controlling measures to increase the profitability of the institution.

The first measures taken in the financial sector materialised in three main operations: first, the issue of 3,600,000 pounds in bonds to reduce the huge debts of the company was undertaken. This was successfully floated in May 1895, probably due to the reliability that the Rothschild's presence afforded. All the bonds were redeemed and the payment of interest was reduced from 200,000 pounds to 74,000 pounds p.a. The Rothschilds matched this measure with another, some months later, dividing shares into ordinary and preferential, which rewarded the shareholders and consolidated their control of the company, while excluding the most conservative shareholders. Lastly, a capital expansion in 1905 was the basis for the liquidation of the oldest debts in the company, which released it from financial encumbrances until the 1930s.⁵³

The Rothschilds managed to introduce subsequent technical reforms through Charles Fielding, a manager from its London Office who became director of Rio Tinto in 1900, and chairman in 1905. Fielding promoted the modernisation of mining production processes with existing technology, like natural cementation used before by Tharsis, which permitted recovery of the copper back from poor pyrites. This process avoided burning the mineral and produced a new product: washed pyrite, without copper but with the entirety of sulphur, which would go directly to the chemical industry. Rio Tinto managed to raise their production to 977,812 tonnes

⁵² Lopez-Morell, *La Casa Rothschild en España*, pp. 312–323.

⁵³ Harvey, *The Rio Tinto Co.*, pp. 105–107; and López-Morell, *La Casa Rothschild en España*, pp. 471–472.

in 1912. As a consequence, 74 per cent of the sulphuric acid consumed in the USA came from the Rio Tinto pyrites.⁵⁴

In 1901 a new metallurgic complex was built in the mine to treat pyrites with more copper, replacing the old foundry and producing about 7,500 tonnes of copper at 98 per cent. In the same way, the extraction process was transformed, discarding the old system of tunnels and pillars and favouring a more effective one of cut and discharge, as well as open-cast mining. In 1907, the refurbishing of facilities was completed, expanding pyrite furnaces, operating in 1913 with 260,688 of copper pyrites to obtain 45,328 tonnes of 21.51 per cent copper.⁵⁵ To conclude the reforms, a superphosphate factory was built, prepared to produce 50,000 tonnes p.a. in 1906, followed by another one to produce copper sulphate.⁵⁶

As a consequence of all of these changes, the profitability of the business rocketed and Rio Tinto enjoyed a time of substantial profits that made it famous. Since 1897, as a whole, sales profits came to more than one million pounds p.a. A peak was reached when, in 1906, the company achieved pretax profits of 2,420,996 pounds. Dividends for ordinary shares were higher than those given by any other European company, which was especially outstanding. This was particularly relevant for the image of the company, granting 110 per cent of the dividends that year, as it was maintaining an inordinately high level during the whole period, since from 1897 to 1913 an average annual dividend of 69.05 per cent of the capital was divided among the shareholders. As an aftermath to this success and the reliability that Rio Tinto transmitted to foreign markets, the industrial company was ranked number 13 in 1912, with a market value of 143 millions US dollars at the Stock Exchange,⁵⁷ not much lower than the Spanish government budget in those years.

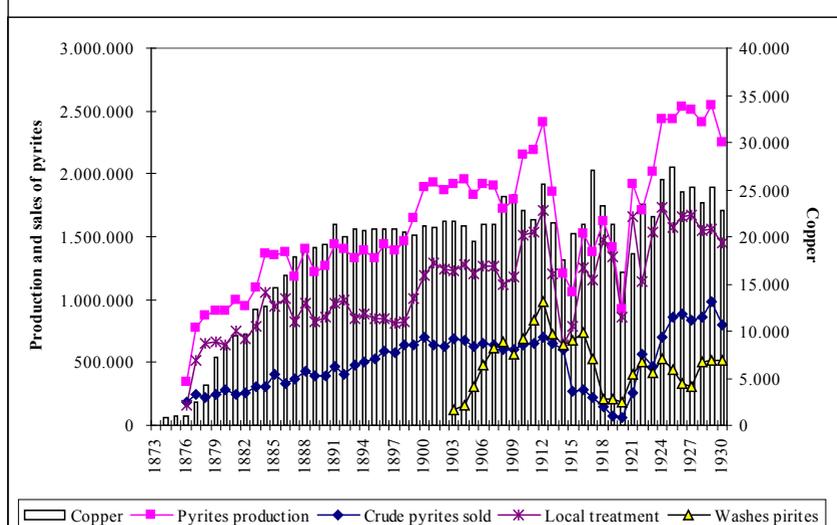
54 The Mineral Industry. 1921.

55 Salkied, *A Technical History of the Rio Tinto Mines*, pp. 63–64, 102–104; and Harvey, *The Rio Tinto Co.*, pp. 89, 97.

56 Harvey, *The Rio Tinto Co.*, pp.160–161.

57 Schmitz, 'The World's Largest Industrial Companies of 1912' (1995), pp. 85–96.

Graph 3 – Rio Tinto pyrite and sub-product output, 1873–1930 (in tonnes)



Sources: Salkied, *A technical history of the Rio Tinto Mines*, p.105–107.

IV.

In order to get a clear picture of the level reached by this process of investment, we represent in Table 2 the ten-year capital flows by operations and investments carried out by the Rothschild family in the period preceding the First World War. We are taking into account not only the amounts directly invested by the Rothschilds themselves, but also the total capital raised by them.⁵⁸ These have been compared here to the entire Spanish investment, as calculated by Carreras, to the foreign investment as a whole, as compiled by Broder.

⁵⁸ A part of the investment not originating from the Spanish economy has been excluded, for example, the MZA shares and stocks controlled by Spaniards.

In the light of the results, the percentages resulting from our figures are very high, as compared to those of the authors quoted. The conclusions to be drawn are several. Within the field of private investment, the table shows that the amounts mobilised are very substantial, between five per cent and 15 per cent of the total investment in Spain at large, up to 55 per cent of the global foreign investment. This is a substantial figure if we take into account, as we will see below, the factor of concentration of these capitals in the most dynamic sectors of economy. Likewise, this is confirmed by the chronology mentioned above, because the gross input reached a peak in the 1870s and the first decade of the twentieth century, although, in relative terms, these are much more important during the first period of railway construction.

Hence, we encounter a prototype of global large-scale investment, which proved to be extremely powerful, as it took the sole control of the strategic sectors of the Spanish economy in the nineteenth century and

Table 2 – Private and public investments in Spain as a whole, coming from foreign capital and from operations made by the Rothschild House (figure in millions of current francs).

Origin of the investment	1851–1860	1861–1870	1871–1880	1881–1890	1891–1900	1901–1913	Totals
National Total (a)	2,282.9	4,443.5	5,148.8	7,374.5	6,814.8	15,137.8	41,202.3
Foreign (b)	338.9	609.9	488.1	718	382.7	737.6	3,265.2
Rothschild (c)	165.9	147.7	270.3	106.6	52.6	173.1	916.2
% (b) about (a)	14.8	13.7	9.5	9.7	5.6	4.9	7.9
% (c) about (b)	50.4	24.2	55.4	14.8	13.7	23.5	28.1
% (c) about (a)	7.3	3.3	5.2	1.4	0.8	1.1	2.2

Sources: Carreras, 'Industrialización, una perspectiva a largo plazo', pp. 42, Broder, 'Les investissements étrangers en Espagne', pp. 45, 62, amended by Chastagnaret, 'L'Espagne, puissance minière', p. 754), and Appendix 1.

Note: we have kept the franc as reference currency in the series, as Broder's figures cannot be singled out annually, they were elaborated in francs for every ten years and the yearly exchange rate franc-peseta cannot be applied to them. In any case, the parity between both currencies was identical during the first four decades it only changed from 1891 onwards, when it grew up to 30% for the franc in 1901. That was the year when the parity started to be similar, becoming identical again in 1914.

the first third of the twentieth century, with a level and continuity in time that we have not come across before or since this model. From this standpoint, the case of the financial activities and investments performed by the Rothschilds in Spain goes beyond the realm of mere example. Therefore, it can be useful to contrast the phenomenon of massive capital transfers towards a single economy and it may offer relevant clues to confirm the real suitability of these capitals for the growth of developing countries on their way to modernization. On the other hand, it is really important to make a reference to the contribution made by the companies controlled by the Rothschilds to the Spanish production system and its markets. As Graph 4 shows, these companies took a significant role in the key and strategic sectors of the Spanish economy: MZA contributed about 30 per cent of the railway lines, with an eminently qualitative character, as it controlled four of the most important radial lines in Spain. It also amassed a similar level as far as commodities and passengers were concerned; Peñarroya and Ríotinto, in turn, gathered most of the domestic production of lead,⁵⁹ copper and pyrites, as well as a substantial portion of coal production; as far as Deutsch & Cie. is concerned, the only figures available are those of the last 15 years of the nineteenth century, when its one-third participation in the national production of refined oil is confirmed, not to mention other significant output contributions of these companies, like that of sulphuric acid, superphosphates, electricity or coal derivatives, where their market issue was also sizeable.

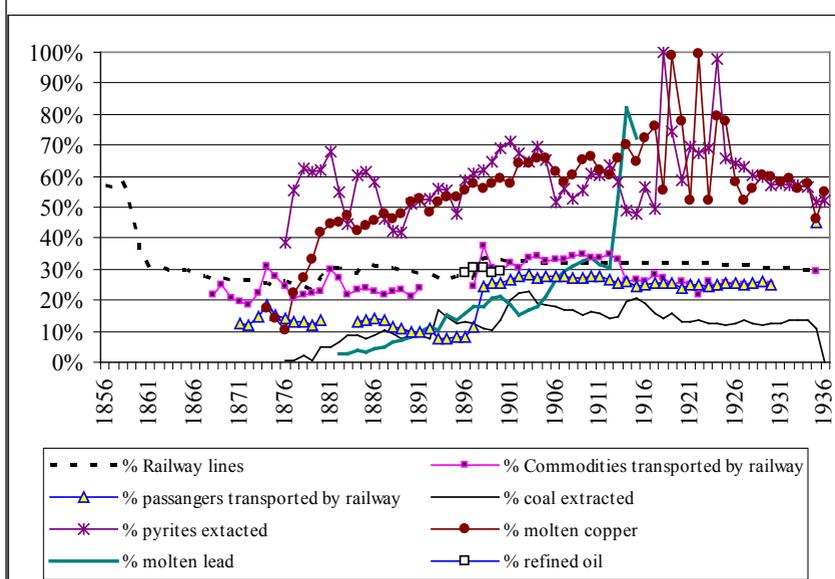
59 Figures of Peñarroya lead output cannot be offered after 1916 because they are mixed with those of overseas output in the company's ledgers. Nevertheless, its contribution remained constant until 1936, and it became even more prominent in the face of the crisis in the sector.

V.

The next question to be posed is the way in which this control over the investment scope of production was attained, and the means through which the House of Rothschild fulfilled its goals. We have highlighted a series of patterns or strategies of behaviour that barely changed throughout the process, which account for the accomplishment of a large amount of their activities; similarly, the way in which they disappeared marks the turning point of a very unusual mode of operation, which was also quite successful from the business point of view.

Firstly, their self-sufficiency in gathering financial resources is the distinguishing element in the businesses that the Rothschilds controlled. In

Graph 4 – Percentage of market issue of Rothschild industries in each and every subsector in Spain, 1856–1936.



Sources: Artola (1978), Tortella (1973), Salkied (1987), Carreras (1989), Tomás (1991), Coll and Sudria (1987), Nadal (1975), Pérez de Perceval and Sánchez Picón (2000); MZA and Peñarroya ledgers; Rothschild Archives, Paris, 132AQ139

each and every case, the weight of the Rothschilds is proven, their influence being in tune with creditworthy financial practices and expansion strategies, as they endowed them with autonomy of resources and credibility in the Stock Exchange. This became crucial for the success of the share and stock issues floated by those businesses, both in the process of their formation and in the expansion stages.

This is a remarkably crucial element that has never been sufficiently valued in the context of Spain's industrial underdevelopment throughout history, since the availability of capital was the differentiating factor between the foreign companies in Spain and the Spanish ones. This difference is partly substantiated in the long tradition of European stock markets in the field of company financing, and the comparatively lacklustre role of the Madrid and Barcelona markets in this area,⁶⁰ as well as in the poverty suffered by national financial companies and institutions, committed to the industrial development well beyond the twentieth century.⁶¹

One cannot overemphasise the relevant role played by the Rothschilds in the initial financiering phase of MZA, nor the plentiful resources this company was granted throughout its history, and not even remotely so enjoyed by any other railway company in Spain. Also, their position was central to the financing of *Deutsch & Cie.*, a partner of the Rothschild's with whom they provided as much capital and circulating resources as needed to ensure solvent management. The first three million invested in capital by the House were used by *Deutsch* to finance the company's first Spanish facilities, a process that took very little time. To support the company's overheads, the Rothschilds created a short-term credit account

60 As Hoyo proves in 'La evolución de la bolsa y las fluctuaciones de la economía española en el S. XIX' (Barcelona 2001). In my own case, I have studied the problems of capital markets in the middle of the nineteenth century, in López-Morell, 'Salamanca y la construcción del ferrocarril de Aranjuez'.

61 García López ('El sistema bancario español del siglo XIX: ¿Una estructura dual?' [1989]) insists on the pervading presence of bank traders as sources of enterprising activity in Spain during the nineteenth century. However, these financiers did not have enough resources to supply large companies with capital, nor were they sufficiently capable of moving out of the Spanish context, with notable exceptions like Salamanca.

that very swiftly amounted to 2,500,000 French francs. In 1897, they did not hesitate to raise the limit up to four million French francs in the midst of a sales crisis, and again up to five million French francs when the company was going through the expansion and refurbishment of their facilities and the building of new factories in Baeza and Badalona.⁶² In Peñarroya, the bankers set up a syndicate with the other two founding partners, Cahen d'Anvers and Mirabaud to finance the company in the short term and manage the capital expansions of 1893, 1903, 1912, 1913, 1914, 1925, 1929 and 1931; the syndicate guaranteed, in each and every one of their issues, the sale and quoting of the shares, in such a way that they managed to get a substantial premium in all their investments.⁶³

Rio Tinto was a special case, inasmuch as it required a strong capitalisation from its onset in order to develop basic infrastructures which took a long time to be repaid. The outstanding financial balance, as we remarked above, was quite lacklustre in the first two decades of its history. Nevertheless, when the Rothschild became shareholders, the company tended to be financially self-sufficient and avoided getting into debt. It managed to do so due to its exceptional liquidity, which avoided capital expansions and ensured both share profitability and the control of capital in the hands of only a few.⁶⁴ Notwithstanding, two expansions were necessary in an 80-year period: the one mentioned in 1905 and another in 1930 to fund Rio Tinto's adventure in Rhodesia, which was promptly financed by the Rothschilds, in the middle of an economic crisis in Spain.

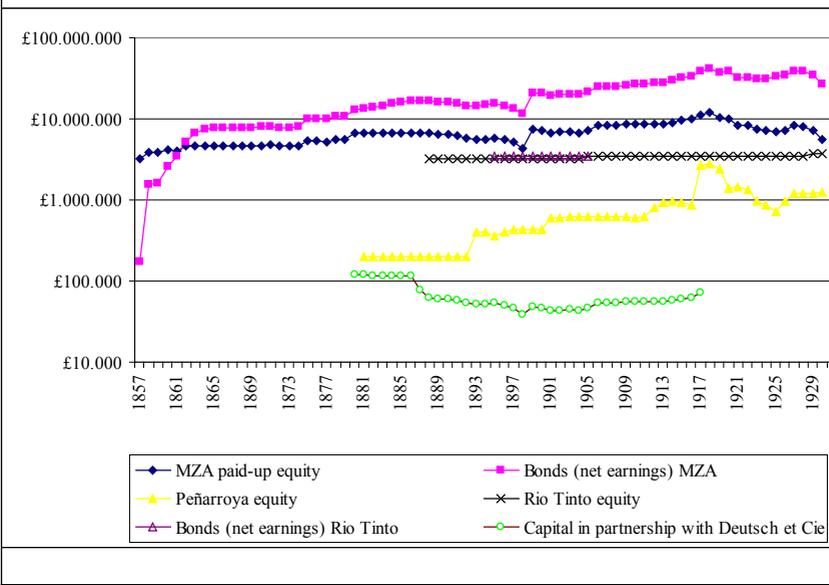
The second element to be regarded when considering the network of the businesses carried out by the Rothschilds in Spain is their skill to control and manoeuvre markets, aimed at monopolising supply and controlling prices. Monopoly was, hence, their pattern of performance, as genuine income seekers. They systematically rejected partaking in

62 ARP, 132 AQ 139 and 354.

63 ARP 132AQ103.

64 López-Morell, *La Casa Rothschild en España*.

Graph 5 – Equity and security issue of the companies controlled by the Rothschilds in Spain, 1857–1930 (in pounds sterling).



Note: The decreases in equity after 1920 are due to devaluations of the French franc.

Source: ARP, 132AQ139.

economic activities in which they were obliged to compete on equal terms with other suppliers, through a careful selection of the sectors and business areas in which they moved: they were always rigid markets on a temporary or permanent basis, with few suppliers (like mercury or financial services in critical periods) or with a very high demand (copper, lead, sulphur). In these situations they managed to exert a powerful influence pricewise. This happened in cases like the mercury in Almadén, then in Le Nickel multinational, followed by a venture with the de Beers diamonds, and overall, in all the companies which they controlled in Spain.

Therefore, there are several elements to consider: firstly, that Deutsch & Cie., from its very inception, dealt with and was part of a group of producers whose main aim was the establishment of a cartel of oil

derivatives;⁶⁵ then, the RTCo developed an iron-clad control of its markets through reaching agreements with the rest of the producers;⁶⁶ finally, Peñarroya took part in several cartel agreements in Spain and Europe.⁶⁷ The case of MZA was very different from the rest of the mining and industrial companies, as railway transport was preconceived in Spain as a truly natural monopoly, due to its radial structure and the persistence on the part of the business sector to avoid the establishment of parallel railway lines. This is a factor which was emphasised further with the 1875 agreement between Norte and MZA, under which commodities were due to be transported by rail with the least distance in kilometres between origin and destination, or the 1896 agreement for traffic delivery.⁶⁸ On the other hand, the Rothschilds were very flexible with their corporate goals, not hesitating to support the implementation of several different models of capital management and production, with the sole aim of optimising the capital yield in each of these cases.

In Peñarroya the family opted to support a model of steady expansion in the company assets. In this way, the bankers gave room for manoeuvre to the company's executive team, made up mostly of technicians, who imposed a model of modern growth on Peñarroya, both horizontally and in the relationship between production and distribution, both through

65 ARP, 132AQ139.

66 The large pyrite companies, Rio Tinto, Tharsis Sulphur & Copper Co. and Mason & Barry agreed to share the market and underwrite an agreement in 1878 to raise prices. This agreement was in effect until 1884 and again from 1905 to 1921. That same year the Association of Pyrite Producers gave entry to the Société de Pyrites and Orkla. Rio Tinto never approved that agreement and before expiring it promoted, supported by Metallgesellschaft, the European Pyrites Corporation, which was in force until 1930. López-Morell, 'El acuerdo de creación de la Asociación de Productores de Piritas' (1996).

67 The Rothschild family kept the exclusivity of the Peñarroya sales throughout the 1881 contract, renewed in 1890, 1891, 1898 and 1904, until the end of 1909. That year, the contract was passed on to Metallgesellschaft, which was organizing a cartel of producers to raise the quotation of lead. After the First World War and the years that followed, the company took over the actual control of their sales through *Minerais & Metaux*, having significant involvement in the formation of international cartels from the middle of the twenties. López-Morell, 'Peñarroya, un modelo de Corporación.'

68 Comín, Martín, Muñoz and Vidal, *150 años de los ferrocarriles en España* (Madrid 1998), p. 216; and Gómez Mendoza, *Ferrocarril, industria y mercado*, p. 59.

internal growth or through continuous mergers, or by the setting up of subsidiaries and cooperation schemes, building up an amazing network of over 60 entities in the first 30 years of the twentieth century. The latter was emphasised by a pervading obsession with technology and an intelligent adaptation of their productive capacity (their own or their suppliers') and their refining and distribution facilities. The resulting industrial network turned Peñarroya into the world leader in the supply of lead, and the main provider of electricity, superphosphates and coal and its derivatives in their surrounding geographical location during the second decade of the twentieth century.⁶⁹

However, such dynamism did not exist in Rio Tinto, and the management made up their minds to take the utmost advantage of privileged deposits, where all the rewards of high-scale production could be effortlessly applied. Therefore, stake numbers remained unaltered, which ultimately proved the lack of ambition of their corporate strategy and the clear policy to encourage dividends, making most effective speculation of their shares in the stock market possible.

MZA, however, showed a totally different model from the previous ones. All its liabilities were turned into bonds with regards to paid-up equities, as was the rule in all the railway companies in the country as a whole. As a consequence, dividends were insignificant during most of the history of the company. The House of Rothschild took pride in keeping control of the company with just a small part of the shareholding interest and no ownership of bonds. Consequently, even if the promotion of MZA was a clear achievement of the Rothschild's, their actual participation in the business was relatively reduced and the risk assumed minimum.

Lastly, the fourth element describes that the success of the Rothschild family in Spain, and their leadership in European finance of the nineteenth century rested precisely in the effectiveness of their business network. The key in this case lays in the unusual structuring of their agencies. The

69 López-Morell, 'Peñarroya, un modelo de Corporación'.

Rothschilds barely had 50 employees in each of the main offices in Paris and London, but they had a wide network of agents and correspondents throughout Europe and America, granting them unprecedented information flows and management efficiency in their time.⁷⁰

The reason for the success of this network lay in complex normative and hierarchical norms, higher than purely economic incentives. In the agencies not all the employees were Jewish, but they were linked by very close family ties prompted by extreme endogamy. The agents, in addition, completed a training period based on the rotation around the different agencies, going through a thorough process of selection. All these factors reduced agency costs to a minimum.

The perfect synchronicity between main offices and agencies of the Rothschild House was completed with an elaborate channelling of economic information, arising from third parties and institutions. Such information was particularly important for setting up specific business and profiting from favourable market situations and it was purchased by the specialists at the House. It was also possible thanks to an undisguised closeness to power circles and the establishment of client networks within the Spanish elite, where insider trading and bribes were the usual instruments.

Similarly, another subtler, less ostentatious way of providing favours, compensating occasional collaborators or getting advantages was the incorporation of those aides to the boards of the companies directly controlled by the House in Spain. Hence, 15 Secretaries of State for the Treasury, nine Secretaries of State for Public Works and up to six Prime Ministers, plus a sizeable number of directors of the Bank of Spain, belonged to the boards of SEMI and MZA until 1923, which conveys a clear idea of the influence exerted by the companies on some members of their executive team.

70 In the Madrid Agency these activities were performed from 1835 by Daniel Weisweiler, who was joined in 1850 by Ignacio Bauer. Both they and their descendants developed a very intense relationship with their parent companies, reflected in uninterrupted correspondence for 90 years.

Peñarroya also made good use of the role of their partners, the Figueroa and the Canalejas family; meanwhile Rio Tinto never hesitated to maintain and strictly control political powers, paying out from their own budgets the expenses of several MPs and high government officials.⁷¹

VI.

On the other hand, it would be extremely interesting to provide some details so as to reflect whether this wide range of investments generated some kind of general business project, or whether, along the years, the presence of the Rothschild family in the shareholding interests of their companies would have originated some kind of cooperation or preferential treatment towards them. The overall conclusion is that there was no general plan to link specific geographical areas, nor was there any effect on the activities within these companies when integration and/or productive cooperation did not take place. In fact, the contacts between with them were scarce and uneasy on occasion.

The only instance of a certain entrepreneurial bond of a steady character was that of Peñarroya and MZA. This relationship had already started with the takeover of the *Cía. de Ferrocarriles de Badajoz*, and was then again inevitable, as the mining company needed the railway to place its production and transport the mineral to the Peñarroya foundry from the region of La Mancha. MZA, on the other hand, had high hopes set in that trade. We are aware that until of the Peñarroya–Puente del Arco line was finished in 1893, and until 1931, Peñarroya and MZA negotiated special contracts to sell their lead from the Peñarroya foundry by way of the port of Seville, as previously this was done through the port of Malaga.⁷² MZA

71 M. López-Morell and J.M. O'kean, 'Stable Network as a Source of Entrepreneurial Opportunities: the Rothschilds in Spain, 1835–1931' (2008).

72 *Spanish Railways Archive*, MZA. Board Secretary. Box 016-03.

even provided part of the material necessary to facilitate the relocation and an engineer to organise the traffic.⁷³ On the other hand, from the moment of their merger with Hullera de Bélmez, Peñarroya offered preferential contracts to MZA with prices lower than those offered to its own sister companies.⁷⁴ Nevertheless, the amounts reckoned were relatively small for the global consumption of MZA. Possibly, because this company used the contracts just to complete the mining production of their La Reunion sites, which provided its southern region network with coal.⁷⁵

We have found, however, several references in the company's books showing a distant, if not highly competitive, relationship between them. Peñarroya, for instance, showed in 1897 a great concern for a project of Rio Tinto's to win the collieries of the Bético–Manchega–Vizcaína, close to their own mines. Rio Tinto would eventually give up the Bético–Manchega, but the conflict with MZA existed who were also interested.⁷⁶ In 1912, the main arguments were certain disagreements between Peñarroya, la Unión Ibérica and Rio Tinto to divide the market of superphosphates in the south of Spain among themselves. Rio Tinto rejected selling pyrites to Peñarroya so as to deny them any kind of advantage, which was the cause of the acquisition by Peñarroya of the Sociedad de Piritas in Seville. In 1913 the market became so depressed that the opponents were obliged to negotiate. However, the results might not have been very good, because in 1914 talks had not been finalised and the consequences of competition were growing.⁷⁷

MZA itself, which at the outset was the closest of Peñarroya's allies, started to show concern for the railway development of the mining

73 *Metaleurop Archive*, PYA-Juridique. no. 257. Minutes of the Board. Book 3, session 24-10-1895.

74 *Metaleurop Archive*, PYA-Juridique. no. 257. Minutes of the Board. Book 3, session 26-5-1898.

75 Tomás, *La minería del Carbón*.

76 *Metaleurop Archive*, PYA-Juridique. no. 257. Minutes of the Board. Book 3, sessions of 14-10-1897 and 26-5-1898.

77 *Metaleurop Archive*, PYA-Juridique. no. 258. Minutes of the Board. Book 6, sessions 26-9-1912, 21-6-1913 and 26-3-1914.

company. In 1906, a confidential report was submitted to the board, which described the dire consequences of the railway connection between Peñarroya and its deposit in Puertollano, and especially, a hypothetical extension of the private line of this company from Puertollano to Linares, and from Conquista del Hoyo, again to Linares. If this extension became a reality, MZA reckoned would-be annual losses of 4,334,986 pesetas, although the disaster could reach greater dimensions if the mining company decided to ally with the Ferrocarriles Andaluces.⁷⁸

On the other hand, MZA also treated Deutsch & Cie. favourably, letting them build a warehouse in the facilities of its station in Madrid, and also buying some of their products for their workshops and haulage section. Nevertheless, the management of the company had no qualms about depriving the company of an oil contract in favour of the Sabadell-Henry House on the grounds of better rice and quality terms in 1912, despite the pressure exerted by the Paris Committee and Robert Rothschild himself.⁷⁹

In conclusion, these examples jeopardise the presumed interaction of the Rothschild companies in Spain. In any case, we would remark that any interest on the part of the bankers to promote actions of this type is highly doubtful. We undoubtedly ignore the response to other initiatives of integration of their industrial companies in Spain, but we reckon that they would have generated certain reluctance in Spain and in the very Boards of Directors of these companies.

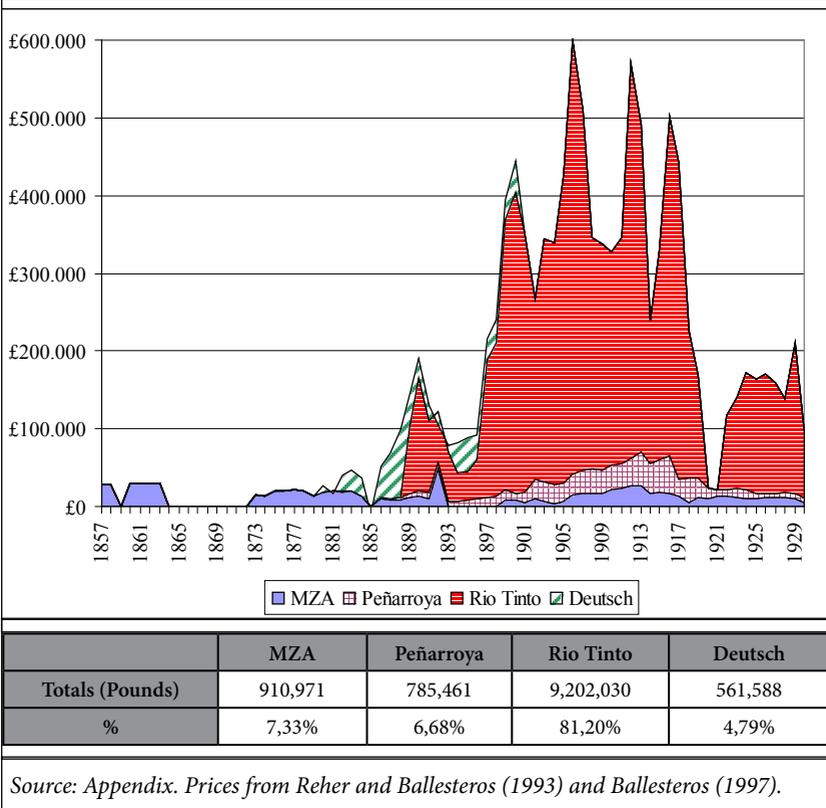
VII.

Moving on to the section on results yielded, we will refer, to begin with, as mentioned earlier, to the specific earnings of the Rothschild's as the

⁷⁸ *Spanish Railways Archive*, MZA. Board Secretary. Box 299-1.

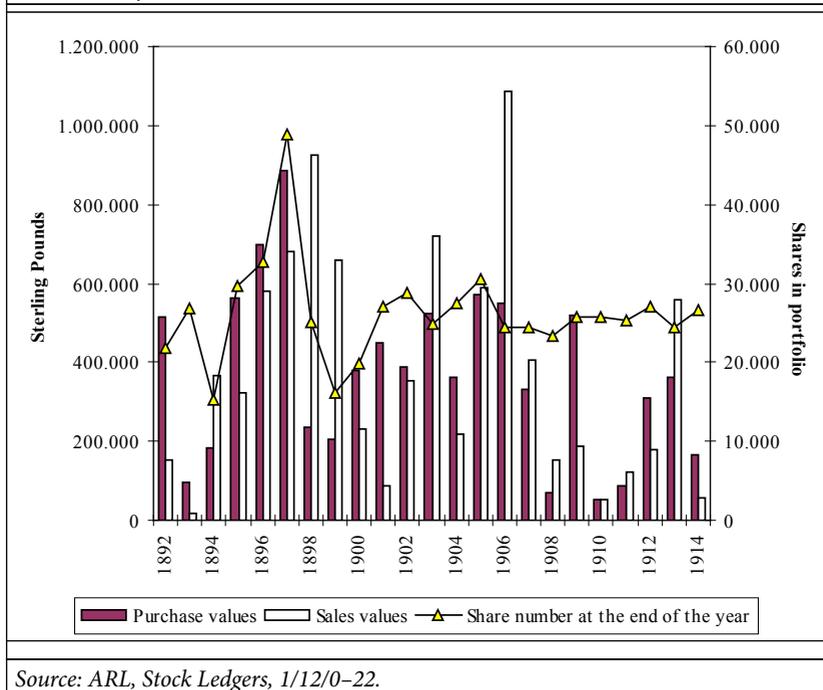
⁷⁹ Letters between René Lisle, of the Paris Committee, to Maristany, MD of MZA, dtd 20-1-1912, 27-1-1912 and 12-2-1912, *Spanish Railways Archive*, MZA. Board Secretary C/149/101.

Graph 6 – Estimation of yearly profits accountable accrued from the investments made by Spain in the House of Rothschild. (1856–1936). (1913 prices).



yield of their private investments. In order to carry out the closest of approaches, the same graph aims to show the amounts entered in the books or liable to be entered in net numbers for each business area, including the profits from dividends and interests⁸⁰ in the hands of the Rothschilds and profits from the financial tutorship of the companies controlled by them – generally profits for advances on holding tenure and a one per cent-commission on the payments of dividends and debenture coupons,

⁸⁰ MZA paid six per cent of the extraordinary interest to the founding partners between 1856 and 1863.

Graph 7 – Development of the stock operations by N.M Rothschild & Sons with Rio Tinto shares, 1892–1914.

although these have been entered in the books exactly when they appear in the documents.⁸¹

From the addition of all of these, plus their graphical expression in Graph 6, two main elements can be singled out: first, that the change from operations in the public sector to business investments did not produce any discontinuity in the balance sheet of the Rothschild House. Therefore, we may infer that the change of strategy marked in their businesses in Spain and their evolution was a success from the point of view of the investor. Secondly, it is easy to see that all the activities of the Rothschild House in Spain were really profitable and, due to the size of both the investment and

⁸¹ Figures previous to 1855 cannot be included, for lack of information on the route taken by most of the credit contracts, of which most of the maturities have not been found.

the assets, it was Rio Tinto, and not MZA that was the most profitable of them all. The financial profitability of this investment was 14.65 per cent p.a. during the whole period this company was under their control, with peaks in the period from 1896 to 1913, when the figure reaches 28 per cent on average. The difference was that the Rothschilds did not have to invest a 1,000 million pesetas to finance it, like they did with MZA.

Besides, there were other profit sources that did not always appear in the official balance sheets of the companies but belonged to the Rothschild business. We refer, for example, to the exclusivity in commercial contracts or speculation in shares of their own companies, or to the bonds issued by them, amongst others. However, no specific data is known on these variables in the archives of the House, either because they were lost or because they were integrated into other items. Fortunately, we are aware of other series of highly significant share accounts, which can act as proof of the profitability of their speculative activity, such as the share portfolio of Rio Tinto in the London Rothschild House.

Graph 7 shows the development of trade operations, their amounts and how the House of Rothschild was able to make large transactions compatible with maintaining a noteworthy share packet in the company. The speculative manoeuvres of the financial entity, which were aided by a substantial dose of insider trading in the company itself, were highly profitable, as the British Rothschilds were able to chalk up a profit and loss account of 1,912,646 pounds during that period. The Paris House possessed a bulkier Rio Tinto stock portfolio and managed to surpass even these figures.

With other portfolios, for example, that of MZA, the Rothschilds were barely able to speculate outside the years of development. They are even presumed to have worked with market prices which generated losses for them, so as to avoid the collapse of quotations during flotation. This was unthinkable in other portfolios of the House.

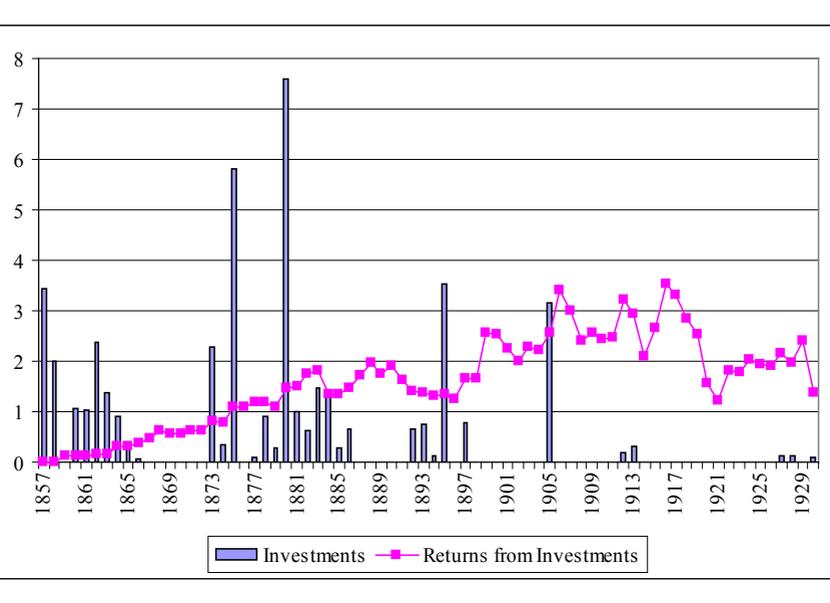
VIII.

A global vision of the price to be paid by the Spanish economy on account of these capital entries can be seen in Graph 8, presenting yearly aggregates resulting from the investment promoted by the Rothschilds in Spain. It is to be remembered that, as shown in Table 2, we are not referring simply to the amounts specifically invested by the house of Rothschild, but also to the capital they raised from the outside the Spanish economy, if we are to get a perspective of the foreign share in the figures presented.

Chronologically, the expansion of capital entries is marked by the peaks coinciding with the first capital injections for railways, in 1856–1864 and 1875–1884, as well as the operations to create and expand the capital of the above-mentioned mining and industrial companies. An evolving growth in the volume of capital withdrawals from the second decade of investment can also be observed. This departure had as its origin the huge financial weight of the MZA bonds, and ranged between one and 1.2 million pounds during the first third of the twentieth century. The spectacular returns from Rio Tinto kept annual averages at 69.05 per cent from 1897 to 1913. In the long run, this would mean a substantial negative net balance, when subtracting capital entries from capital withdrawals. However, applying a net balance to these capital returns regarding respective entries, and directly relating them to evolution of the balance of payments of the country at large, makes no sense.

In fact, to be even more accurate, other variables would have to be taken into account, like taxes paid by the companies involved, salaries, reinvestments which had not been accounted for, and many other items which would introduce a different perspective to the analysis. From 1918 to 1936 MZA, for instance, paid the government more taxes, duties, tariffs and franchises than those noted in the withdrawals we present, by virtue

Graph 8 – Capital entries from abroad through investments generated by the House of Rothschild and their remuneration (in million pound sterling)



Source: Calculated from Appendix 1.

of interest payments, redeemed bonds and shareholders' dividends.⁸² However, these sums cannot be reckoned as reinvestments.

Such frantic activity, with so many resources gathered, cannot be separated from the economic context of Spain at that moment. Despite the fact that some of the processes were completely speculative, their development necessarily exerted influences on other sectors. The map presented below represents graphically the powers of the industrial and service network directly controlled by the Rothschilds in the years 1919–1920, when these companies can be said to have reached the peak of their productive development and maturity, providing employment for more than 70,000 people.

⁸² MZA, *Actuación del Compañía durante los últimos 20 años, 1913–1931* (Madrid 1931), p. 231.

Map 1: Company facilities controlled by the Rothschild family or their subsidiaries, 1919–1920.



Source: *Our own elaboration.*

Regarding MZA's contribution to the Spanish economic development, the relevance of the communication and connection between the Catalan markets with those of the centre of Spain, Levant, Badajoz and the low Andalusia can be clearly seen in the graph. The arguments against the network, as an instrument created and linked to an export mining activity with a colonialist perspective lose their point in the light of the evidence supplied by recent historiography.⁸³ On the one hand, the analysis of the commodities transported by MZA, at the peak of mining production, clearly indicates that in no way were they the main component of the commodity railway traffic, as they never surpassed 20 per cent of the

⁸³ Nadal, *El fracaso de la Revolución industrial*, p. 50.

value of the commodities transported. In fact, most of the goods transported consisted of manufactured products and farming produce.⁸⁴ Gómez Mendoza,⁸⁵ applying G. Fogel's 'Social Savings'-concept to Spanish railways stated that the savings generated by the railway in Spain amounted to ten to eleven per cent of the national income in 1878 and 19–23 per cent in 1912. Although the deployment of this analysis has been controversial,⁸⁶ today no one questions the decisive contribution made by the railways, since it integrated the national market and helped the general development of the contemporary Spanish economy.⁸⁷ Additionally, in the case of MZA, capital came from French investors who, encouraged by the prestige of the House of Rothschild, invested their savings in an activity that would have a direct influence on the economic development of Spain, as it improved its communication network without employing the resources of private domestic savings.

The arguments for and against the mining investments in Spain and its economic development, particularly the foreign ones, could be summarised in two versions, one pessimistic and the other optimistic.⁸⁸ The pessimistic version dwells on the actual fact that there was little 'retained value' in the mining investment in the country.⁸⁹ That is to say, it refers to the profits of final sales that stayed in Spain regarding the returns that remained in the intermediaries' pockets and those belonging to the shareholders of the large foreign mining consortiums. According to some

84 Comín, Martín Aceña, Muñoz y Vidal, *150 años de ferrocarril*, vol. 1, pp. 226–228; and Anes, 'Relación entre el ferrocarril y la economía española'.

85 Gómez Mendoza, *Ferrocarriles y cambio económico en España*, pp. 93–97.

86 Barquín, 'El ahorro social: una perspectiva dinámica' (Madrid 1999), gave lower figures than those supplied by Gómez Mendoza, with the same parameters of analysis.

87 Garrabou and Sanz, 'Introducción' (Barcelona 1985), pp.29–67, remarked on the importance of the railways when reducing transport costs and equalizing farming prices all over the country.

88 Escudero, 'Pesimistas y optimistas' (1996).

89 Nadal, *El fracaso de la Revolución industrial*; Broder, *Le role des Interest*; Chastagnaret, *Espagne puissance minière*; Muñoz, Roldán and Serrano, 'La vía nacionalista del capitalismo español' (1978); Harvey and Taylor, 'Mineral Wealth and Economic Development' (1987); and Escudero, 'Pesimistas y optimistas', among others.

authors, this amount barely reached 30 per cent in some cases,⁹⁰ covering their share in the productive system and their contribution to the Spanish balance of trade. Also, recent research explicitly shows how small the influence of the mining activities was on the economic development of the country. In fact, an increasing number of specialists hold that mining, even in its most industrial scope, is a production branch which has little influence on the economic environment at large.⁹¹

However, the optimistic vision must be agreed upon,⁹² in the sense that there were also advantages in investment: the percentage, sometimes minimal, of the retained value is dramatically higher than the low results of the farming exploitations developed in the mining areas, all of which are of little economic value. In this context, mining activities would be much more profitable. As far as the rest of the arguments are concerned, we would point out again that we are dealing with an investment coming from overseas, which did not hinder the development of other sectors with less need of venture.

Finally, the question of 'indirect incentives' remains. Actually, many foreign companies searched for, requested and obtained extraordinary facilities for investments in Spain, mainly the Rothschild group. It is true that in some cases that practice seems to be confirmed, while in others the cause-effect relationship is not so clear, and has not been verified by documentary evidence. The railway case is very revealing. The heart of the mistake seems to be in stating the fact that the boom of railway building was a consequence of banking and railway legislation, apparently imposed by groups of specific foreign origin, even on the House of Rothschild itself. In fact, this is quite the opposite case. As we stated above, in 1855, when

90 Ibid.; Prados, *De Imperio a Nación*, pp. 192–195 reflects the opinion of some authors, although he reckons the retained figure was 89 per cent between 1875 and 1913.

91 Dobado, 'Boom minero y localización industrial' (Motril 1999), has proved that Almadén, a highly profitable mining exploitation had very little repercussion on the past and present economic development of the area. In other Spanish mining areas identical circumstances have occurred.

92 Tortella, *El desarrollo de la España contemporánea*; Prados, *De Imperio a Nación*; Coll, 'El Sector Minero' (1985); and Harvey and Taylor, 'Mineral Wealth and Economic Development'.

the new railway legislation had been in force for some months, nothing indicated such a spectacular rise as the one that took place months later. In actual fact, no demand for concessions had taken place to justify this. There were neither pressures nor bribes on the part of the Rothschild group or their agency to influence the format of this law, or the one related to banking passed in 1856. If there was any pressure, it came from the Pereires themselves, who, by then, had not granted any loan whatsoever to the Spanish Government, nor had they assumed any similar agreement. Undoubtedly, the competition between the Pereires and the Rothschilds' moving into Spain was a relevant factor in preventing the railway evolution taking place in the same lacklustre way as it had until then, notwithstanding the facilities granted by the law.

The relationship between the mining boom and the 1868 law merits the same interpretation. Contrary to what has been stated before, this legislation had no immediate effect and is not basis for the progress of investment. It was not to be consolidated in this sector until the 1880s, when the great European powers overcame the political and financial crisis of the beginning of the 1870s, reactivating their capital flows to overseas terrains. The marked increase in the demand for raw materials in Europe had also produced a rise in the demand for Spanish minerals some years before, and this brought about the origin of some well-known companies in the mining sector, such as the Real Compañía Asturiana de Minas, with Belgian capital, or the Tharsis Sulphur & Copper Co, with Scottish capital, within the framework of the previous legislation (1853 and 1866, respectively). Other investments, however, had their origins in other motivations, and are not in the liberal spirit of the Spanish politicians, even if they were to be associated with the needs of the Treasury, as in the case of Río Tinto Co, which was not the product of a concession born from the mining legislation, but from a sale carried out by the State of a part of its heritage.⁹³

93 Pérez de Perceval, 'Minería e instituciones: papel del Estado y la legislación en la minería peninsular contemporánea' (Madrid 2006), is of the same opinion.

On the other hand, Escudero, as Nadal before,⁹⁴ has repeatedly dwelt on the fact that the framework law favoured foreign capital over the small Spanish entrepreneur, who otherwise would have been able to exploit the natural resources of the country. I do not share this opinion. From my point of view, the endemic shortcomings of the entrepreneurship in the Spanish economy also occurred in the mining sector,⁹⁵ with the addendum that there were a series of comparative advantages granted to the foreign investments, to the detriment of their Spanish counterparts. In the first place, these entrepreneurs had solid financing sources and easy access to the market capitals of their countries of origin. This is due to the tradition of European stock exchanges, as compared to the poor financing given to Spanish companies by the Madrid and Barcelona stock exchanges.⁹⁶ It is also noteworthy that the foreign companies and entrepreneurs had better contacts in the international markets, although it has also been revealed that, on many occasions, the foreign entrepreneurs alternated their activities with overseas concerns, of which they were mere subsidiaries, which was a determining factor to profit from large scale production, thus reducing distribution costs.⁹⁷ Finally, these entrepreneurs adapted to new technologies more efficiently, which allowed them to operate with much lower costs than those of their domestic competitors. All of these advantages were absorbed by the House of Rothschild in that very sector. Therefore, we do not think that a more thorough protection of this sector, or of a specific group of Spanish entrepreneurs, would have meant a significant improvement for the Spanish industry, or its capacity to surpass Rio Tinto and Peñarroya in the international mining context. The latter, as

94 Escudero, 'Pesimistas y optimistas', pp. 86–88; and Nadal, *El fracaso de la Revolución industrial*.

95 Tortella, *El desarrollo de la España contemporánea*, cap. 7; and Carreras, Tafunell, and Torres, 'Business History in Spain' (Cambridge 2003), have elaborated on the railway.

96 Hoyo, 'La evolución de la bolsa', has proved that until the twentieth century 98 per cent of the capital collected by the Madrid Stock Exchange was focused on public debt.

97 Escudero, 'Concentraciones verticales en las minas de Vizcaya' (1998), himself has proved the importance of this factor for most of the Biscay companies.

I stated above, merged many a company in Spain, many of which offered themselves to be taken over, and always for the same reasons: their incapacity to finance themselves, the technical problems and the difficulties to place their production in the best possible conditions in the international market.

Nevertheless, Escudero is right when he criticises the traditional tax system in the mining area and the fact that its excessive lassitude meant a relevant loss of opportunities for the Spanish economy,⁹⁸ which was able to benefit very little from the golden age of mining in the country. Likewise, the companies controlled by the Rothschild group efficiently handled the channels of progress, as they did the pressure from the Basque area.

IX.

In this work it has been proven that the Rothschild group dominated most of the resorts of the Spanish economy at large, and played an important role in the evolution of its main industrial sectors. Its influence was extremely significant and diversified and undoubtedly its contribution was very consequential in economic growth, as their companies as a whole gathered hitherto unused resources and facilitated the speedy access of technology, so increasing the stock of human capital in Spain. This performance shows that in Spain there existed relevant business opportunities of an industrial basis, with a wide operative advantage over the surrounding countries, which just needed the factors available in its markets.

The weak point of these activities is that their performance generated fewer business prospects for the Spanish economy at large than investment could have meant in terms of development. In most cases it even impelled the massive export of profits, rather than the re-investment of production. On the other hand, these companies generated an overall framework

98 Escudero, 'Leyes mineras y grupos de presión' (1993).

of administrative corruption and rent seeking, both in the markets themselves and in the legislative scope, frequently clashing against the interests of the Spanish political and economic elites.

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Appendix 1: Variables in the Estimation of Capital Entries through Investments Generated by the Rothschild House and their Remuneration (1856–1930)

Capital Entries

- *SEMI*: Stock Capital.
- *MZA*:
 - Stock Capital: issues of 1856, 1875, 1877, 1880 and 1898.
 - Bonds. Only bonds issued abroad: Series 1 to 20, *Sevilla a Córdoba, Badajoz*. The last two after their takeover of *MZA*.
- *Rio Tinto*:
 - Stock Capital: issues of 1873, 1880, 1905. Not included 1929 issue, because it was full dedicated to investments outside Spain.
 - Obligaciones: issues of 1873, 1875, 1880, 1883, 1891 y 1895.
- *Peñarroya*: issues of 1880, 1893, 1903, 1912, 1913 and, 1914. For the 1925, 1929 and 1931 issues only the capital dedicated to investments in Spain.
- *Deutsch et Cie*. Capital of the partnership.
- *Compañía Agrícola del Lukus*. Contributed capital by Rothschilds in 1927, 1928 y 1931.

Remunerations from Investments

- *SEMI*: Share dividends and surplus in the liquidation, in 1868.
- *MZA*:
 - Share dividends received by non Spaniards.
 - Extraordinary interest for the founders (6% yearly between 1856 and 1863).

Interests of bonds issued abroad.

- *RTCo.*:
Share dividends
Interests of bonds issued between 1873 and 1896 to 1905.
- *Peñarroya*: Share dividends
- *Deutsch et Cie.*: net benefits. Only figures available from 1880 to 1900.
- *La Compañía Agrícola del Lukus*.

Changes applied: Martín Aceña (1989), pp. 390–391.

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The Presence of Foreign Capital in the
Banking System of Poland in the Interwar
Period (1918–1939)



FOREIGN CAPITAL IN POLISH BANKING 1918-1939

WOJCIECH MORAWSKI

Abstract

Before the First World War, foreign investments in Polish banking was rare, if we assume that the three countries occupying Poland at the time did not count as 'foreign'. The first large influx of foreign capital came in the 1920s, when Polish banking had been weakened by the war and subsequent inflation. In most cases the investments were short-lived, and the majority of capital was withdrawn during the Great Depression. The remaining foreign shares were eliminated during the liquidation of privately owned banks in the spring of 1946.

Introduction

Polish banking saw the first significant foreign investments in the 1920s. Most investors withdrew during the Great Depression, with the remaining foreign shares eliminated during the communist liquidation of privately owned banks in the spring of 1946.

Two important studies of the subject were published in the interwar period by Mirosław Smerek and Leopold Wellisz. Both authors distinguished home from foreign capital, through its country of origin, although Smerek also used a separate category of 'zionist capital'. The Second World War changed this approach, particularly with the disloyalty of the German minority in Poland. In 1943 Andrzej Grodek prepared a study of 'alien'

Table 1 – Estimated share of home and alien capital in Polish banking around 1938 according to Andrzej Grodek

		Banking houses	Joint-stock banks	Capital	Share in per cent
Home capital	Polish	3	14	194	68,8
	Jewish	25	3	28	9,9
	German	-	4	4	1,4
	Ukrainian	-	1	5	1,8
Home total		28	22	231	81,9
Foreign capital	German	-	12	30	10,6
	Belgian	-	1	0	0,2
	French	-	1	10	3,5
	English	-	1	2	0,8
	Swiss	1	-	2	0,8
	Dutch	-	1	1	0,4
	Swedish	1	-	5	1,8
	Foreign total		2	16	50
Grand total		30	38	281	100

*Source: A. Grodek, 'Żywioł obcy w przemyśle, górnictwie, finansach i handlu Polski. Próba ujęcia statystycznego, maszynopis z 1943 roku', in A. Grodek, *Studia nad rozwojem kapitalizmu w Polsce* (Warsaw 1963), Appendix no 2.*

(*obcy*) capital in the Polish economy. The term 'alien' had a wider meaning than 'foreign', and was used to further divide home capital using ethnic and national criteria. While perhaps understandable during the trying years of the war, today it strikes us as overly nationalistic. It should be noted, however, that Grodek decided against publishing his study: it

appeared posthumously in a volume of his collected works. The results of his research can be seen in Table 1.

The validity of some of Grodek's claims can be questioned – in particular he underestimated the importance of Belgian capital. Even so, his results are useful in that they illustrate different ways of understanding 'foreign capital' and the differences between 'alien' and 'foreign' capital.

Two authors tackled the question of foreign capital in Poland after the Second World War. Working together, Zbigniew Landau and Jerzy Tomaszewski, published a collection of primary and secondary sources, as well as a popular outline of the subject.

I. Foreign Capital in Polish Banking – a Chronological Approach

While capital from the three occupying countries was free to enter Polish banking during the partitions, investments from outside of this sphere were rare. Banks in the Russian partition boasted a strong financial position, strengthened by Russian banking law: restrictive but safe, and not dissimilar to its British equivalent. Considering it to be just another form of harassment, Poles mostly failed to see its virtues, including unparalleled stability: before Russia's departure from Poland in 1915, not a single private bank went bankrupt. Their strong position allowed Polish banks to penetrate the Russian market, while the reverse was rare. From among big Russian banks the two most heavily invested in Poland were Bank Włociański and Bank Azowsko-Doński. Truly foreign capital, coming from outside of the Russian Empire, appeared in Królestwo Polskie as late as 1913, in the form of French investments in Bank dla Handlu i Przemysłu SA in Warsaw.

Private banking in the Austrian partition was significantly weaker. Austrian law was based on a system of easy to obtain concessions: as a

Table 2 – Share capital of Polish joint-stock banks (in millions of 1927 złoty)

		1913	1919	1925	1930	1937
Share capital	Russian partition	510				
	Austrian partition	158				
	Prussian partition	59				
	Total	727	27	182	263	162

Capital given in 1927 Polish złoty based on the exchange rates: 1 rouble = 4.55 zł; 1 mark = 2.13 zł; 1 krone = 1.82 zł; 1 złoty 1927 = 29.8 Polish marks; 1919; 1 złoty 1927 = 0.71 złoty 1925.

Source: H. Nowak, *Bankowość w Polsce, vol. 1 (Warsaw 1932), p. 357, 364; Bulletin Statistique du Ministère des Finances, (Warsaw 1927–1937).*

result banks were relatively insecure. From among eight banks founded before the great Austrian banking crisis of 1873, only two remained in operation at the outbreak of the First World War. The failed banks had been undermined by further crises in 1886, 1890 and 1899. Viennese and Czech banks also operated in Galicia and the Duchy of Cieszyn. By law and practice credit systems of the various states of the Empire were partially separated and instead of the Österreichische-Ungarische Bank, their particular public banks acted as lenders of last resort. In Galicia this role was played by Bank Krajowy dla Królestwa Galicji i Lodomerii z Wielkim Księstwem Krakowskim.

From among the three, the weakest Polish banking sector could be found in the Prussian partition. First, joint-stock banks had been founded in the 1860s, starting in 1862 with Bank Bniński, Chłapowski i Plater ‘Tellus’ SA in Poznań. During the crisis of 1873 ‘Tellus’ went bankrupt and in the following years Polish banking was considered unsafe: a sentiment the Prussian administration tried to nurture. It wasn’t overcome until the first

Polish union banks flourished, with Bank Związku Spółek Zarobkowych SA w Poznaniu – acting as the group’s coordinator – founded in 1886. While an important institution for Polish national interests, it posed no threat to big commercial banks from Germany.

The First World War and the subsequent inflation significantly weakened Polish private banking, as can be seen in Table 2.

Banks in the Russian partition suffered the greatest losses. First, the evacuation of Królestwo Polskie in 1915 cut off their ties with the Russian financial market, and then the revolution of 1917 resulted in a final loss of assets in the old lands of the Empire. Most Galician banks were based in Lwów, and their greatest plight came during the first months of the war and the Russian offensive. After Austria retook Lwów, their situation got better, and the occupation of Królestwo Polskie allowed them to expand into the former Russian partition, starting in 1916. Prussian banks were able to do the same as early as 1915, achieving the strongest position from all three groups by the end of the war. As restrictive Russian law was lifted in the Królestwo, the system evolved towards the German model of banking. As a result, in the first years of Poland’s independence many new banks appeared, but they were neither safe, nor financially strong. At the same time, postwar inflation saw the first large influx of foreign capital into Polish banking.

Władysław Grabski’s 1924 reforms ended the period of inflation. Grabski believed that the private sector was strong enough to provide short-term credit, but post-war reconstruction needed long-term credit that could only be supplied by the state. He consolidated the public sector into three main banks: Bank Gospodarstwa Krajowego (BGK), Poczтовая Kasa Oszczędności (PKO) and Państwowy Bank Rolny (PBK), with two more added later: Bank PKO SA (founded in 1929) and Bank Akceptacyjny SA (founded in 1933). A new banking law was promulgated in December 1924. It followed the concessional model of registration and introduced a novel system (based on Czechoslovakian solutions) of minimum share

capital requirements, which differed, depending on the location of each bank's head office. In Warsaw they amounted to 2.5 million zł, in Katowice, Kraków, Lwów, Łódź and Poznań – 1.5 million zł, and finally one million zł elsewhere.

A banking crisis, which began in September 1925, highlighted the relative financial weakness of Polish private banks. At the same time, however, foreign capital started showing more interest in the Polish market, with the second half of the 1920s bringing major investments. They brought hope to the sector, which expected foreign capital to strengthen the chronically under-capitalised units. A few transactions were particularly important. An international consortium entered Bank Handlowy w Warszawie. Galician banks fostered their ties with Austrian capital, and Österreichische Credit Anstalt owned a strong concern containing Bank Dyskontowy Warszawski, Akcyjny Bank Hipoteczny in Lwów and Śląski Zakład Kredytowy in Bielsko. The 1925 crisis brought big losses for French capital with the bankruptcy of Bank dla Handlu i Przemysłu in Warsaw. In 1926, the French oil company Devilder acquired Polski Bank Przemysłowy SA. German capital owned a network of banks used by the German minority, and backed by major banks in Germany. While British capital made no major direct investments in Poland, it played a significant role through its short-term credit facilities, widely used by Polish banks. Belgian capital evolved into another major player: 1928 saw the creation of Société Financière et Industrielle Belgo-Polonaise (Finapol), which acquired Polski Akcyjny Bank Komercyjny SA in Warsaw. The Belgians were mostly interested in Polish power plants. Italian capital was represented by Banca Commerciale Italiana, which invested in Bank Handlowy Warszawski.

The 1925 crisis resulted in a clear division of labour on the market. Private banks concentrated on short-term credit and gave up on long-term credit, which remained the domain of public banking. The crisis also forced the government to change its banking policy in December 1926: a

banking supervision unit was established within the Ministry of Treasury, and weaker banks were dissolved. Finally, the government prepared a new banking act, promulgated in March 1928. More restrictive than its predecessor from 1924, in some points it came near to the old Russian model. Foreign banks were forbidden to operate branches in Poland. There were two exceptions: under the Upper Silesian Convention from 1922, German banks were allowed to keep their branches in the Polish part of the province, and an exclusive privilege was granted to Banque Franco-Polonaise from Paris.

In practice, government policy favoured the presence of foreign capital in banking. This did not apply to German capital which was viewed as hostile (unlike investments from Austria and Danzig). As a result, Germany's involvement was often hidden, like in the case of the Giesche concern and the Harriman group. If German capital was an example of hostility, French investments could be placed at the opposite pole. They were often motivated by political rather than economic means, and proved less solid than expected.

As foreign capital owners encountered problems in their home countries, the Great Depression started making itself felt in Polish banking. In March 1931, after the fall of Devilder, the French-owned Polski Bank Przemysłowy SA was forced to suspend payments. When Österreichische Creditanstalt fell in May 1931, a wave of panic struck Polish banks with Austrian capital. The German crisis, which came during the summer, provoked similar reactions towards banks with German involvement. The level of deposits kept falling until the middle of 1934, although the rate of withdrawal decreased after 1931. As the depression unrolled, a significant percentage of foreign capital left Polish banking. There were two exceptions: German capital was motivated by the political needs of the German minority in Poland, while the Belgians managed to secure a solid economic position. As private banking lost its standing, state-owned units grew in importance.

In the late 1930s, Polish banking slowly recovered from the Great Depression, but some scars proved difficult to hide. Much of foreign capital had left for good, private banks lost their position, and were supplanted by state-owned units. While the former managed to achieve a level of stability after 1936, the sector came increasingly under governmental surveillance,

Country of origin	1930			1936		
	Number of banks	Capital in millions of zł	Share in per cent	Number of banks	Capital in millions of zł	Share in per cent
France	3	17,3	7,3	1	3,0	2,0
Austria	7	16,3	6,9	4	5,1	3,6
Sweden	1	10,0	4,2	-	-	-
Great Britain	5	8,1	3,4	2	3,8	2,6
Germany	5	6,5	2,8	5	7,5	5,1
Belgium	3	6,3	2,7	3	10,0	6,8
USA	2	5,1	2,2	-	-	-
Switzerland	2	4,5	1,9	2	1,0	0,7
Italy	1	2,9	1,2	1	0,3	0,2
Hungary	1	1,8	0,7	1	0,6	0,4
Netherlands	-	-	-	1	5,0	3,5
Total		78,8	33,3		36,3	24,9
Grand total in joints-stock banks		236,7	100,0		145,8	100,0

Source: W. Morawski, Bankowość prywatna w II Rzeczypospolitej, (Warsaw 1996), p. 142. The difference between Table 1 and Table 2 stems from the fact, that Table 1 includes all privately-owned banks, while Table 2 only joint-stock banks.

especially with the introduction of exchange control in the same year. The Ministry of Treasury was free to revoke the right of every bank to trade in foreign currency, making its operations nearly impossible. This power remained the government's strongest weapon and was exercised but once: in the case of German-owned banks and Bank Komercyjny in Kraków, which fell under German control. Tables 3 and 4 show how the situation evolved.

The outbreak of the Second World War brought further changes. Banks operating on territories annexed by the Reich were liquidated. In the General Government, banks deemed Jewish, as well as those owned by countries at war with Germany, were either liquidated or taken over by Germany; banks with Italian capital enjoyed privileges until July 1943. State-owned banks were taken over by the Reich. Polish private banks could operate in a limited fashion, under the supervision of Die Bankaufsichtsstelle (banking supervisory authority). Apart from Bank Emisyjny w Polsce, there were four major players in the General Government: Dresdner Bank (through its subsidiary Bank Komercyjny w Krakowie, which was saved from liquidation), Deutsche Bank, Commerzbank and, starting in 1942, Bank der Deutschen Arbeit. In January 1945 they were all evacuated to the Reich.

After the Second World War, the nationalisation of banks seemed imminent. The Polski Komitet Wyzwolenia Narodowego Manifesto of July 1944 suggested the new government was committed to this, and with the Nationalisation of Industry Act from January 1946, it did indeed receive appropriate powers. Surprisingly, banks were instead closed down. The pre-war banking act from 1928 gave the Ministry of Treasury powers to revoke concessions, should any bank be found operating outside of the law. In December 1945 they were extended to banks deemed redundant for the national economy. Using this clause, almost all joint-stock banks and banking houses were put into liquidation in April 1946. This move absolved the state from any compensation to foreign shareholders (potentially only from Allied countries, as German-owned property had been taken over

Table 4 – Foreign liabilities and assets of Polish banks in 1928–1938.*			
Year	1928	1933	1938
Total			
- liabilities	536	234	116
- receivables	200	96	34
Great Britain			
- liabilities	110	45	17
- receivables	39	9	8
France			
- liabilities	90	48	20
- receivables	3	9	2
USA			
- liabilities	61	4	3
- receivables	72	13	4
Germany			
- liabilities	85	56	38
- receivables	20	20	13
Austria			
- liabilities	67	21	-
- receivables	7	2	-
Free City of Danzig			
- liabilities	19	12	10
- receivables	17	14	1
Belgium			
- liabilities	11	11	2
- receivables	1	0	0
The Netherlands			
- liabilities	46	11	6
- receivables	14	3	2
Switzerland			
- liabilities	19	11	10
- receivables	7	6	1
Sweden			
- liabilities	3	4	3
- receivables	1	0	1
Italy			
- liabilities	8	4	1
- receivables	1	0	0
Czechoslovakia			
- liabilities	11	1	2
- receivables	3	2	0
Other			
- liabilities	4	6	4
- receivables	15	9	2

* (In million zloty, data comprises Bank Polski, state banks, joint-stock banks, bigger banking houses and credit unions; in 1928 data from 31 December; in 1933 and 1938 from 30 September)

Source: W. Morawski, *Bankowość prywatna w II Rzeczypospolitej* (Warsaw 1996), p. 143.

without compensation). In practice, restoring the situation from before the war would have been very difficult, as Allied capital had been taken over by Germany and underwent significant changes and restructuring.

II. A Survey of Foreign Capital in Polish Banking

Austrian Capital

Austrian capital had been present in Galician banking before the First World War, and used these ties as a vehicle of expansion to other partitions after the conflict had finished. In most cases Galician branches of Viennese banks were reestablished as new firms, which kept their ties with the original owners.

In 1905 Österreichische Credit-Anstalt took part in a bail out of Bank dla Handlu i Przemysłu in Krakow, but this involvement proved short-lived. After the First World War, ÖCA transferred its Galician branches to Akcyjny Bank Hipoteczny SA in Lwów. It then invested in Bank Dyskontowy Warszawski and in 1922 co-founded Śląski Zakład Kredytowy in Bielsk. This created a strong ÖCA concern in Poland, composed of three banks (ABH, BDW, SZK). ÖCA's initial involvement in Polski Bank Przemysłowy SA in Lwów ended during the banking crisis of 1925, when the bank came under French control. After ÖCA's fall in May 1931, it lost control over the three Polish banks, which together became known as the BDW group. The group not only survived the Great Depression without any Austrian or Polish help, but enjoyed a surprisingly good financial position in the late 1930s. It was argued that this was partially caused by informal ties with Vienna (ÖCA representative Henryk Kaden remained a member of all three banks' management), and partially by an unofficial alliance with Bank Zachodni SA in Warsaw. The offices of both banks (which survived the war and stand to this day) were located next to each other on Aleksandra

Fredry Street in Warsaw. As it turns out, their treasuries were connected by an underground tunnel.

As banks merged in Austria, so did their subsidiaries in Poland. Before the First World War Boden Credit Anstalt became involved in Bank dla Handlu i Przemysłu, in 1920 renamed Bank Małopolski SA and based in Kraków. In 1923 a branch of the Viennese Union-Bank transformed into Bank Unii w Polsce SA with headquarters in Vienna. In 1928 Boden Credit Anstalt acquired Union-Bank, and Bank Małopolski took over Bank Unii. In 1930 Boden-Credit Anstalt was in turn incorporated into ÖCA, and Bank Dyskontowy Warszawski acquired Bank Małopolski.

When Germany gradually gained control over Austrian banks, the Polish administration changed its attitude towards their subsidiaries in Poland. In 1920 branches of Merkurbank in Lwów and Kraków were incorporated as Bank Komercyjny SA w Krakowie, fully controlled by its mother company in Vienna. During the 1931 crisis, the German Darmstädter und Nationalbank gained control of Merkurbank. As a result, Bank Komercyjny SA was treated in Poland like a firm with German capital: in was not given the right to trade in foreign exchange, and in 1938 was put into liquidation. This was cancelled in 1939, as the bank found a favourable patron in the General Government.

In 1923 Galician branches of Wiener Bank-Verein were established as Powszechny Bank Związków SA we Lwowie, which in 1930 moved to Warsaw, forming one of the 'big six' of Polish privately-owned banks. The involvement of Austrian capital in the bank was relatively stable, but Belgian capital slowly gained ground.

Powszechny Bank Kredytowy SA was founded in Lwów in 1910 with Österreichische Länderbank as its sole proprietor. The latter went under French control in 1922, and changed its name to Zentral Europäische Länderbank. The French owned 60 per cent and Austrians 40 per cent of its shares: the same proportions applied to PBK and remained unchanged until 1939.

Śląski Bank Eskontowy SA in Bielsk was founded in 1893 by Niederösterreichische Escompte Gessellschaft. Its primary goal was to provide credit for the textile and coal industries in its home city and the Ostrawsko-Karwiński industrial zone respectively. After the First World War, it was taken over by the Wiener Lombard und Escompte Bank, which went bankrupt in 1924. ŚBE managed to stay afloat, but its ties with Austrian capital were broken. Niederösterreichische Escompte Gesellschaft took part in the 1927 bail out for Bank Handlowy w Warszawie SA, buying seven per cent of its share capital. This involvement lasted until the Great Depression.

Two Italo-Austrian firms: Societa Italiana di Credito Commerciale and Banco di Credito Italiano-Viennese (each with head offices both in Milan and Vienna) co-founded Polski Powszechny Bank Kredytowy SA in Katowice, which operated briefly between 1924 and 1925.

Leon Biliński (former governor of Österreichische-Ungarische Bank) tried to found the Vienna-based Bank Polsko-Austriacki. Despite the co-operation of Dom Bankowy Robert Goldschmidt, the initiative failed.

German Capital

After the First World War German banks could not remain in direct control of their branches in Poland (apart from the Silesian voivodeships). As a result, they founded new banks under Polish law.

Dresdner Bank thus gained control over the Bank für Handel und Gewerbe AG in Poznań (founded in 1920), controlling assets of Ostbank, which had moved to Königsberg; a small company in Katowice; Oberscheisen Bank AG; and Landesgenossenschaftsbank in Poznań. The last of these acted as coordinator of German union banks in Poland, and in turn controlled Bank Spółek Niemieckich w Polsce SA (founded in Łódź in 1920) and Agrar und Commerzbank SA (founded in Katowice in 1922).

Deutsche Bank controlled Oberschlesische Bankverein AG in Pszczyn, founded in 1920 and later moved to Królewska Huta (Chorzów from 1934).

Darmstadt Bank remained in control of Oberschlesische Discontobank AG (Górnośląski Bank Dyskontowy SA) in Rybnik, which, after the partition of Silesia, also moved to Królewska Huta.

Under the Upper Silesian Convention, three German banks retained the right to keep their branches in the Polish part of the province: Bank für Handel und Industrie in Katowice, Mysłówice and Rybnik; Deutsche Bank and Dresdner Bank in Katowice; under the same Convention, the direction of der Discontogesellschaft had the right to open a single branch in Katowice. On the basis of reciprocity, two Polish banks had the right to keep their branches in the German part of the province. In Pomorze, German banks preferred to operate via Danziger Privat Aktionbank, as companies from the Free City of Danzig were treated better by Polish authorities. Danziger Handels und Industrie Bank, founded in 1922 in co-operation with the Scheibler concern in Łódź, controlled Bank Międzynarodowy Warszawski SA. Both were put into liquidation in 1933. The former's branches in Łódź then formed Dom Bankowy Najda, Bracia Winter i Weiss.

The 1925 crisis did not negatively affect German banks in Poland. They were able to get financial help from Germany, and improve their position in the market. The Great Depression saw a consolidation of big German banks – as a result almost all German banking in Poland came under the control of Dresdner Bank. Moreover, after its acquisition of the Vienna-based Merkurbank, Dresdner Bank became the owner of Bank Komercjalny in Kraków.

The *Anschluss* (annexation) of Austria widened the German presence in the market, provoking reactions from the Ministry of Treasury. In 1938 it revoked foreign exchange rights of the Dresdner Bank branch in Katowice and Bank Komercjalny in Kraków, and subsequently placed them in liquidation.

French Capital

Following the alliance of 1891, French capital moved into Russia. Mostly pursuing industrial investments in the Empire's hinterland, its owners considered Królestwo Polskie too close to Germany, and as a result too dangerous. It wasn't until 1913 that Union Commercial et Industriel de Paris invested in Bank dla Handlu i Przemysłu SA in Warsaw. The latter rode the wave of inflation to become the biggest Polish privately owned bank, but the banking crisis of 1925 saw it go bankrupt in an equally spectacular manner. This ended the career of Union Commercial et Industriel de Paris in Poland.

In 1922 Banque de Paris et Pays-Bas acquired 60 per cent shares of the Viennese Zentral Europäische Länderbank, and through it – Powszechny Bank Kredytowy SA in Lwów (moved in 1926 to Warsaw) – which it retained until the outbreak of the Second World War. A reliable company, it was one of the 'big six' Polish privately owned banks in the 1930s.

While the previous two examples were motivated economically, Bank Śląski SA in Katowice was founded for purely political reasons. In November 1920 Polish authorities sent Artur Benis, an economist from Kraków, to interface with Entente members in order to garner support for Poland on the Silesian question. Even though he had been given the power to grant considerable economic concessions, the results were meagre: neither the British nor the Italians were interested, and while the French engaged in further talks, they had already supported Poland. Among other concessions, the French were granted the right to found a joint Polish-French bank known as Bank Śląski SA in Katowice. The bank proved to be too weak and unable to counter the strong German position. Polish shares were administered by the state-owned BGK, while the rest were divided among a number of French companies, such as Skarboferm, Mines de Czeladź and the Parisian bank Société Generale de Credit Industriel et Commercial. Skarboferm was a joint Polish-French company founded in

1922 to manage coal mines in Upper Silesia. In 1925 Bank Śląski reported losses, and in the following years wasn't able to turn a profit. In 1931, it was quietly decided to put the bank into liquidation, which indeed happened in May 1932.

While French capital in Poland suffered heavy losses during the crisis of 1925, in August 1926 the French oil concern Devilder (formed by Crédit Général des Pétroles and Société Financière de Paris) acquired 92 per cent of the shares of Polski Bank Przemysłowy SA in Warsaw. It acted as a link between French capital and the Polish oil industry, but failed as a result of Devilder's bankruptcy in 1931.

Due to the volatility of the market, the safest way to influence the Polish economy was through a bank located outside of the country's borders. French capital seemed to have learned this fairly early, and in 1920 Banque Franco-Polonaise SA was founded in Paris. Its shares were owned by Banque de Paris et des Pays-Bas (Paribas), Banque de l'Union Parisienne, Société Général de Crédit Industriel et Commercial, and Skarboferm. It received a unique right to open its branches directly in Poland.

British Capital

British capital appeared in Polish banking as early as 1919, with an investment in Bank Handlowy Wilhelm Landau SA in Warsaw, although the bank was weak and the engagement short-lived. Bank Angielsko-Polski SA, mostly owned by British Overseas Bank Ltd., was a more serious endeavour. BOB was founded in London in 1919 and aimed to operate in Poland and the Baltic states. BOB's chairman – Arthur Gardner – assumed the same role in Bank Angielsko-Polski. BOB itself had a wide array of shareholders including: Anglo-South American Bank, Dominion Bank (Canada), Glyn, Mills Currie & Co., Charles Hoare & Co., Imperial Ottoman Bank, Northern Bank Corp., Union Bank of Scotland and

William Deacon's Bank. The group mostly showed interest in the Polish sugar industry. Bank Angielsko-Polski SA managed to survive the crisis in 1925, and while not big, it maintained a fairly strong position and was a considered a foothold for British interests in Poland. It controlled Spółka Handlowa Cukrowni Związkowych (which united sugar-refineries from the Russian partition). BOB influenced those in the Prussian partition through credits granted to Bank Cukrownictwa SA in Poznań. In 1934 Bank Angielsko-Polski merged with the largest Polish privately-owned bank, Bank Handlowy w Warszawie (which had also been partially owned by Hambros Bank from London, as a result of its bail out in 1927). After 1934 BOB became the largest foreign shareholder of BHW, but its role decreased. It withdrew entirely in 1938, due to difficulties with its Spanish and German operations.

In 1924 Johnson Matthey & Co. bought 95 per cent of Powszechny Bank Depozytowy SA in Warsaw. In May 1925 the bank engaged in currency speculation, which led to the arrest of one of its board members. The bank had ties with its sister company Matthey & Co. in Vienna. The Great Depression undermined its position and liquidation followed suit in 1934.

In 1924 the Jewish Colonial Trust from London bought 58 per cent of shares in Łódzki Bank Depozytowy SA. The situation remained unchanged until 1939, although Jewish Colonial Trust underwent restructuring.

On 22 September 1925 'The Times' published an article about the crisis in Polish banking. Warning British investors against engaging in Poland, its author recommended using banks from the Free City of Danzig when practicable. This provoked a serious reaction from the Polish government. In late 1926 BGK and Anglo-International Bank co-founded The British and Polish Trade Bank AG in Danzig, with the aim of preventing German banks from controlling Anglo-Polish trade. BGK owned 81.5 per cent of its shares, and its partner the remaining 18.5 per cent.

In general, the British share in Polish joint-stock banks wasn't very impressive (3.4 per cent, fourth position in the ranking). On the other hand, British banks acted as the main foreign providers of credit for the Polish sector, which gave them a strong position.

Belgian Capital

Belgian capital in Poland rose to prominence gradually. Banque Belge pour l'Étranger in Brussels became its first representative, with a purchase of shares in Powszechny Bank Związkowy SA in Lwów. The Belgian company had ties with one of the biggest European banks: Société Générale de Belgique. Its presence in PBZ lasted until 1939 and the bank was considered one of the 'big six' of Polish privately-owned banking.

Banque de Bruxelles took part in the 1927 bail out of Bank Handlowy w Warszawie SA, and later owned six per cent of its shares, although its presence diminished during the Great Depression.

In 1928, Société Financière et Industrielle Belgo-Polonaise ('Finapol', founded in 1919) acquired Polski Bank Komercyjny SA in Warsaw. The banks served the electric power industry, as 'Finapol' controlled 15 per cent of Polish power plants.

Before the Great Depression the presence of Belgian capital in Polish banking shares amounted to 2.6 per cent and gave it the sixth position. It engaged in a number of select enterprises, avoided speculation, and did not use the opportunity to make Polish banks dependent through short-term credit. During the depression, unlike its counterparts from other countries, Belgian capital was not withdrawn. As a result, Belgium emerged as the most important source of foreign capital in Polish credit facilities in the late 1930s.

In 1932 Jean B. Richard, a banker from Brussels, attempted the bailout of Polski Bank Handlowy SA in Warsaw, which changed its name to Bank

Likwidacyjno-Kredytowy SA. Richard bought 3.7 per cent of its privilege shares, each worth ten votes. As a result he possessed 37 per cent of votes. His attempt did not save the bank from bankruptcy.

American Capital

For American capital, the biggest opportunity in Poland came via ties to Poles living in the United States (part of the Polish diaspora, or Polonia). In 1921 Guaranty Trust co-founded Syndykat Przekazowy Banków Polski SA, which aimed to service money transfers from American Polonia to Poland. The enterprise failed to achieve its goal, which was taken up in 1929 by the state-owned Bank PKO SA.

The time of inflation saw a number of attempts to directly engage the Polonia in Polish banking, in particular through Polski Bank Handlowo-Przemysłowy SA in Kraków, Bank Centralny dla Handlu, Rolnictwa i Przemysłu SA in Warsaw and Bank Stowarzyszenia Mechaników SA in Warsaw. None of these firms survived the 1925 banking crisis. In 1920, after an American visit of priest Stanisław Adamski, further Polonia investments were made in Bank Związku Spółek Zarobkowych SA in Poznań. Before the decision, American Poles wanted to be sure that the bank had no privilege shares – and Adamski misled them saying that it did not. When they bought shares from the bank's ninth issuance, the tenth and eleventh issuances had already been prepared. Both contained privilege shares, which Adamski had known. This dissuaded the Polonia from further investments, and its share, which in 1926 amounted to some 22.5 per cent, systematically fell in subsequent years.

In 1923 the American Jewish Joint Distribution Committee bought Bank Rosyjsko-Polski SA in Warsaw (founded in 1921), and changed its name to Bank dla Spółdzielni SA. The bank was supposed to become the base for the committee's welfare operations in Poland. In the late 1920s, the

committee's engagement in the bank fell to ten per cent and during the Great Depression the company was put into liquidation.

Since German capital was mistrusted in Poland, between 1925 and 1926 the American group of William Harriman de iure took over the assets of the tin concern Gieshe in Upper Silesia. In 1927 Harriman's group took part in the Bank Handlowy w Warszawie SA bail out, buying eight per cent of its outstanding shares. The group withdrew from BHW during the Great Depression.

American capital no longer directly engaged in Polish banking after the Great Depression. Indirectly, it continued to drain the Polish market through credit.

Italian Capital

Ties between Polish and Italian banking date to before the First World War. Józef (Giuseppe) Toeplitz, a member of one of the leading Warsaw banking families, started working in Banca Commerciale Italiana. He became its chairman in 1917 and held the position until 1933. In 1919 BCI acquired Bank Zjednoczonych Ziem Polskich SA in Warsaw.

During the time of inflation, Italian capital had a foothold in Upper Silesia in the aforementioned Polski Powszechny Bank Kredytowy SA in Katowice, owned by Italo-Austrian firms: Societa Italiana di Credito Commerciale and Banco di Credito Italiano-Viennese. In 1925 the bank was put into liquidation.

In 1927 BCI took part in the bail out of Bank Handlowy w Warszawie SA. As a result, Bank Zjednoczonych Ziem Polskich merged with BHW, and BCI gained nine per cent of the latter's share capital. In 1935 they were taken over by Giuseppe Toeplitz's heirs and Assicurazione Generali Trieste.

Italian investments in Polish banking were surprisingly effective, considering their modest size. Italy was the most important foreign

shareholder in the biggest Polish private bank and two chairmen of the Polish Banking Union (Związek Banków w Polsce): Henryk Kaden (1924–1927) and Stanisław Lubomirski (1932) had ties with Italian capital.

Czech Capital

Czech capital had been present in Polish banking during the Austrian partition: Żiwnostenska Banka owned a branch in Bielsk, Pražská Úvěrní Banka in Lwów and Brody, Česká Průmyslová Banka in Kraków, Ústřední Banka Českých Spořitelém in Kraków and Lwów, and Záložni Úvěrní Ústav from Hradec Kralowe – in Kraków. All of these banks left Poland soon after the First World War.

Bielsko-Bialski Bank Handlowy i Przemysłowy SA had been founded in 1869. A small bank, in the late 1880s it found competition from Union Bank (Prague) hard to bear. Its owners could either close the bank down or invite Czech capital. The latter path was chosen, and from 1891 the bank operated as a branch of the Czech Union Bank. In 1920 it became independent and changed its name to Śląski Bank Przemysłowy SA in Bielsk. Most of its shares were taken over by Polski Bank Przemysłowy SA in Lwów, which for a short time also had ties with Czech capital.

The same bank from Lwów acquired Bank Przemysłowy Warszawski SA. It had been co-founded in 1913 by Żiwnostenska Banka from Prague. In 1918 two other banks from Prague: Pražská Úvěrní Banka and Agrobanka helped increase the share capital of Ziemski Bank Kredytowy in Lwów and for a few years controlled half of its board.

Shortly after the First World War, Poland was a fairly attractive market for Czech banks, which could count on old Austro-Hungarian ties. For a time one could even talk about an attempt to create a large Czech group in Polish banking (Polski Bank Przemysłowy, Warszawski Bank Przemysłowy and Śląski Bank Przemysłowy). However, as a result of inflation and poor

political relations between the two countries, Czech capital withdrew in the mid-1920s.

Swiss Capital

Banque de Commerce de Bâle was one of the shareholders of Powszechny Bank Związkowy SA in Lwów, which in 1930 moved its head office to Warsaw. When the bank had to quietly reduce liabilities by 10m zł to avoid bankruptcy in 1933, the Swiss withdrew and Belgian capital acquired its shares.

In 1927 La Séquanaise Capitalisation, a company from Geneva, acquired Bank Prywatny SA in Warsaw, expanding its share capital from 0.5 million zł to the legal minimum of 2.5 million zł. At the same time the bank's name was changed to Szwajcarsko-Polski Bank Kapitalizacyjny SA w Warszawie. As a result of the Great Depression, the bank was put into liquidation in 1931, as it was 'unable to meet the goals it set for itself'.

Dom Bankowy A. Holzer in Kraków and Dom Bankowy Wohl in Zurich were bound by strong ties throughout the entire period, resulting from family connections.

Latvian and Estonian Capital

In 1921 Polski Akcyjny Bank Komercyjny SA was created in Łódź, taking over Polish branches of the Petersbursko-Ryski Bank Handlowy SA. It kept strong ties with the mother institution's successors: the Ryski Bank Handlowy and Estoński Bank Przemysłowo-Handlowy in Dorpat (Tartu). PABK moved to Warsaw, but its losses during the 1925 crisis convinced Latvian and Estonian capital to pull back. In 1928 the bank was taken over by the Belgians.

Swedish Capital

In 1926 Ivan Kreuger's match concern founded Bank Amerykański w Polsce SA in Warsaw. The name was misleading, as the bank had no connections with America, and served as the Swedish concern's fund. Kreuger believed that the adjective 'American' (amerykański) commanded particular trust in Poland. After Kreuger's fall in 1931, the bank came under Dutch control.

Dutch Capital

As Ivan Kreuger's concern went bankrupt, the Dutch match monopoly took over Bank Amerykański w Polsce SA.

Hungarian Capital

Despite common history in the Habsburg Empire, there were no banking ties between Galicia and Hungary. In 1928 Pesti Magyar Kereskedelmi Bank took part in the bail out of Bank Handlowy w Warszawie SA, gaining 6 per cent of its shares, but withdrew during the Great Depression. Also during the depression, Ungarische Allgemeine Creditbank entered Bank Dyskontowy Warszawski SA, becoming the owner of – coincidentally – six per cent of its shares.

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THE DETERMINANTS OF FOREIGN BANKING ACTIVITY IN POLAND DURING THE INTERWAR PERIOD

CECYLIA LESZCZYŃSKA

Abstract

This paper attempts to find explanatory variables for foreign banks' activity in interwar Poland, considering three categories of factors: risk conditions (capital controls, host country conditions), political connections and foreign investment flows (FDI). Polish borrowers on the bond loan markets were the government, banks and industrial companies. Bond loans were issued through large foreign banks and foreign companies.

World War I created a new situation in the Polish financial markets. After the turbulent times of 1920–1924, financial markets were opened, especially when the gold standard was restored from 1927. Poland returned to completely free foreign exchange markets and international capital movement. During this time foreign loans contributed to economic development. Further, the growth of GDP was among the highest in the Poland's interwar period. The Great Depression of the 1930s, capital outflow and a wave of exchange control in European countries put pressure on Polish foreign exchange reserves. In 1936 foreign trade and foreign lending became subject to regulations and restrictions. The reaction of the Polish government to the presence of foreign financial institutions and foreign capitals in the Polish economy changed from acceptance to criticism.

Introduction

The presence of foreign banks in the Polish economy in the mid 1920s and early 1930s as well as the determinant of their largest activity in terms of volume observed in the period are the subject of this analysis. What attracted foreign banks to start their activity in Poland was first of all the political and financial stability achieved by eliminating the main barriers and risks. After the financial reform of 1924 Poland based its currency system on the gold exchange standard and made some steps to facilitate free and unrestrained foreign exchange payments. A central Bank, Polski S.A., which was independent from the government had been founded; its aim was to implement a stable zloty exchange rate policy. The period was aborted by the currency and banking crisis of 1925, which was connected to the economic recession. In the years 1927–1929 foreign banks once again took interest in their activity in Poland, which had weakened in times of crisis and had come to a de facto stop by the mid-1930s.

The activity of foreign banks in the Polish economy has adopted diverse forms. In principle, we can divide it into: loans to the Polish government; the acquisition of shares in the initial capital of Polish banks or in the establishment of their own branch offices; and the extension of credits (direct and indirect) to enterprises and banks. Each of these forms has been induced by different factors. They will be analysed in this study. In Part I the determinants of the foreign banks' activity on a theoretical level have been presented. In Part II the economic-financial situation of Poland has been characterised, which has appeared to be a significant factor affecting the foreign banks' activity. In Part III the loans granted to the Polish government by the foreign banks have been described. In Part IV the activity of the foreign banks within the Polish banking sector has been analysed. Part V contains the conclusions.

I.

The expansion of foreign banks' international activity is a historical process, however, its scale and dynamics have been gathering significant pace only in recent decades. Nowadays, scientists' research refers to many theories¹ on the determinants of banking activity worldwide, and their attention has been drawn to two tendencies in particular. The first indicates that the banks follow the customers, so that their presence in external markets results from the international activity of non-financial companies. The second one indicates the banks' intrinsic expansion, and some scientists turned to pay their attention to such determinants as the differences in levels of interest rates, specific local advantages or finally, to the attributes of national economies, where expansion takes place.²

While explaining the banks' activities and expansion on a worldwide scale, some researchers refer to theories describing the activities of multinational companies. Banks' foreign expansion is discussed on the basis of a theory of internationalisation concerning an enterprise, which explains the reasons why enterprises are founded abroad, or why an enterprise gets involved in activity on an international scale.³ These processes are explained with the help of a theory of foreign direct investment (FDI).⁴ Usually, scientists refer to an eclectic theory by J.H. Dunning, which is considered a general FDI theory, and to an analysis by S.H. Hymer.⁵ Dunning puts forward a hypothesis that an enterprise takes decisions on FDI in

1 E. Chrabonszczewska, *Międzynarodowe strategie banków* (Warsaw 2006), pp. 2–3.

2 Theories' review: S. Fotopoulos and F. Siokis and H. Papapanagos, 'The Determinants of the Foreign Banks Expansion in South Eastern Europe. Do Greek Banks Still Follow Their Customers Abroad or Not?', 2010 International Conference on Economics, Business and Management IPEDR, 2 (Manila 2011).

3 J. Rymarczyk, *Internacjonalizacja i globalizacja przedsiębiorstwa* (Warsaw 2004), p. 11.

4 I. Romiszewska, *Internacjonalizacja banków niemieckich* (Poznań 2004), p. 21.

5 J.H. Dunning, *International Production and Multinational Enterprise* (London 1981, 1988); S.H. Hymer, *The International Operations of Nation Firms. A Study of Foreign Direct Investment* (Cambridge 1976).

the event that its activity abroad is considered to be more profitable than that of domestic markets. Foreign expansion and direct investment takes place only in the situation where the company gains certain advantages (profits): ownership-specific advantages, location, and internalisation. The ownership advantages are connected with higher managerial skills, technology, effects of economy of scale, and the differentiation of services. Location advantages result from a favourable position and country conditions in international transactions. The greatest advantage of internalisation lies in its merging of international arbitration and capital flow.⁶ When presenting factors which motivate entrepreneurs to invest, Hymer has pointed out that direct investments may be understood as a specific form of capital flow and they may result from international operations performed by companies willing to keep control over production and competitors, and that the portfolio of investments result from differences in interest rates.⁷

The authors developing the location theories were looking for factors which determined the direction of expansion, including direct external investments.⁸ Branch offices opened abroad were expected to secure the company's presence in the international market, and thus its investment efficiency and competitiveness. In other papers it has been shown that the effectiveness of expansion depends on a level of development of the bank and its position in the domestic market; it also depends on profit opportunities, GDP per capita and the inflation level in the destination country.⁹

6 J.H. Dunning, 'The Eclectic Paradigm As An Envelope for Economic and Business Theories of MNE Activity', *International Business Review*, 9 (2000), pp. 164–84.

7 S.H. Hymer, *The International Operations*, pp. 10, 30–1.

8 E. Cerutti, 'How banks go abroad: Branches or subsidiaries?', *Journal of Banking & Finance*, 31 (2007), pp. 1669–92.

9 D. Focarelli and A.F. Pozzolo, 'Where Do Banks Expand Abroad? An Empirical Analysis', *Journal of Business*, 6 (2005), pp. 2436–61; G. Birindelli and S. Del Prete, 'The Internationalization of Italian Banks: Direction and Organizational Reshaping', *Journal of Money, Investment and Banking*, 18 (2010), pp. 107–17.

Others referred to the maximum profit theory and the theory of diversification of external investments.

Banks operating in international markets also perform financial and operational functions. They support and finance the external investments of domestic companies, secure financial aid for the exportation of goods, and guarantee the quality of capital flow and payment services. They also fulfil an information function, give advice to customers on business perspectives and overseas regulations. The way in which the internationally operating bank enters international markets depends on its size, its profits and to what extent the bank is internationalised.

Modern empirical studies do not determine which of the determinants of banking activities are dominant. The research conclusions listed by L. Voinea and F. Mihaescu are presented in Table 1. These concern different countries. They prove that the most frequently observed and recurring factors were: foreign trade, FDI and political risk.¹⁰

As L. Voinea and F. Mihaescu have reported, some of the factors, which are important to banks' external investments, like the 'follow the customer' factor, have been included in such factors as FDI or bilateral trade. You may even call it a sort of foreign capital flow order: FDI – banking loans – portfolio investments. Another group of factors is connected with market attractiveness, and characterised by the GDP level and expected financial profits. What seems to be of importance is the level of development of the financial market, which in many studies is treated as a significant factor. In the case of the Eastern European countries it has not yet played a major role. The next group of factors can be bound with the risk notion: here we talk about political risk, banking sector stability risk or the risk of the currency exchange rate. However, in the cited studies they did not show to be of greater importance.¹¹

10 L. Voinea and F. Mihaescu, 'The Determinants of Foreign', p. 6.

11 L. Voinea and F. Mihaescu, 'The Determinants of Foreign', pp. 7–8.

Table 1 – Determinants of foreign banking entry/activity			
Authors	Countries	Explanatory variables	Significant
Bol et al (2002)	Croatia and 7 countries from Central Europe - recipient	Reform EU accession	Yes (+) No
Aviat, Coeurdacier (2004)	19 countries (incl. 13 EU countries) – origin 62 countries (incl. Bulgaria, Croatia and 7 countries from Central Europe) - recipient	Trade Distance	Yes (+) Depends
Papaoannou (2005)	19 countries (incl. 13 EU countries) – origin 51 countries (incl. Bulgaria, Croatia, Romania and 7 countries from Central Europe) - recipient	Size Institutions EU law harmonization Distance Political risk Corruption	Yes (+) Yes (+) Yes (+) Yes (-) Yes (-) Yes (-)
Magri et al (2004)	Italy - recipient	Trade FDI Profit opportunities Country risk	Yes (+) No Yes (+) No
Buch (2000)	Germany - origin	FDI Trade GDP	Yes (+) Yes (+) Yes (+)
Wezel (2004)	Germany - origin	Manufacturing FDI Financial market development Country risk GDP Trade	Yes (+) Yes (+) Yes (-) No No
Garcia-Herrero, Martinez-Peria (2005)	Italy, Spain, US – origin	Trade Market size (GDP) Lack of banking freedom Entry costs Inflation Country risk	Depends Yes (+) Yes (-) Yes (-) No No

Source: L. Voinea and F. Mihaescu, "The Determinants of Foreign Banking Activity in South East Europe: Do FDI, Bilateral Trade and EU Policies Matter?", The wiiw Balkan Observatory. Working Papers, 067 (2006), 6.

The above cited studies concern the contemporary period, which significantly differs from the interwar period. Nevertheless, they can be useful because they identify the determinants of banks' foreign activity. They also show that some of the factors are not universal and their weight depends

on a particular situation of the territory. The 20s and 30s of twentieth century in the case of Poland are characterised as much less secure than nowadays, and the risk factor in those times played a much bigger role. On the other hand, the economic factors seem to be more universal, even though the weight of each of them keeps changing, depending on the historical context or the economic situation of a specific country.

II.

As a result of the First World War the state of Poland has come back to life. The newly agreed territory (388.6 thousand sq. km) consisted of Polish regions, earlier belonging to Prussia, Russia and Austria, and which in the previous 100 years were linked to these states. That resulted in an adjustment to their economies and financial markets accordingly.¹²

The interwar period was a time of profound and turbulent changes. The situation in the Polish economy and politics was very difficult, especially at the beginning of the 1920s. One of the most important problems was a poor adjustment of the production potential and structure of its formerly partitioned territories to the new markets and the necessity of integrating new territories into the commonwealth.¹³ Other problems were political instability and a generally unbalanced economy: budget deficits and high inflation, financial disorder, low levels of saving, a shortage of capital and a poorly developed banking system.

In 1924 a reform of state finances and a currency reform were undertaken. Poland implemented its monetary system on a gold exchange standard system and had partially liberated its foreign financial payments. The reform was not fully successful and in 1925 a monetary and banking

12 C. Leszczyńska and Ł. Lisiecka, 'Polish Lands Before and After The First War: Effects of Breaking the Economic Ties with Germany, Austria and Russia for the Polish Regions', *Studia Historiae Oeconomicae*, 25 (2004), pp. 12–26.

13 C. Leszczyńska and Ł. Lisiecka, 'Polish Lands', p. 18.

crisis ensued. Full economic stability was achieved only after 1927, when Poland carried out a second monetary reform and thereafter eliminated all restrictions in foreign financial movement. Along with an economic boom worldwide, more foreign banks entered the Polish economy.

From 1929 on, the Polish economy suffered more and more from the world crisis. Unlike the majority of the countries, Poland did not depreciate its national currency – the zloty – and did not stop making foreign payments, as it wanted to maintain the foreigners' trust. In spite of that, significant capital was withdrawn by foreign investors, and the convertible currencies of the Bank of Poland were almost completely exhausted. That is why in 1936 the Polish government decided to control the movement of payments, with the aim of protecting the remaining reserves and to keep the zloty exchange rate stable.

Poland, in those times, was a poorly developed country. In 1929 the per capita GDP in Poland constituted ca. 38 per cent of British GDP, 45 per cent of that of France and 52 per cent of Germany. These numbers in 1938 were: 35, 49, and 44 per cent respectively.¹⁴ Modernisation of the Polish economy called for huge investments. Low levels of domestic savings and a small domestic capital made it obvious that foreign investments were necessary. They appeared not to be significant because of a limited trust of foreign investors in the abilities of the new state and in its credibility. Low confidence in Poland also resulted from its international situation, its geopolitical location and poor political relations with Germany. The western states also perceived a potential threat to Poland's stability from Russia.

The legal and institutional conditions of the activity of foreign banks in Poland were regulated by abiding rules. In the years 1918–1924 joint-stock banks could start their activities after they had been registered (given a concession). Their status had to be confirmed by the Minister of Treasury. The rules of their activities were settled in general by the Act on banking

¹⁴ A. Maddison, *The World Economy*, Vol. 1, *Millennial Perspective*, pp. 94, 100; Vol. 2, *Historical Statistics*, pp. 440–1, 446, OECD 2006.

supervision.¹⁵ The course of granting the allowance of activity to foreign joint-stock companies and limited liability partnerships in Poland was settled by regulation in 1922. The allowances were granted by the minister of treasury and the minister of industry and trade. The companies, which before 1918 were seated on the territory of the occupying states, and outside of Poland, could perform their activities on the territory of Poland, subject to the proper allowance. Companies from countries other than the occupying states, if prior to 1918 they had obtained the proper allowance, they did not have to apply for a new allowance. However, they had to abide by the general regulations in Poland such as: declaring the balance of activities of the company generally as well as its activity in Poland; appointing capital for its activity; and applying to the Polish authorities for permission to raise or to reduce its capital.¹⁶

In 1924 more details were provided to the law, regulating the banking activities.¹⁷ A rule was adopted, stipulating the minimum amount of initial capital for joint-stock banks and limited liabilities partnerships. The amount depended on the size of the town where the bank was seated, and the bank was obliged to raise its initial capital to the amount required within the indicated time limits. For banks situated in Warsaw the initial capital was stipulated as 2.5 million zloty, and in the biggest towns (Krakow, Lviv, Poznan, Katowice, Lodz) as 1.5 million zloty. For the remaining towns the amount was one million zloty. That regulation did not concern the mortgage banks, as their minimum initial capital allocation had been stipulated as five million zloty. The banks had been obliged to raise their initial capital by the end of 1924. Had they not been able to raise their initial capital to the stipulated amount, they were to be liquidated.

These regulations were very important as they forced the banks to raise their initial capital after a fusion with domestic banks or through the

15 *Dziennik Ustaw RP*, 1920, no 30/175.

16 J. Piekalkiewicz, 'Statystyka spółek akcyjnych', *Kwartalnik Statystyczny* 1 (1928), p. 56.

17 *Dziennik Ustaw RP*, 1924, no. 114/1018.

acquisition of foreign capital – thus forcing a bank concentration process in the Polish banking system.¹⁸ The banking crisis in 1925 added to the process of liquidation of weaker banks.¹⁹ Many banks were not able to get money in the Polish market and they were forced to apply for foreign support.

The above described regulations were maintained in the banking act law of 1928. It was the first time when a separate act of law had been published, where rules on how to set up a branch office of a foreign bank were provided. Such a branch office, after having received an official permit by the Minister of Treasury, was regarded as a self-sufficient banking enterprise.²⁰

Due to the fact that demand for capital substantially exceeded its supply, interest rates were very high. With the aim of reducing them, in June 1924 the government announced a law which set a maximum interest rate for banking credits.²¹ Until June 1926 the permissible interest rate was 24 per cent. In 1926 it was reduced to 16 per cent; in 1927 to 12 per cent; in 1930 to 11 per cent; and at the end of 1932 to 9.5 per cent. After that date there were no changes.²²

Banks which did not abide by the law were subject to a fine and, in addition, they could meet with a refusal when applying for a rediscount credit. The regulation on the maximum interest rate appeared to be unprofitable for the banks. The borrowers, who could gain access to foreign markets, could easily pay much less for credits, because the interest rate in the banks of developed countries was half of that in Polish banks.

Regulation of currency payments was very important for foreign banks in Poland. They were subject to frequent changes. A reason for this was the

18 M. Scheffs, 'Konsolidacja banków w Polsce', *Gazeta Bankowa*, 17–18 (1927), p. 408.

19 F. Zweig, *O programie gospodarczym Polski* (Warsaw 1926), p. 52.

20 *Dziennik Ustaw RP*, 1928, no. 34/321.

21 *Dziennik Ustaw RP*, 1924, no. 56/574.

22 C. Leszczyńska and Ł. Lisiecka, 'Useful or Harmful? Money Usury Law in the 2nd Republic of Poland', *Studia Historiae Oeconomicae*, 26 (2006), p. 72.

level of currencies in the central bank and the situation of the balance of payments. In the years 1919–1924 there were different forms of control of the foreign currencies market, especially through the restriction of capital flows. The banks had to apply for permission to take gold abroad and to transfer convertible currencies. Those regulations were loosened in 1924, but due to the monetary crisis they again became stricter.²³

Only in November 1927 was a full liberalisation of foreign payments introduced, after Poland had implemented a stabilisation plan. Free and unrestrained currency payments had been introduced as well as a full convertibility of the bills of the central bank with other states currencies at a fixed exchange rate (8.92 zloty per 1 USD).²⁴ Those regulations were valid until April 1936, when foreign payments became subject to wide-ranging restrictions and currency rationing.²⁵

III.

Unbalanced public finances and the need to look for foreign loans to cover the expenditures of the state were the two significant problems of the Polish economy in the first half of the twentieth century. It was also difficult for the Polish government to find a creditor institution. Private banks were of the opinion that it was too risky to lend money to Poland, and they insisted on guarantees.²⁶ Loans offered by governments were attached with political-economic conditions. That is why the Polish government was of the opinion that it would be proper to borrow money from private banks rather than governments.²⁷ Another goal was to make the

23 *Dziennik Ustaw RP*, 1925, no. 57/408; *Dziennik Ustaw RP*, 1925, no 120/867 and no 124/888.

24 *Dziennik Ustaw RP*, 1927, no. 97/858.

25 *Dziennik Ustaw*, 1936, no. 32/249.

26 Z. Landau and J. Tomaszewski, *Anonimowi władcy. Z dziejów kapitału obcego w Polsce (1918–1939)* (Warsaw 1968), pp. 31–34.

27 Z. Landau and J. Tomaszewski, *Anonimowi władcy*, pp. 40–50.

foreign (especially American) financial institutions place their confidence in the Polish economy. Sometimes concessions were inevitable, like those in 1921, when the nationality of Upper Silesia was decided while others, such as when the Polish government, made some concessions to France and French companies. Among other concessions it agreed to create the Bank Śląski with 50 per cent shares for the French capital.²⁸ It did not, however, develop wider activity, mainly due to a small initial capital.

The loans taken by the government were used for purchases of foreign currencies needed to compensate the payment deficit and to reinforce the currency reserves of the Bank Polski S.A. Such a situation was observed in the years 1924–1925 and in the 1930s. From time to time the Bank Polski took intervention loans to strengthen the zloty exchange rate.

Here we shall analyse three loans taken directly from financial institutions: one from the Italian bank Banca Commerciale Italiana (1924); one from the American investment bank Dillon Read & Company (1925); and a so-called stabilising loan taken from a group of American and European banks (1927).

The inside story of the first loan is connected with Mr. Józef (Giuseppe) Toeplitz (of Polish descent), managing director of the Banca Commerciale Italiana (BCI). The BCI bank had been involved in different banking activities including the provision of industrial credits. A loan agreement of 400 million lira (90 million zloty) with the Polish government was signed in March 1924, at seven per cent, with a repayment schedule of 20 years. The repayment was secured by national wealth and state revenues, and, in particular, by movable property and fixed assets of the Polish Tobacco Monopoly.²⁹ In the loan agreement there was also a statement to the effect

28 Z. Landau and J. Tomaszewski, *Anonimowi władcy*, pp. 61–3.

29 After signing the agreement a nephew of Giuseppe Toeplitz was released from prison by the Polish authority, and the BCI bank granted a credit to the *Warszawska Spółdzielnia Mieszkaniowa* (eng. Warsaw Dwelling Cooperative) for building the dwelling houses in Warsaw. Mr. Teodor Toeplitz (Giuseppe's brother) was a chairman of the Cooperative. The Polish Tobacco Monopoly ordered the dwellings for its workers.

that in the case of war, the Italian government would fly an Italian flag on the PMT building (being the mortgage guarantee to the contract). In 1930 the debt was 330 million lira, and in 1939 it was 180 million lira. When WWII broke out the government of Poland suspended loan repayment.

British and American loans were of great importance to the Polish government. Talks with British banks were started in the second half of 1924 with no results due to the City of London's low confidence.³⁰ In December 1924 the government started negotiations with the American investment bank Dillon & Company. It was a renowned financial institution, especially after its participation in refinancing the Goodyear Tire & Rubber Co. in 1920.³¹ That was a very difficult time when the Polish government applied for a loan. A couple of months earlier, Grabski's government carried out a monetary reform and yet they were still afraid that permanent monetary stabilisation might be endangered. In February 1925 Dillon started to sell Polish loan bonds on the American market.³² Both the National City Bank and the Guaranty Trust Co. refused to participate due to – as they said – too high a risk that the bonds sale would not be successful.³³ And indeed the bonds issue was not a success. They sold bonds for 27.5 million USD whereas the planned sale had been for 35 million USD. The future claims of the bond owners were secured by collateral in a form of revenues of the Polish railways and an excise tax levied on sugar. The bonds' issue rate was 85, with interest at eight per cent. The failure to sell all of the bonds led American financial circles to think even worse about Poland's payment credibility. Furthermore, in August 1925 the zloty exchange rate tottered, the bond price fell significantly on the NYSE stock exchange, and the willingness of American banks to give Poland a new loan grew weaker. In this

30 M. Rataj, *Pamiętniki 1918–1927* (Warsaw 1965), p. 235.

31 Ch. R. Geisst, *Encyclopedia of American Business History* (New York 2006), p. 119.

32 Z. Landau, 'Pożyczka dillonowska. Przyczynki do działalności kapitałów amerykańskich w Polsce', *Kwartalnik Historyczny*, 3 (1957), pp. 84–5.

33 Z. Landau and J. Tomaszewski, *Kapitały obce w Polsce 1918–1939. Materiały i dokumenty* (Warsaw 1964), p. 205.

situation credits granted to the Bank Polski itself became the only possibility. Talks on that with the New York Fed started. It was not only the financial dimension of the loan which was important but also the need to break through Poland's isolation as reported from New York by Mr. Feliks Młynarski,³⁴ an envoy of the Polish government. Dillon, when granting the said loan, looked at it mainly from the financial point of view. How difficult it was to get a loan in that situation of high risk can be understood when looking through the conditions put down in the loan agreement. Also, the documents available in the Polish Ministry of Foreign Affairs show what was behind the talks which lasted till the end of 1925.³⁵

Because the currency situation in April 1925 appeared to be very difficult, efforts were made to get credits needed to secure the zloty exchange rate. Talks were conducted with the Irving Bank Columbia Trust Company in New York. An agreement on a credit of six million USD was signed in June 1925, and the credit was secured with gold deposited in Poland. Similar talks conducted with the Bank of England failed, because the bank insisted that gold be deposited in London. For the same purpose of securing the zloty exchange rate, the Bank Polski made use of credits from the following banks: the Société de Banque Suisse (20 million French francs), the NY Fed (up to ten million USD), the British Overseas Bank (0.25 million pounds) and the Banque Franco-Polonaise (0.6 million USD).³⁶ With the aim of getting credit from the NY Fed, the Bank Polski had to transfer gold – as a collateral – to the deposit in the Bank of England.³⁷ Talks with other banks led to a sorrowful observation, namely that there was no chance of finding a bank which would agree to a loan, with the reservation that the collateral

34 F. Młynarski, 'Za kulisami wielkich wydarzeń. Garść wspomnień osobistych', unpublished (Krakow 1960), pp. 330–43.

35 Z. Landau and J. Tomaszewski, *Kapitały obce*, p. 241.

36 Z. Landau, 'Dwie stabilizacje złotego (1924–1927)', *Studia Historyczne*, 4 (1970), p. 522.

37 AAN, Bank Polski SA, sygn. 69, Protokół KWE RBP z 23 lipca 1926 r. A credit of 50 million zloty from the Fed has been completed by the end of 1925, and the value of gold transferred was 42 million zloty. The debt was repaid in 1926.

gold would remain in Warsaw.³⁸ The situation, however, was so bad that there was even an idea of raising the initial capital of the Bank Polski by means of selling it to foreign banks (eventually it did not work out).³⁹ In spite of many efforts, the time came for the fall of the zloty exchange rate at the end of July 1925.⁴⁰ The following months saw many attempts to stabilise the rate but eventually on 11 November 1925 the Bank Polski gave up: in July the rate was 5.18 zloty per USD; in November-December it was between nine and eleven zloty per USD. The total amount of intervention credits totalled 33 million zloty, which were repaid in 1926 and in the first half of 1927.⁴¹ The collapse of the zloty only added to the lack of confidence abroad in the Polish economy. A reason for their caution was also – as was reported by Polish diplomats – an anticipation that an eventual outburst of trade conflict with Germany (June 1925) would only make the financial situation of Poland worse.⁴²

In 1926 Poland made even more intensive efforts to get a big loan from the USA. The point was to build up a guarantee for a long-lasting stabilisation of Polish finances and the rate of zloty. In the mid 1920s a habit of making use of so-called stabilisation loans came to life. They served as a means of increasing the reserves of the central bank for the purpose of currency stabilisation and regaining the confidence of ‘high finance’ in the country. Such subscriptions were executed and it was connected with putting the finances of the loan-borrower country under the control of lenders. Poland’s financial situation and the course of its changes were to be stipulated by an American mission consisting of American experts with

38 AAN, Bank Polski SA, sygn. 69, Protokół KWE RBP z 13 stycznia 1926 r.

39 AAN, Bank Polski SA, sygn. 68, Protokół RBP z 18 grudnia 1925 r.

40 AAN, Bank Polski SA, sygn. 69, Protokół Specjalnej Komisji RBP z 26 sierpnia 1925 r.

41 AAN, Bank Polski SA, sygn. 68, Protokół RBP z 5 listopada 1925 r.; S. Pszczołkowski, *Kapitały zagraniczne i ich rola w polskiej polityce kredytowej* (Warsaw 1927), p. 22.

42 A. Ringman, *Polsko-niemieckie stosunki gospodarcze na tle wojny celnej* (Warsaw 1929), pp. 23–5.

Edwin Kemmerer and the representatives of the Bankers Trust Company.⁴³ The Polish government was convinced that the loan would enable the long-lasting stabilisation of zloty, would create a proper atmosphere for foreign deposits, and would improve Poland's debt service capacity and credibility in financial markets.⁴⁴ Trust in Poland still remained limited, all the more so after a *coup d'état* in May 1926.⁴⁵

The so-called stabilisation loan was granted to the Polish state by a consortium of over 40 banks, of which the most important were the Bankers Trust Company, the Chase Securities Corporation, and the Blair & Company. The subscription was carried out from 18 October 1927 in New York, London, Paris, Amsterdam, Basel, Stockholm and Warsaw. The loan nominal amount was 71.73 million USD (62 million USD and two million £), its interest was seven per cent, and its collateral consisted of customs revenues. Advocates of the loan agreed that in spite of the tough financial conditions placed by the lenders, it was badly needed to raise the rating of Poland, to gain foreign investors, and to secure a long-lasting stabilisation of the zloty exchange rate.⁴⁶ As E. Spät clearly established: There was a very poor knowledge of the Polish market, and they treated it as an 'experimental field'.⁴⁷

In the following years the Polish government did not take any other big loans or credits from foreign banks, while Bank Polski did make use of such a possibility. These credits helped it to raise its currency reserves. Credits were taken from the Bank of France (a sum of 100 million zloty taken in the mid-1931, and a sum of 185 million zloty at the end of 1936) and from a group of French banks headed by the French-Polish Bank (up

43 Z. Landau, 'Misja Kemmerera', *Przegląd Historyczny*, 2 (1957), p. 275.

44 Z. Landau, *Plan stabilizacyjny 1927-1930. Geneza, złożenia, wyniki* (Warsaw 1963), pp. 85-6.

45 AAN, Bank Polski SA, sygn. 69, Protokół KWE RBP z 26 maja 1926 r.

46 L. Barański, 'Pożyczka stabilizacyjna a program gospodarczo-finansowy', *Przemysł i Handel*, 43 (1927), p. 1458.

47 E. Spät, 'Podwyższenie stopy Banku Polskiego', *Gazeta Bankowa*, 10 (1929), p. 263.

to 12 million zloty).⁴⁸ These credits were of a different nature from those taken in the years 1925–1926, as they were utilised as a form of financial assistance connected with the presence of Poland in the so-called Gold Bloc, established in 1933.

Summing up, it may be affirmed that the above-mentioned loans and credits did play an important role for the financial situation of Poland. Their interest was in the range of seven to eight per cent and they corresponded to rates of the loans granted in that time to the states in southern Europe. The financial conditions were favourable to creditors, and the collateral assurance consisted of the fiscal revenues of the state. This cautious approach expressed a lack of trust by the loan-lenders in the repayment credibility of Poland and thus it exemplified a peculiar risk bonus.

IV.

Three main reasons for foreign banks' willingness to get engaged in the Polish banking system can be observed. The first one is when they are connected with industrial companies active in Poland either directly as shareholders or indirectly as creditors. In the second case, we can talk of activity connected with FDI, a so-called 'follow the customer' mode. The second one is when foreign banks render services to the joint financial and trade operations carried out by foreign and Polish enterprises. The third one resulted from interpersonal relationships, particularly among persons of Jewish descent communicating with financial circles abroad. What needs underscoring is the fact that, to a large extent, thanks to these connections, the Polish banking system could establish financial relations with foreign banks.

⁴⁸ C. Leszczyńska, *Polska polityka pieniężna i walutowa w latach 1924–1936. W systemie Gold Exchange Standard* (Warsaw 2013), pp. 308–10.

The activity of foreign banks in Poland, in principle, could take the form of shares in Polish banks, shares in industrial companies, and in granting credits both to banks or industrial companies operating in Poland. Foreign banks were present in the Polish banking system until the last decades of the nineteenth century. Those relations were broken by the WWI. It also brought about the way these banks could operate. After WWI Poland came back to life and German and Austrian banks appeared to be foreign banks. Immediately after the war Polish banks tried to get contacts with foreign banks, mainly because they badly needed credits. Also, foreign trade called for good financial services. These relations were revived after achieving currency stabilisation in 1924. Foreign banks played a significant role in foreign investments in Poland. They were able not only to grant credits, but also to disseminate information about the economic situation in Poland about the credibility of Polish enterprises and last but not least, the fact that they could be trusted.⁴⁹ Interrelations were loosened in the years of the great crisis. A shrinkage of international commodity trade and transport, a drop in investments and rising political tension only added to the crisis of confidence.⁵⁰

In the first years of independence, apart from banks operating on this territory before 1914, a couple of foreign banks opened their branch offices in Poland. In 1923 there were 111 joint-stock banks and in 1924 there were 110 (number given for the end of the year). Change in the banking law of 1924 and the banking and currency crises in the years 1925–1926 brought about the liquidation of the weakest banks. At the end of 1925 there were 87 joint-stock banks, and in 1929 only 50.⁵¹ After those liquidations and fusions a new banking structure emerged, with four dominating banks: the

49 E. Rydel, 'W obronie bankowości prywatnej', *Gazeta Bankowa*, 21 (1926), pp. 499–500.

50 R.K., 'Należności i zobowiązania wobec zagranicy instytucji bankowych w Polsce w 1933 r.', *Gazeta Bankowa*, 21–22 (1934), pp. 401–402.

51 B. Friediger, 'Fuzje w bankowości zagranicznej a bankowość polska', *Gazeta Bankowa*, 21 (1929), p. 32. The numbers given do not include banks that were not shareholders units. They did not play any significant role in the Polish banking system.

Powszechny Bank Związkowy – operating in southern Poland; the Bank Związku Spółek Zarobkowych – operating in western Poland; the Bank Handlowy w Warszawie SA and the Bank Dyskontowy w Warszawie SA – in central Poland. At the end of 1928 the above-mentioned four banks gathered 51 per cent of total deposits and 65 per cent of all foreign credits.⁵² Except for the Bank Związku Spółek Zarobkowych, in all other banks foreign capital was strongly present.

The number of entirely foreign banks did not change much. In the 1920s there were six foreign banks with ten to eleven branch offices. In the years 1928–1929 the number of branch offices increased to 18. In the years 1931–1933, because of fusions taking place in the foreign banks, their number in Poland fell to five, and the number of their branch offices fell to 13–14. As many as ten branch offices were placed in the western voivodeships (five of which were in the Silesian Voivodeship and the remaining four in central voivodeships).⁵³ In the year 1938, there were four foreign banks in Poland with nine branch offices.⁵⁴

The number of all joint-stock banks in Poland fell rapidly after 1932: in part due to their liquidation and in part due to their fusions. In 1933 there were twelve banks in the state of liquidation.⁵⁵ In 1933 there were 39 joint-stock banks; in 1936 32 joint-stock banks; and in 1938 26 joint-stock banks.⁵⁶

In the 1920s an estimated 100 million zloty of foreign capital in Polish private banks was present, which ran from 29 to 38 per cent of their share capital. Credits granted to Polish banks from abroad amounted to

52 B. Friediger, 'Fuzje w bankowości', p. 32.

53 W. Malinowski, 'Rozdział kredytów bankowych w Polsce 1931–1932', *Statystyka Polski*, 23 (1934), p. 8.

54 *Mały Rocznik Statystyczny*, 1939 (Warsaw, 1939), p. 209; *Rocznik Statystyki Rzeczypospolitej Polskiej*, 1925/26 (Warsaw 1927), p. 307; *Rocznik Statystyki Rzeczypospolitej Polskiej*, 1928 (Warsaw 1929), p. 266; *Rocznik Statystyki Rzeczypospolitej Polskiej*, 1930 (Warsaw 1931), p. 217.

55 Ł. Zmirski, 'Banki akcyjne w roku 1932', *Gazeta Bankowa*, 9 (1933), p. 193.

56 W. Morawski, *Bankowość prywatna w II Rzeczypospolitej* (Warsaw 1996), p. 127.

Table 2 – Foreign banks in Poland – their participation in the share capitals of the Polish banks and in the credit operations in 1931 (State as of 31 December)

Specification	Share capitals	Foreign credits [*]	Foreign banks participation	
			in share capitals	in credit operations [*]
	in million zloty	%		
Total (51 banks)	265.4	1295.2	29	22
Banks with foreign share capitals (25 banks)	143.5	751.5	54	32
of which: banks with significant share capitals				
Austrian (6 banks)	79.3	392.4	43	36
Österreichische Credit-Anstalt (3 banks)	28.1	137.6	33	39
other Austrian banks (3 banks)	51.2	254.8	49	35
German (9 banks)	16.7	171.7	65	35
French (2 banks)	12.2	55.5	58	33
British (3 banks)	12.2	52.0	58	28
Swedish (1 bank)	12.6	42.2	100	3
Palestinian-Jewish (2 banks)	6.4	25.5	34	0
Belgian (2 banks)	4.1	12.1	46	2
Banks with no foreign shares (26 entities)	121.9	543.7	-	-

* Rediscount credits and state on correspondent accounts.
Source: M. Smerek, 'Kapitały zagraniczne w bankowości polskiej', *Bank*, 2 (1933), 39–40.

400 million zloty.⁵⁷ In the first stage of the great crisis the capital share started falling and by the end of 1931 it was estimated at 76 million zloty, which totalled 29 per cent of the share capital of all Polish private banks.

⁵⁷ Ł. Zmirski, 'Zagadnienie kapitalizacji w Polsce w dobie obecnej', *Gazeta Bankowa*, 7 (1933), p. 149.

A scale of capital and credit engagement of foreign banks in Poland is presented in Table 2.

The most important banks in the Polish banking system were Austrian banks and, in particular, the Österreichische Credit-Anstalt (OCA). Other banks connected with the OCA consortium also participated in the share capital of Polish banks. In the years 1928–1929 the OCA took over another big Austrian bank – the Österreichische Boden-Credit-Anstalt. It was the biggest fusion in Austria. The OCA became the dominant institution in the Austrian banking system and via many corporate links also in many branches of industry.⁵⁸ The Austrian banks, including the OCA, had a strong position in the Polish banking system and industry. Activities of the OCA bank were connected to the highest extent with the following three Polish banks:

1. Bank Dyskontowy Warszawski SA (other shareholders: Böhmsche Eskompte Bank Credit-Anstalt in Prague; Lazard Brothers Co. in London; other Polish and foreign companies belonging to the OCA concern; with the Vienna Banking House Rothschild);
2. Akcyjny Bank Hipoteczny in Lviv SA;
3. Śląski Zakład Kredytowy in Bielsko (OCA founded the bank in 1922; other participants (connected with OCA): Amstelbank in Amsterdam SA; Akcyjny Bank Hipoteczny in Lviv SA; Bank Dyskontowy SA in Warsaw; Pollak Brothers Co. in Bielsko; other Polish and foreign companies belonging to the OCA concern).

⁵⁸ S. Glass, 'Z zagadnień polityki bankowej', *Gazeta Bankowa*, 21 (1929), pp. 527–29.

Together, with taking over the Boden-Credit-Anstalt, the OCA concern acquired the Bank Małopolski SA in Cracow as well (which formerly belonged to the Boden-Credit-Anstalt group).⁵⁹

It has been estimated that by the end of the 1920s OCA shares in Polish banks reached 30–40 per cent of their share capital. The remaining shares belonged to banks – members of the OCA group. Also, the capital engagement of OCA in Polish industrial enterprises has been valued at ca. 20 million USD (180 million zloty) in the same period.⁶⁰ Other Austrian banks investing in the Polish banking system were:

- Niederösterreichische Escompte – Gesellschaft in Vienna (financial connection with the Berliner Handels-Gesellschaft). It held shares of the Bank Handlowy w Warszawie SA (BHW);
- Wiener Bank Verein – it held a parcel of shares in the Powszechny Bank Związkowy in Poland (other shareholders: Banque Belge pour l'Étranger and Banque Commerciale de Bâle). Powszechny Bank Związkowy was de facto a filial bank of the Wiener Bank Verein;
- Central Europäische Länderbank was seated in Paris and officially was a French bank with the name Banque des Pays de l'Europe Centrale. It held 40 per cent of shares in the Powszechny Bank Kredytowy in Lviv, while the remaining 60 per cent of shares belonged to the Banque de Paris et de Pays-Bas.⁶¹
- Merkur Bank in Vienna had the majority of shares in the Bank Komercjalny w Krakowie, but after the Merkur Bank had been taken over by the Darmstadter Bank, the Bank Komercjalny depended on the German shares.⁶²

59 S. Glass, 'Z zagadnień polityki', p. 529; K.N., 'Wpływ banków wiedeńskich na nasze życie gospodarcze', *Gazeta Handlowa*, 261 (1929), p. 4.

60 M. Smerek, 'Kapitały zagraniczne w bankowości polskiej', *Bank*, 1 (1933), pp. 14–17.

61 'Powszechny Bank Kredytowy we Lwowie', *Gazeta Bankowa*, 4 (1923), p. 12.

62 K.N., *Wpływ banków wiedeńskich*, p. 4.

Austrian capital played a very important role in the industry of southern Poland, and especially in big metallurgical enterprises: the wagons manufacturer Zieleniewski and Fitzner-Gampner SA, which belonged to the biggest plants in the machinery industry in Poland; and to the locomotives manufacturer – the Fabryka Lokomotyw in Chrzanow. Thus the roots of the presence of Austrian banks in these industries and banking systems were both of a historical and business nature.

In 1931, after the crash of the OCA and the German Danat-Bank the strong engagement of Austrian banks reverberated in a disadvantageous way in the Polish banking system. It caused a strong deposits drain from the banks connected with Austrian capital. Luckily, this phenomenon was of a local character only, and it was only the Śląski Bank Eskontowy in Bielsko which endured a slump.⁶³ Other banks also suffered but on a comparably smaller scale than was the case in Germany or Austria.⁶⁴ In spite of the collapse of the Austrian banking system and its negative impact on the situation in Poland, the great Vienna banks remained a sort of a liaison body among western financial institutions and the Polish banking system.⁶⁵

German banks were ranked only second to Austrian banks, as far as their capital share in the Polish banking system is concerned. First of all, they had acquired all shares in some Polish banks, or in their branch offices, mainly in Upper Silesia. In the early 20s they had their shares in the form of separate branch entities of such banks like the Bank für Handel und Industrie, the Dresdner Bank, the Deutsche Bank and the Disconto-Gesellschaft. Their primary customers constituted the big industrial

63 R. Koranyi, 'Banki polskie w r. 1931', *Gazeta Bankowa*, 1932, no. 15, p. 342.

64 B. Friediger, 'Odporność bankowości polskiej na kryzys gospodarczy', *Gazeta Bankowa*, 1931, no. 4, pp. 82–84.

65 O. Pollak, 'Udział bankowości austriackiej w rozwoju gospodarczym Polski', *Gazeta Bankowa*, 1929, no. 7, p. pp. 185–186.

enterprises such as the Giesche Erben.⁶⁶ At the end of the 1920s German banks were in possession of parcels of shares of the following banks:

1. The Dresdner Bank (or its subsidiaries) was in possession of the Poznański Bank dla Handlu i Przemysłu (Bank für Handel und Gewerbe) and the Bank Górnośląski (Oberschlesische Bank);
2. The Darmstädter Bank was in possession of the Górnośląski Bank Dyskontowy (Oberschlesische Diskontbank);
3. The Deutsche Bank was in possession of the Górnośląski Bank Związkowy (Oberschlesischer Bankverein) in Pszczyna.⁶⁷

What distinguishes the German banks from the Austrian banks is the concentration of their ownership. The above-mentioned Polish banks were almost entirely comprised of German capital. They were relatively small units, when compared to the capital of their mother banks such as Deutsche Bank, Dresdner Bank or the Disconto-Gesellschaft. In the mid-20s, the total share capital of four German banks in Poland was less than one million zloty (in the same period the capital of their mother banks was 500 million zloty).⁶⁸ At the end of the 1920s German capital engaged in Polish banks was estimated to be six million zloty with credits of ca. 100–150 million zloty.⁶⁹ This activity was closely connected to the presence of German capital in the Upper Silesian industry. The banks were involved in credits, finance and trade services. This is documented by credit liabilities, to which I refer later on.

French and British capital were represented in the Polish banking system relatively weakly, if their participation in share capital is discussed.

66 B. A., 'Banki na Górnym Śląsku', *Gazeta Bankowa*, 1921, no. 22, p. 11; L. Mikołajczyk, 'Poznańskie banki akcyjne w 1922 r.', *Gazeta Bankowa*, 1923, no. 13–24, p. 6.

67 B. Whale, *Join stock banking in Germany. A Study of the German credit banks before and after the war* (London 1930), pp. 299–300.

68 S. Pszczółkowski, 'Statystyka spółek akcyjnych', *Kwartalnik Statystyczny*, 1 (1928), p. 91. In 1925 the rate of Mark-Zloty was 100RM=123 zloty, after the devaluation in 1927 it was 100 RM=212 zloty.

69 Ł. Zmirski, *Zagadnienie kapitalizacji*, p. 149

The presence of French capital has a strong economic-political context, as it has been connected with the politically privileged position of France in the Polish coal and oil mining industry. In that context, in the year 1920, the Bank Śląski was founded, where half of the shares were assigned to French companies connected with the Upper Silesia industry, and the other half belonged to the Polish state. This bank suffered tremendous losses in the bank crisis of 1925–26, and its bankruptcy was announced in the time of the great crisis. The same happened to the Polski Bank Przemysłowy in Lviv (PBP), where one of the shareholders was the French capital group *Crédit Générale des Pétroles* in Paris, an owner of one of the petroleum concerns in south-eastern Poland. The PBP bank was bound with French capital because of its presence in the Polish petroleum industry. In 1925, after having raised the initial capital for PBP, the French group became a majority shareholder.⁷⁰ However, the PBP bank had permanent financial problems. In 1930 it raised its share capital from six million to twelve million zloty, and a year later it had to announce high losses. The direct reason for that were the problems of the Devilder's holding and those of its subsidiary, the *Société Financière de Paris*, an owner of over 90 per cent of the PBP portfolio. These companies, credited by the PBP bank, made a loss of 10.6 million zloty, which had brought about their downfall. Eventually the PBP French shares were bought out by Polish petroleum companies.⁷¹ The third bank, with French capital participation was the Bank dla Handlu i Przemysłu w Warszawie, where the *Union de Commerciale et Industrielle de Paris* was one of the shareholders. Neither of these banks developed any positive activity, and in the 30s got into financial troubles. Finally, the Parisian banks: *Banque de Paris et des Pays Bas* and *Banque des Pays de l'Europe Centrale* – which I mentioned when writing about the Austrian

70 'Sprawozdanie Polskiego Banku Przemysłowego we Lwowie za rok 1925', *Gazeta Bankowa*, 15–16, 17 (1926), pp. 385, 423.

71 K. Piławski, 'Bankowość prywatna w Polsce w dobie przesilenia', *Gazeta Bankowa*, 2 (1932), p. 26.

capital – were in possession of all shares of the bank Powszechny Bank Kredytowy in Lviv.⁷²

The only efficiently functioning bank was the Bank Francusko-Polski (Banque Franco-Polonaise) in Paris with some branches in Poland. It had been founded by French entrepreneurs, who were shareholders in a Polish mining company known as ‘Skarboferm’, together with a couple of Parisian banks: Banque de Paris et des Pays-Bas (Paribas), Banque de l’Union Parisienne and Société Générale de Crédit Industriel et Commercial. Some of these banks, as I have mentioned before, were involved in granting intervention credits to the Bank Polski.

As far as the British banks are concerned, they were active in Poland in two main areas: first, they cooperated with British companies involved in Polish industry, mainly the textile and sugar industries; and second, they were active in crediting trade operations and offering agency services.

Another example is that of the British Overseas Bank (BOB) founded in 1919, which was strongly engaged in the Polish economy. That bank specialised in contacts between British companies and Eastern Europe, e.g. facilitating the foreign trade of the British Isles and the Empire in all matters of exchange, payments and receipts abroad, as well as handling foreign collections, documents and securities. In 1920 the British Overseas Bank was involved in the formation of the Anglo-Polish Bank in Warsaw,⁷³ and it collaborated with the banking house Adolf Peretz in Warsaw. In the 20s the BOB bank was engaged in crediting the companies with shares in the Polish textile industry. The Widzewska Manufaktura SA is a good example of the activity. In the years 1922 and 1928 the BOB bank granted credits for cotton raw materials and for investments, e.g. for the purchase of machinery and installations. In the 30s the Widzewska Manufaktura SA ran at a loss and got into debt with domestic and foreign financial institutions; among these were the BOB bank and The British and Polish Trade

72 ‘Powszechny Bank’, p. 12.

73 G. Jones, *British Multinational Banking: 1830–1990* (Oxford/New York 2001), pp. 142–143.

Bank A.G. (seated in Gdansk). The Lodz textile industry was also given credits from other banks, like the Dresdner Bank, Barclays Bank Limited or the Schweizerischer Bankverein in Zürich.⁷⁴

In the mid-20s the Bank Angielsko-Polski was also involved in extending credit to the Polish sugar industry (export of sugar), and ca. 40 per cent of its share capital was taken over by the Polish sugar companies.⁷⁵ Sugar production and trade were strongly cartelised in Poland, and they were financed, among others by the Bank Cukrownictwa. That bank was established with Polish capital, but it made frequent use of foreign credits. British capital was also present in the Bank Handlowy w Łodzi and in other big banks in Warsaw such as the Bank Handlowy w Warszawie SA (BHW). In the mid-1930s the BOB held 49 per cent of shares in the Bank Angielsko-Polski. In 1935 there was a merger of the Bank Angielsko-Polski and the BHW bank. It was related to the fact that the Banca Commerciale Italiana (BCI) stepped back from the BHW bank.

The BCI bank connections with Poland had their personal context through Mr. Giuseppe Toeplitz, who became the Director of the BCI bank in the 20s, and whose family had good relations with the banking and industrial sectors in Poland.⁷⁶ The BCI bank was a creditor, among others to the textile industry companies in Lodz.⁷⁷ In 1919 the BCI bank acquired a majority shareholding in the Bank Zjednoczonych Ziem Polskich (BZZP), the share capital of which was 3.6 million zloty (0.4 million USD) in 1927. More significant, however, was the BCI bank share capital in the BHW bank – the biggest Polish private bank. One of its founders in 1870 was Józef Henryk Toeplitz, uncle of Giuseppe Toeplitz. After World War I and

74 K. Badziak, 'Obraz łódzkiej burżuazji przemysłowej w okresie międzywojennym. Działalność ekonomiczna (wybrane problemy)'; in: R. Kołodziejczyk (ed.), *Image przedsiębiorcy gospodarczego w Polsce w XIX i XX wieku* (Warsaw 1993), pp. 194, 199.

75 W. Morawski, *Słownik historyczny bankowości polskiej do 1939 roku* (Warsaw 1998), p. 93.

76 K. T. Toeplitz, *Rodzina Toeplitzów. Książka mojego ojca* (Warsaw 2004), pp. 146–167; K. Reychman, *Szkice genealogiczne. Toeplitz* (Warsaw 1936).

77 J. Marcus, *Social and Political History of the Jews in Poland 1919–1939* (Berlin 1983), pp. 107–08.

inflation, the standing of the BHW bank grew weaker. With the aim of strengthening the bank's capital the authorities of the bank commenced talks with the Banque de Bruxelles and the French Banque Privée. In 1923 the two banks bought a small parcel of shares of the BHW bank. After 1924 talks with the Banque de Bruxelles were continued and thereafter they decided to establish contacts with the BCI bank. A collapse of the zloty and a slump in 1925 disturbed the talks. The BHW bank suffered a serious financial loss and it had to reduce its share capital down to 6 million zloty. In those dramatic times it was the Polish government and the BCI bank who helped to recover the BHW bank's financial liquidity with credits of ca. 22 million zloty and two million zloty respectively. Due to the risk, the B CI bank was unwilling to employ more capital.⁷⁸

Discussions on a more serious capital engagement of the BCI bank were commenced in 1926 and finalised in 1927.⁷⁹ The share capital of the BHW bank was raised from six to 20 million zloty, where the foreign shareholders (four entities forming a consortium, among which the BCI bank) owned shares worth six million zloty. The increase of the capital of the BHW bank was related to its merger with the BZZP bank, owned by the BCI bank. The BCI bank participated with 9.6 per cent in the share capital of the BHW bank in 1928; the share of all foreign shareholders was 42.5 per cent.⁸⁰ The important role of the BCI bank did not so much concern its financial involvement, but the large credits it had given to the BHW bank. This made the BCI bank the biggest creditor of the Polish bank. In the late 20s the authorities of the BHW bank made attempts to raise the share capital. They took up talks with British banks. In 1930 the bank's share capital was raised

78 Z. Landau and J. Tomaszewski, *Bank Handlowy w Warszawie SA. Zarys dziejów 1870–1995* (Warsaw 1995), pp. 71–2.

79 Two other Italian banks present in the Polish banking system: Societa Italiana di Credito Commerciale S.A. and Banco di Credito Italiano-Viennese. Both companies participated in the foundation of the Powszechny Bank Kredytowy S.A. 1924 in Katowice. Later on it has been liquidated.

80 Z. Landau and J. Tomaszewski, *Bank Handlowy*, p. 75.

to 30 million zloty, and the new shares were bought by a group of sugar factories from west Poland, connected to British capital.

During the time of great crisis the BHW bank had serious financial problems. Credits granted to Polish enterprises in many cases had been lost. The BHW bank was looking for foreign institutions, which were willing to support the bank financially. This was particularly the situation after Giuseppe Toeplitz stopped being its managing director in 1933 and the BCI bank was considering stepping back from the BHW bank. In 1934 the share capital of the BHW bank was 30 million zloty, the BCI bank share was 7.91 per cent, and credit liabilities towards the BCI bank were estimated to be 18 million zloty. The burden of the BHW bank restructuring was taken by the Polish Treasury. BHW bank share capital was reduced from 30 million down to 15 million zloty. This meant losses to the shareholders of the BCI bank. The Polish Treasury took over the credits of the BCI bank, which were frozen in Polish enterprises and deemed to be lost. The other loans to Polish enterprises were taken over from the BCI bank by the Towarzystwo Kredytowe Przemysłu Polskiego. They were mainly credits extended to the textile industry companies in the Łódź region such as Scheibler and Grohman, Geyer, I.K. Poznański, Widzewska Manufaktura SA, to name a few. Some of these companies were family interrelated with Giuseppe Toeplitz; his brothers or distant relatives co-created or were incorporated in the management of many of these enterprises.

There were a number of reasons for the BCI bank to get engaged in Poland: the presence of the BCI bank in the Polish banking system, loans granted to the government, loans for industrial enterprises – an extensive range of activities. No doubt, one of the reasons was a close relation of Giuseppe Toeplitz with Poland. In literature he is often said to have favoured investments in Poland. Whereas his international operations were usually successful, his engagement in Poland brought losses. His businesses in Poland did not deliver positive results and they contributed to the foreign losses of the bank – due to troublesome hardships connected

with the Bank Handlowy in 1927, and also to the direct financing of some enterprises and the Polish government itself.⁸¹

In 1935, with the active role of the Polish government, a merger of the BHW bank and the Bank Polsko-Angielski S.A. was signed, where the British Overseas Bank was a majority shareholder. The share capital was raised by ten million zloty, shares of the value of 2.5 million zloty were taken over by the BOB bank in exchange for shares of the Bank Polsko-Angielski S.A., and the remaining shares were bought by Polish sugar factories.⁸² Earlier, in 1933, the BHW bank took over a banking house of Adolf Peretz with whom the BOB bank had been cooperating since the 20s. Finally, we ought to mention the Bank Amerykański in Poland. It was founded in 1926 and entirely owned by the Krueger's concern. Its activity was focused exclusively on economic-trading operations.⁸³

The total amount of short term credits lent by all Polish banks (state, municipal and private, without the Bank Polski) by the end of 1929 equalled 1930 million zloty; private banks comprised 1414 million zloty of the total (domestic banks: 1230 million zloty; and branches of foreign banks: 194 million zloty). Similar amounts of credits were granted in 1930. A decline has been observed starting in 1931. By the end of 1933, the total amount of short credits was 1051 million zloty. Private banks comprised 690 million of the total amount (domestic banks: 605 million zloty; branches of foreign banks: 85 million zloty).⁸⁴

Let us stop for a moment and talk about credits granted by the branch offices of the foreign banks. About 60 per cent of these credits were granted to industry (of these 31 per cent to the metallurgical industry); about

81 M. D'Alessandro and G. Montanari, 'BCI and International Capital Transfers to Poland between the wars', in: A. Cameron, H. Houtman De Smedt, *Towards a global system? European Banks within the Evolving Economy*, The Annual Conference of the European Association for Banking and Financial History (EABH) e.V, vol. 1 (Warsaw 2000), pp. 21 (no pagination).

82 Z. Landau and J. Tomaszewski, *Bank Handlowy*, p. 80.

83 W. Morawski, *Słownik historyczny*, pp. 91–92.

84 W. Malinowski, 'Struktura rozdziału kredytów bankowych w Polsce', *Kwartalnik Statystyczny*, 2 (1934), p. 205.

30 per cent went to mining. This confirms the connections between the branch offices of the foreign banks to heavy industry. One more element is worth noting: about 55 per cent of the credits granted to the mining industry originated from the branch offices of the foreign banks. In the metallurgical industry it was 67 per cent (average for the years 1931–1933). A structure of credits granted by domestic joint-stock banks looked different. Credits to the industry were 51 per cent (of which six per cent went to the metallurgical industry) and six per cent to the mining industry. Domestic banks very heavily invested in the food industry (20 per cent, of which 14 per cent went to the sugar industry) and trade (14 per cent).⁸⁵ The numbers given are the average for the years 1931–1933 and they come from the Central Statistical Office. We do not have comparable data for the former or subsequent periods.

Now, let us make a quantitative presentation of credits received by the Polish enterprises from the foreign banks via the Polish banks. The indebtedness of all Polish banks (excluding Bank Polski) to foreign banks was by the end of 1923 13.5 million zloty; in 1924: 63.0 million zloty; in 1925: 95.2 million zloty (to British banks: 37.7 million zloty; to French banks: six million zloty; to German banks: 12.0 million zloty; to Austrian banks: 7.7 million zloty; and to American banks: 12.0 million zloty).⁸⁶

After 1927 a strengthened flow of foreign credits to Poland was observed.⁸⁷ By the end of 1928 the liabilities of all Polish banks to foreign banks comprised 535 million zloty, in 1929: 673 million zloty, and in 1930: 640 million zloty. During the Great Crisis new credits were not available and Polish banks only repaid existing credits. Thus, the liabilities were decreasing: by the end of 1931: 401 million zloty; in 1932: 292 million zloty; and in 1933: 248 million zloty, of which the liabilities of the private banks were 184 million zloty (the six biggest joint-stock banks comprised 94

85 W. Malinowski, 'Rozdział kredytów', p. 24; W. Malinowski, 'Struktura rozdziału', p. 248.

86 S. Pszczółkowski, *Kapitały zagraniczne*, p. 23.

87 B. Friediger, 'Kredyty zagraniczne w naszej bankowości', *Gazeta Bankowa*, 13–14 (1929), p. 341.

million zloty, and the branch offices of foreign banks held 52 million zloty in liabilities). In the years 1931–1933 Polish banks had the largest liabilities toward German, British and French banks. Their total value was in 1931 was 292 million zloty, in 1932: 184 million zloty, and in 1933: 166 million zloty. In 1933 the amount of liabilities to German banks was 58 million zloty; to British banks 56 million zloty; and to French banks 51 million zloty. Liabilities to foreign banks in other countries differed from a few to more than a dozen million zloty. By the end of 1938 the liabilities of Polish banks were only 116 million zloty.⁸⁸

Apart from the decline of credits in times of crisis, it should be stated that the credits received by Polish banks in those times were of great importance. They allowed Polish banks to establish contacts with foreign institutions, increase their scale of operations, and inspire confidence in the Polish market. Foreign credits had become an important factor of financing the economy in the 1920s. About 20 per cent of credits granted by private banks came from foreign credits. In 1930 foreign credits were higher from the discount credits received from the central bank.⁸⁹ Dividends from Polish banks were not high, and in the years 1926–1928 between four and eight per cent. In the following they had an average of ten per cent and were comparable to dividends abroad.⁹⁰

Finally, we should mention credits received by Polish enterprises from foreign entities (banks and enterprises). In the years 1925–1926 they were on average 560 million zloty yearly; at the end of the 1920s 1,000 million zloty; and at the beginning of the crisis they fell to ca. 800 million zloty. After 1933 they did not exceed 400 million zloty.⁹¹

88 R.K., 'Należności i zobowiązania', pp. 401–2; W. Morawski, *Bankowość prywatna*, p. 143.

89 B. Friediger, 'Kredyty zagraniczne', p. 341.

90 M. Szarski, *Bankowość polska* (Warsaw 1928), p. 20.

91 'Bilans płatniczy Polski 1931 i 1932', *Statystyka Polski*, 19 (1935), pp. 23–25; 'Bilans płatniczy Polski 1933', *Statystyka Polski*, 22 (1935), pp. 1–2; 'Bilans płatniczy Polski 1934 i 1935', *Statystyka Polski*, 51 (1937), pp. 33–38; *Rocznik Ministerstwa Skarbu, 1927–1930* (Warsaw 1931), pp. 14–15; M. Smerek, 'Bilans płatniczy Polski za 1930 r.', *Statystyka Polski*, 17 (1933), pp. 84–7.

V.

Poland was a newly risen peripheral state of a relatively low level of development and with a poorly developed banking system. In its best period of development in 1929, the equity capital of all Polish private banks exceeded 300 million zloty (34 million USD). They were lower than the equity capital of Deutsche Bank, for example. An increase in the equity capital of Polish banks was a must, but despite their significant growth in the second half of the 1920s the scale of capital and credits invested by foreign banks was not satisfactory. There were many circumstances and reasons for this situation. In normal conditions economic determinants govern the activity of foreign banks such as: profitability, scale of direct investments by non-financial entities, scale of trade turnover, and expected profit. In the case of 'emerging markets' non-economic aspects also play an important role. These are: political risk, freedom of capital flow, and knowledge of the market. Also, banks operating on an international scale are badly needed.

The activity of foreign banks in Poland changed significantly, in light of international prosperity, the domestic economic situation in Poland, and economic and political risk. From the Polish perspective that risk was not deemed to be too high; from the foreign perspective it was. That is why in the first half of the 1920s the capital and credit engagement of foreign banks in Poland was relatively small. There were some Austrian and German banks present in Poland, because they knew the Polish market or were historically bound. Sometimes political aspects or personal contacts could play a role. Investments in the Polish market were treated as risky. Governmental guarantees on one side, and a knowledge and network of interpersonal links on the other were making decisions easier. In the second half of the 1920s, as soon as foreign circles became convinced that the situation in Poland was politically and economically strong, the interest of foreign banks grew stronger. Freedom of capital

flow, a stable currency rate, growing trade contacts, and growing direct investments by the non-financial sectors created a positive climate for investments. This optimistic atmosphere soon changed for worse due to the Austrian and German banking crisis of 1931, which was followed by a worse international economic situation. That is why Poland, in spite of the fact that it had introduced currency liberalism, kept running a policy of fixed exchange rates, and Polish entities were timely in repaying their credits and loans. All of that did not help to redirect the flow of capital: with its short financial history, Poland was treated as a high risk country. This allows us to conclude that factors determining the engagement of international banks in the Polish economy depended, first of all, on the situation in international markets.

The country of origin was not as important as the scale of operations. The strongest position was that of great internationally operating banks such as: Austrian Österreichische Credit Anstalt, German D-banks, British Overseas Bank, Italian Banca Commerciale Italiana, and then the smaller banks from other countries. The banks, (the follow-thy-customer banks) in fact, were stepping in after the industrial companies. Their activity was deeply connected with those industrial companies present in Poland. These banks often participated directly or indirectly in the share capital of Polish enterprises and financial institutions. They also granted credits. These were first of all operations of an economic character. Foreign banks were granting credits in times of banking crises as well (in 1925 and temporarily in the 1930s), so they served to sustain cash flow liquidity and the solvency of the respective Polish institutions. The American banks were absent from the Polish economy (they rendered loans to the government and public institutions). They had no relations with the Polish economy. They hardly knew the Polish market and investments in Poland were in their opinion very risky - to prove it we can look into the terms and conditions of the loans granted to the Polish government. On the other hand, the Polish government was most interested in American capital, and it

repeatedly talked to American financial institutions. The same was the position of big British banks. We may adopt the assumption that these talks concerned the economic certitude of repayment of the quota lent and their profitability, which were the decisive factors.

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A BANKER FROM POLAND: EXPLORING JÓZEF TOEPLITZ'S INTERNATIONAL CONNECTIONS THROUGH HIS CORRESPONDENCE

GUIDO MONTANARI

Abstract

Józef Toeplitz (Zychlin, near Warsaw, 1866 – Sant'Ambrogio Olona, Varese, 1938) was born into one of the most important Jewish upper middle class families. In 1890 he went to Italy and undertook a career as a banker, which led him to become a managing director of Banca Commerciale Italiana (BCI) from 1917 until 1933, when he left his leadership because of the BCI crisis in 1931.

During the 1920s, Toeplitz pursued a strategy of wide internationalisation by creating the largest foreign banking network spread across Europe. In the early 1920s particular attention was paid to expansion toward Eastern Europe. The devaluation of the Balkan currencies vis-à-vis the lira made direct investments in that area very attractive and at the same time it was realised that Italian traders could take advantage of the difficulties faced by German exporters. From 1918 to 1929, under Toeplitz's leadership, BCI had its foreign network, in addition to North and South America, in Switzerland, France, Turkey, Austria, Romania, Bulgaria, Hungary, Egypt, Poland, Yugoslavia and Greece. During the 1920s the BCI's expansion abroad was impressive, particularly considering the difficult climate in which it was operating. In particular, from 1926–1927 BCI ventured into Poland, already strongly favoured because of Toeplitz's connection with his native country. The Bank Handlowy of Warsaw was purchased in a joint venture with Harriman of New York and three other banks. Furthermore, a great part of the commercial and industrial business carried on between Italy and Poland passed through the hands of the Toeplitz secretariat, which always had a Polish secretary available to handle Polish affairs.

As one can see from his correspondence (more than 20,000 letters and telegrams), kept at Intesa Sanpaolo Historical Archives, Toeplitz was at the centre of a dense network of contacts involving especially the world of international finance and the great Italian industry. Moreover, the managing director always kept in touch with his relatives in Poland, closely participating in the political and social events of his country. Correspondence with his wife Jadwiga Mrozowska has been analysed, in particular.

I. Biography and Activities at Banca Commerciale Italiana

Józef (Giuseppe) Toeplitz was born in Zychlin, near Warsaw, in 1866, from one of the most important Jewish upper middle class families.¹ His father, Bonawentura,² manager of large land properties and owner of sugar-beet refining plants, gave him a cosmopolitan education. He studied classics at the Mitau high school in Latvia and attended engineering courses at Gand University and at the Technische Hochschule Aachen. In 1890 he left his studies to marry Anne de Grand Ry, a Dutch noblewoman he had met in Aachen.³ He then went to Genoa to undertake a period of training at Banca Generale's Genoa branch, whose manager, Otto Joel, was his distant cousin. In 1894–1895 he worked at the Genoese branch of Banca Russa per il Commercio Estero (Russian Bank for Foreign Commerce) and in June 1895 he was hired by Banca Commerciale Italiana (BCI), founded in Milan one year before by a consortium of German, Austrian and Swiss Banks.⁴

1 Regarding Toeplitz family, see K. Reychman, *Szkice Genealogiczne, Serja I* (Warsaw 1936), pp. 187–90; O. Budrewicz, *Sagi Warszawskie* (Warsaw 1983); and K.T. Toeplitz, *Rodzina Toeplitzów. Książka mojego ojca* (Warsaw 2004), pp. 152–80. Interesting and well done is K. Toeplitz's book, *Rodzina Toeplitzów. Książka mojego ojca*, of which an English translation is desirable.

2 See picture 1.

3 Regarding his short biography see G. Montanari, 'Introduction' to *the Inventory Archivio dell'Amministratore Delegato Giuseppe Toeplitz, 1916–1934* (Milan 1996), IV–XLVII, and K.T. Toeplitz 2004, pp. 152–180.

4 See P. Hertner, 'Central banking and German-style mixed banking in Italy, 1893/5–1914: from coexistence to cooperation', in: R. Sylla, R. Tilly, G. Tortella, *The State, The Financial System and Economic Modernization* (Cambridge 1998), pp. 182–209.

His career was very fast, as he became the right hand of BCI senior manager Otto Joel: Toeplitz stood out. He opened the Naples (1898) and Venice (1900) branches, and negotiated in person with several important industrial and financial groups. In 1906 Toeplitz was appointed senior manager at the head office in Milan, and in 1907 became head of the branch inspectorate. He exerted noteworthy international activity, helping, for instance, to open the London Branch in 1911. In this period the majority ownership of BCI became Italian and Toeplitz obtained Italian citizenship (1912).

During the neutralist Italian period, between 1914 and 1915, he became a sort of BCI ambassador in Europe, travelling throughout European countries to reassure London and Paris financial markets and to persuade German and Austrian BCI board directors to resign. Moreover, during the war period Toeplitz managed, on behalf of BCI, the repatriation to Italy of Italian companies' shares owned by German financial groups, mainly in electric, engineering and mining sectors.⁵ After the war Toeplitz remained in touch with founder banks' managers, even if they never again became members of the BCI Board of Directors.

In March 1917 he was appointed managing director together with Pietro Fenoglio, but in 1920, after the retirement of his colleague, he remained the sole managing director, and successfully led the BCI's defence against the Perrone Group, which had attempted a hostile takeover. After this episode he remained the undisputed head of the bank until 1931.⁶

During the 1920s Toeplitz made a very important contribution to financing big enterprises, which was necessary for Italian industrial recovery after the war.⁷ Further, during the 1920s, Toeplitz pursued a strategy of wide internationalisation, creating the largest international

⁵ See Telesca 2000, pp. 58–96.

⁶ See picture 2.

⁷ Regarding Toeplitz's management during the 1920s, see Telesca 2000, pp. 100–250, and Toniolo 1994, pp. 57–69.

banking network across Europe. In the early 1920s particular attention was paid to expansion towards Eastern Europe, often paving the way for Italian diplomacy. The devaluation of the Balkan currencies made direct investments in that area very attractive; at the same time it was realised that Italian banks and traders could take advantage of the difficulties faced by Germany. From 1918 to 1929, under Toeplitz's leadership, BCI acquired its foreign network, in addition to North and South America, in Switzerland, France, Turkey, Austria, Romania, Bulgaria, Hungary, Egypt, Poland, Yugoslavia (Hrvatska Banka at Zagabria) and Greece. The BCI's expansion abroad was impressive, particularly considering the difficult climate in which it was operating.

Most revenues in the international division of BCI were generated by transnational operations. Beyond dealing in bank acceptances, mainly coordinated by the London Branch, BCI made considerable profit in foreign exchange transactions, mainly in arbitrage. At the end of the 1920s, BCI held large stocks in many companies, so that industrial bankruptcies would have had a disastrous effect on the value of BCI, which thus became an industrial holding company. In 1931 BCI was involved in the collapse of the European mixed banks system and Toeplitz had to ask the Fascist Government to be rescued, which was ratified with the agreement of 31 October 1931. As a consequence, in 1933 IRI (a new state-owned holding company) took over the BCI share portfolio and Toeplitz had to resign as managing director. He was replaced by Raffaele Mattioli and Michelangelo Facconi. He remained as vice chairman until the following year. He then retired to his villa at Sant'Ambrogio Olona, near Varese, where he died on 27 January 1938.

His international standing and his relationship network are poignantly reconstructed in Giuseppe Telesca's doctoral thesis.⁸ To help us to imagine

⁸ See G. Telesca, 'Un uomo solo al comando. Giuseppe Toeplitz e il problematico governo societario della Banca Commerciale Italiana negli anni "20"', in: F. Amatori and A. Colli, *Imprenditorialità e sviluppo economico. Il caso italiano*, sec. XIII–XX (Milan 2009).

him, we found a description of Toeplitz: ‘Smart, old, short man with a big belly dressed with a white waistcoat, crossed by a gold chain: a sir with a persuading smile, whom, it was told, neither prefects, nor ministers, nor cardinals nor beautiful women could withstand.’⁹

II. Toeplitz’s Relationship with Poland¹⁰

The affection for his native country and the care of his family’s business interests – together with his natural tendency as a universal banker to provide the bank with new business – were the factors which determined Toeplitz’s feeling for Poland. Toeplitz always kept in touch with his relatives in Poland, closely participating in the political and social events of his native country.¹¹ In 1919, shortly after the foundation of the Polish Republic, Toeplitz had already constructed a large network of relationships with Polish politicians, businessmen and industrial managers, making it possible for him to receive, in a short time, information necessary to plan new business deals. He was helped in this task by his brother Ludwik (Lodovico), who had been living with him in Milan since 1895, becoming head of the international division of BCI in 1920.¹²

His relatives were the heart of this network, including his brothers Zygmunt, Henryk and Teodor, and others working as industrial managers

9 Translated from: *Elegante anziano bassotto portatore di un lauto ventre fasciato da un gilè bianco, attraversato da una catena d’oro: un signore dal sorriso suavisivo, a cui si diceva non resistevano né prefetti, né ministri né cardinali né belle donne* (De Lagarda 1974), p. 13. See also picture 3.

10 Section partially extracted from my paper, wrote with Michele D’Alessandro for the Annual Conference of the European Association for Banking and Financial History (EABH) e.V., see M. D’Alessandro, G. Montanari, ‘BCI and International Capital Transfers to Poland between the Wars’, unpublished paper presented in the Annual Conference of EABH, ‘Towards a global system? European Banks within the Evolving Economy’, (Warsaw, 18–20 May 2000).

11 For instance see ASI–BCI, ST, box 80.1. See also the memories of Józef Toeplitz’s son, in: *L. Toeplitz de Grand Ry, Il banchiere* (Milan 1963), pp. 129–33.

12 Regarding Ludwik Toeplitz’s career, see L. Contini, *Introduction to the Inventory Servizio Estero e Rete Estera* (Milan 1997), pp. 3–4. As head of the international division he spent a lot of time travelling abroad to look after BCI’s foreign business and Poland was often one of his destinations.

or dealers, placed in different areas of Poland. Toeplitz placed many of his relatives as BCI trustees in Polish or Italo-Polish companies in which BCI had vested interests (see Table 1). The head of this information network was Toeplitz's brother-in-law, Jerzy Meyer. His trading company, Herman Meyer of Warsaw,¹³ often participated in many enterprises promoted by BCI. In this way Toeplitz developed a competitive advantage in Italian business with Poland. In some cases he was also able to help companies under his protection to overcome the fierce competition of France and Great Britain. A great part of both the commercial and industrial business carried out between Italy and Poland passed through the hands of the Toeplitz secretariat, which always had a Polish secretary available to handle Polish affairs.¹⁴ From 1919, as a result of a Toeplitz initiative, BCI took part at different levels in all sectors of the Polish economy. However, the most relevant ones were textiles (especially with the cotton company I.K. Poznanski of Lodz), mining and metallurgic industries. BCI's lending and investment policy in Poland was characterised by a flexible strategy, readily modified in relation to changes in the macroeconomic and political situation. During the years 1918–1923 Toeplitz wanted to establish trade relations between Poland and Italy and especially take advantage of the trading of Polish coal. This was potentially important for a country like Italy, which lacked raw materials. In January 1924 BCI set up, in Upper Silesia,¹⁵ the company Società Italo-Polacca Miniere di Rybnik (Sipmer), in order to acquire concessions and mining rights of coal fields in Poland. Toeplitz was the first chairman.

13 This company was established by Herman Meyer, Jerzy's father, in Warsaw in 1867. It had dealt mainly with the corn trade and, after the First World War, coal and iron products. Jerzy Meyer hired Henryk and Teodor Toeplitz to work in his firm. Since 1919, the company was in difficulty because of the loss of the Russian market and as a result the company always needed BCI backing. Thus, in 1922, BCI changed it into a joint-stock company.

14 During the 1920s, Juliusz Stock from Lwow was the Polish secretary.

15 To this purpose in August 1923 BCI and Consorzio Mercantile Italiano of Rome had established a small company, Sindacato di Studio per la Concessione di Miniere Carbonifere nel Circolo di Rybnik. Antonino Laviosa, as engineer of Consorzio Mercantile, led the mission in Poland; see ASI-BCI, VCA, 24 October 1923, and UF, box 22.1.

In 1924 BCI mounted the issue of a 400 million lira loan (about \$17.7 million at current exchange rates) to the Polish government. It was part of the monetary and financial reform programme to which Prime Minister Władysław Grabski had committed his government. The Italian government was also given the right to provide the Polish monopoly with a certain amount of Italian tobacco out of the 60 per cent quota accorded to the Ugo and Folco Pecchioli, Florentine traders in the tobacco industry. Toeplitz had always kept his distance from the Fascist Government, and was a defender of the bank's independence, preferring not to meet Benito Mussolini in Rome. Therefore, it is emblematic that up till now the only documented meeting in the 1920s between Toeplitz and Mussolini was the one in the first days of March 1924, which settled the final details of the Polish loan. Although by 1927, after the stabilisation of both the Italian lira and the zloty, the value of the latter in terms of lire had nearly halved, the Polish government regularly met all the obligations stemming from the loan. In 1933, however, an agreement was passed between the two governments, under which Poland was allowed to draw on the reserve fund for the service of the debt, and from 1936 coal exports became a partial substitute for repayment.¹⁶

BCI channelled important flows of funds to a handful of Polish credit institutions, in particular to Bank Handlowy w Warszawie (Handlobank),¹⁷ the biggest Polish private bank, with strong affinities to BCI, as they both were the most important private banks in their respective countries and had a long standing tradition of close relations with industry. Toeplitz's uncle and brother-in-law had been respectively one of the founders and directors of the Polish bank. In 1927 Handlobank's control was purchased by a joint venture formed by BCI, W.A. Harriman & Co. of New York,

¹⁶ H. Kozłowska, 'I rapporti economici tra Italia e Polonia nel periodo 1918-1939', unpublished thesis (Milan 1984), p. 75.

¹⁷ ASI-BCI, VCD, Vol. 8, 7 September 1927.

Niederösterreichische Escomptegesellschaft of Wien and the Banque de Bruxelles.

On a global scale business with Poland did not bring many advantages. On the contrary, it resulted in the most relevant loss to the BCI foreign system. Financial distress originated from both its participation in Handlobank and from loans given to some Polish companies, and the Government. According to a gentlemen's agreement with the Polish Treasury on 27 January 1935, BCI transferred its private credits to the Polish Treasury and received in return an equal amount of Treasury bonds.

III. Sources and Correspondence

Upon Toeplitz's resignation from BCI in 1934, most of his records were moved to a record centre in Milan, and in 1942 they were transferred to the new BCI's record centre in Parma, thus escaping from the Milan record centre's destruction in the bombing of August 1943.

But in 1973 the Parma record centre was burned down and the majority of the papers were destroyed: bound registers of correspondence in alphabetical order, files on current business, and correspondence from the secretariat of the managing director. Only five out of 42 wooden crates escaped from the fire, because they had been recalled in 1972 to Milan. These now comprise, with other few folders, Toeplitz's secretariat papers within the Intesa Sanpaolo historical archives.

We can add to the above-mentioned records, 73 letter-books of Giuseppe Toeplitz (more than 35,000 pages), that had returned from Parma to Milan in 1946. This series encompasses 4,154 persons' names and 838 entries concerning corporations and public institutions. Considering the inaccuracy or incompleteness of names and surnames in the texts, especially in the case of foreign correspondents, the historical archives corroborate the data with the help of researchers from different countries, with particular

attention to Polish names.¹⁸ The most relevant collections of correspondence can be summarised as follows:

1. Italian world of industry: most important is the Venetian businessman Giuseppe Volpi, pioneer of trades with the Balkans and Minister of Finance (1925–1928), whose correspondence is of great historical interest.¹⁹ Moreover, correspondence with managers of main industrial sectors such as electricity and telecommunications (Maurizio Capuano, Giuseppe Cenzato, Achille Gaggia and Giangiacomo Ponti), iron and steel (Arturo Bocciardo from Ilva), engineering (Giovanni Agnelli and Vittorio Valletta from Fiat), shipbuilding (Rocco Piaggio), mining and chemistry (Guido and Gustavo Donegani from Montecatini), textile and artificial silk (Riccardo Gualino from Snia).
2. The financial world: Bank of Italy Governors (Bonaldo Stringher and Vincenzo Azzolini), Alberto Beneduce, starter of the so-called mixed economy (state intervention after the Big Crisis), Guido Jung (Minister of Finances), Edgardo Morpurgo (Assicurazioni Generali's chairman).
3. The political world (Benito Mussolini and Leandro Arpinati), diplomacy (Salvatore Contarini, Dino Grandi and Giacomo Paulucci di Calboli, later chairman of Istituto Luce, the official news broadcaster of the fascist regime), and the journalists Olindo Malagodi and Otto Kahn (correspondent in Rome for *Frankfurter Allgemeine Zeitung*).
4. Entrepreneurs, bankers, financiers and foreign managers of international standing, often personal friends of Toeplitz, listed by geographic location: Berlin (we list some as Herbert Gutmann from Dresdner Bank, Paul Hermann von Schwabach

¹⁸ Correspondence index compiled by A. Gottarelli – *Intesa Sanpaolo Historical Archives*.

¹⁹ See S. Romano, *Giuseppe Volpi. Industria e Finanza tra Giolitti e Mussolini* (Milan 1979).

from S. Bleichroeder and Paul Wallich from J. Dreyfus & Co.), Bruxelles (Daniel Heineman from Sofina and W. Thys from Banque de Bruxelles), London (Davison Dalziel from Compagnie Internationale des Wagons-Lits and Reginald McKenna from Midland Bank), Paris (Horace Finaly and Edouard Noetzlin from Paribas, Robert Snoy from Wagons-Lits), Warsaw (Stanislas Lubomirski from Bank Handlowy), and Wien (Camillo Castiglioni, entrepreneur and financier, and Hugo Marcus from Wiener Bankverein). In addition, the relationship with American financiers (as John E. Aldred, James Maitland from Bombright & Co., Thomas W. Lamont from J.P. Morgan & Co., and Nicholas Raffalovich from Field, Glore & Co. Inc.) mainly developed after the BCI business mission to the United States of 1928, which aimed at placing Italian stocks and bonds in US financial markets.²⁰

5. Managers and board members of BCI: the most important group of letters consists, without doubt, of those sent almost daily to Rome (Pietro Fenoglio and Ugo Baracchi); among the board members who should be mentioned are Ettore Conti, Silvio Crespi and Bernardino Nogara; among the managers of foreign branches and subsidiaries are Roberto Adler (Wien), Guido Ansbacher (Berlin), Enrico Consolo (London), Anton Eber (Prague from Böhmisches Union-Bank), Siro Fusi (New York), and former secretaries, Alessandro Joel and Enrico Marchesano.
6. Relatives of Toepfritz: his son Ludovico, his wife Jadwiga Mrozowska, his brothers Ludwik and Zygmunt, his brother-in-law Jerzy Meyer and his sister-in-law Isabelle de Grand Ry. Many letters are written in the Polish language.

²⁰ See picture 4.

From these letters many biographical details about Toeplitz come out, including his private life and hobbies; of particular interest is the correspondence with family members or with friends and partners in business such as Daniel Heineman, Giuseppe Volpi or with BCI managers Pietro Fenoglio, Enrico Consolo and Giuseppe Zuccoli.

We find that Toeplitz was highly interested in all new technological discoveries and media with a great impact on society, such as radio and telecommunications, highways – he promoted the first Italian highway, Milano-Laghi, which opened in 1924 – and civil aviation. He was one of the first users of civil aviation in the 1920s. Moreover, he was interested in the motion picture industry, at first supporting cinema production and distribution companies. After his retirement, he supported the activity of his son Ludovico, who became a film producer in London in the 1930s.²¹

Correspondence with his wife, half in Italian and half in Polish, is a very useful source for discovering aspects of his biography dating back to his youth. It includes details about his business travels across Europe, dinners in Paris, London, Prague, Budapest and so on.²² His second wife was the famous Polish actress Jadwiga Mrozowska.²³ They got married in 1918 and Toeplitz financed her geographical expeditions to Asia, checking every stage of her trips. As an example he wrote to his friend Heineman:

‘Je vous remercie beaucoup pour l’intérêt que vous prenez a la santé de Madame Toeplitz qui n’est pas bonne. Elle a eu, lors de son expédition au Tibet Central, une première de attaque de appendicite, qui repère ensuite à Bombay.’²⁴

21 See L. Toeplitz de Grand Ry 1964.

22 Thanks to Francesca Pino for analysis of Toeplitz’s letters to his wife.

23 See K.T. Toeplitz 2004, pp. 154–55.

24 ASI–BCI, CpT, 21 October 1926, Vol. 51/170.

In 1929 he helped her to get machinery and films to produce a documentary about her Indian voyages²⁵ and to find a German translator for her book *Visioni d'Oriente*.²⁶

From the letters we can learn a lot about his land house in Sant'Ambrogio Olona, near Varese, with marvellous gardens and an astronomical observatory,²⁷ where he gave hospitality to relatives and friends, among them the sculptress Maryla Lednicka, who received commissions from the business entourage of the banker.²⁸ His passions were dogs,²⁹ cars and music.³⁰ The correspondence attests to his friendship and support of Arturo Toscanini, the famous conductor, and his generosity in inviting bankers and friends to his box at the Scala Theatre.

Moreover, relevant information about the Pilsudski 'revolution' of 1926 in Warsaw can be found,³¹ as well as his troubles in managing BCI, especially in the years 1926 and 1931.³²

In conclusion, we hope that this review can help to locate new sources about Toeplitz's activity. A first survey in Poland has been recently carried out by Michał Szelecht, who found in Breslau (Wrocław) and Ossolinski National Institute (Zakład Narodowy im. Ossolińskich), many letters between Toeplitz, his wife Jadwiga, Polish relatives and friends. In Lodz some folders of the textile companies Poznanski and Scheibler & Grohman, both financed by BCI, are kept in the state archives (Archiwum Państwowe w Łodzi).

25 ASI-BCI, CpT, letter to Jadwiga, 3 May 1929, Vol. 63/200.

26 ASI-BCI, CpT, letter to Jadwiga, 30 May 1930, Vol. 68/64. See also Mrozowska 1930.

27 See picture 5.

28 ASI-BCI, CpT, letter to Jadwiga, 11 May 1929, Vol. 63/270. See also Mori 2013.

29 See the telegram of 15 September 1926 to Jadwiga, who was at Darjeeling, asking her to bring two young dogs from India, ASI-BCI, CpT, Vol 50/299. See also picture 6.

30 His preferences can be read in letter to Jadwiga, 25 April 1930, Vol. 67/317.

31 ASI-BCI, CpT, letter to Jadwiga, 20 May and 18 June 1926, Vol. 48/257 and 49/52. See also W. Roszkowski, *Historia najnowsza Polski 1914-1945* (Warsaw 2003), pp. 213-21.

32 ASI-BCI, CpT, letter to Jadwiga about the spreading of the banking crisis in Europe, 19 July 1931, Vol. 73/400.

Moreover, it would seem to be of the utmost importance to start a bilateral cooperation between the Leopold Kronenberg Foundation and Intesa Sanpaolo Historical Archives in promoting the translation in English of the above-mentioned correspondence with his wife in order to enhance their accessibility for scholars.

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MI	Carte miscellanee di Raffaele Mattioli (Miscellaneous Papers of Raffaele Mattioli)
SE,d	Servizio Estero, dirigenti (Managers of the International Division)
SOF	Società Finanziaria Industriale Italiana (Sofindit)
ST	Segreteria Toeplitz (Secretariat of Toeplitz)
UF	Ufficio Finanziario (Financial Secretariat)
VCA	Verbali del Consiglio di Amministrazione (Minutes of Board Meetings)
VCD	Verbali del Comitato della Direzione Centrale (Minutes of the Management Board)
VCE	Verbali del Comitato Esecutivo (Minutes of the Executive Committee)

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Tables and Pictures

Table 1 – Toeplitz family network in Polish business (1919–1934)						
Company	Head-quarters	Sector	Dates	Names	Relationship	Seat
Azienda Scambi Commerciali (Asca)	Milan	Trade Companies	1928-1933	Meyer Jerzy	Brother in law	Director
Azienda Scambi Commerciali (Asca)	Milan	Trade Companies	1928-1934	Toeplitz Teodor	Brother	Director
Bank Handlowy w Warszawie	Warsaw	Banks	1900-1934	Meyer Jerzy	Brother in law	Director
Bank Handlowy w Warszawie	Warsaw	Banks	1927-1934	Toeplitz Henryk	Brother	Director
Bank Handlowy w Warszawie	Warsaw	Banks	1927-1933	Toeplitz Józef	=====	Director
Modrzejow-Hantke	Warsaw	Metallurgy	1928	Wellisz Leopold	Brother in law	Chairman
Polski Fiat	Warsaw	Engineering	1920-1921	Toeplitz Teodor	Brother	Director
Poznanski (I.K.) AG	Lodz	Textiles	1932-1934	Toeplitz Zygmunt	Brother	Chairman
Saturn	Sosnowiec	Metallurgy	1924-1925	Reicher Maksymilian	Brother in law	Director
Société Anonyme Minière et Industrielle Dobioszowico	Sosnowiec	Mining	1925	Reicher Bronislaw	Nephew	Director
Società per il Commercio Italo-Polacco	Milan	Trade Companies	1920	Toeplitz Ludwik	Brother	Director
Società Italo Polacca per le Miniere di Rybnik (Sipmer)	Milan	Mining	1924-1934	Toeplitz Józef	=====	Chairman
Tomaszowska Fabryka	Warsaw	Textiles	1925-1934	Toeplitz Zygmunt	Brother	Chairman
Tomaszowska Fabryka	Warsaw	Textiles	1925-1934	Toeplitz Ludwik	Brother	Director
<i>Source: ASI-BCI, Data base on BCI's trustees</i>						



Picture 1 – Bonawentura Toeplitz, Warsaw, about 1900



Picture 4 – Józef Toeplitz, third from the left, on the steamer Duilio sailing to New York, May 1926



Picture 2 – Józef Toeplitz, Milan, about 1930



Picture 3 – Józef Toeplitz, at his left Jadwiga Mrozowska, at his niece Rysia Toeplitz's wedding, Sant'Ambrogio Olona, 1932



Picture 5 – Toeplitz's country house in Sant'Ambrogio Olona, Varese, about 1938



Picture 6 – Józef Toeplitz with a dog, about 1910

CONTROL AND REGULATION OF CAPITAL FLOWS BETWEEN POLAND AND PALESTINE IN THE INTERWAR PERIOD

JERZY ŁAZOR

Abstract

Palestine was a major destination for migrating Jews in the interwar period, with around 40 per cent of all newcomers coming from Poland. Palestine's fast economic growth was the result of a large import of capital brought by these immigrants. Throughout the period the main goal of the Polish government was to minimise capital transfers to Palestine while trying to sustain Jewish migration. In 1925 an attempt was made to limit the transfers, but political pressure forced the government to reconsider its position. Between 1927 and 1936 capital moved freely between the two countries, but in order to influence its flow, Polish authorities set up two banks in Palestine, and the extent of capital transfers was monitored by a number of governmental agencies. When exchange control was re-established in Poland in 1936, the Jewish Agency in Palestine and the Polish government signed a transfer agreement, which proved inefficient. Poland terminated the agreement in 1938 and set up a new unilateral transfer system in which the Polish side controlled all aspects of capital flows.

The flow of capital played an important, if hidden role, in the evolution of economic relations between Poland and Palestine. Not as prominent as trade or migration, it nonetheless shaped Polish policy. The purpose of this article is to show this influence and prove that in time it grew to become the most important factor in Polish-Palestinian relations. I will concentrate on

two key periods: the mid-1920s, with their first surge of migration, and the late 1930s, when Poland's exchange control regime resulted in two subsequent clearing arrangements.¹ The role of capital transfers in the economic development of Palestine is well known, but I have found no studies concerning the Polish part of the issue – in particular ones that would use the archival collections of Archiwum Akt Nowych in Warsaw and the Polish Institute and Sikorski Museum in London. Together with materials from the National Archives in London, they form the basis of this work.

While interwar Palestine was a powerful magnet for Jewish immigrants, its attraction changed with time. There were two main *aliyot* (waves of immigration, plural of *aliyah*), during which newcomers from Poland dominated: the fourth, or Grabski, *aliyah* and the fifth, sometimes called the Hitler *aliyah*. The former, named after Władysław Grabski, author of Poland's post-war monetary stabilisation, peaked between 1924 and 1926, while the latter was particularly strong in 1932–1936. In total over 330,000 Jews arrived in Palestine during the interwar period, some 40 per cent of them from Poland.

Immigration to Palestine was strictly controlled by the British, who created a system of certificates and categories, each with its own set of rules. Three categories were particularly important: the so-called capitalists, workers coming within the 'labour schedule', and dependents. Capitalists were able to enter Palestine without restrictions, as long as they possessed at least £500 (£1000 in the 1930s). They were a crucial source of capital for the mandate. The labour schedule was formed by poorer Jews, allowed to immigrate within the 'absorptive capacity' of Palestine,² as long as they managed to obtain one of the rare certificates. Finally, dependents were family members of Jews already living in Palestine. Immigrants of the

1 Y. Weiss, 'The Transfer Agreement and the Boycott Movement: A Jewish Dilemma in the Eve of the Holocaust', *Yad Vashem Studies*, 26 (1998); L. Weinbaum, *A Marriage of Convenience: The New Zionist Organization and the Polish Government 1936–1939* (New York 1993), pp. 106, 172.

2 S. Reichman, Y. Katz and Y. Paz, 'The Absorptive Capacity of Palestine, 1882–1948', *Middle Eastern Studies*, 33 (1997), 2, pp. 338–61.

two latter groups transferred small sums – Polish consular estimates quote as little as 4–20 £P (Palestinian pounds) per person.³ Together with funds transferred by capitalists, this formed the first important channel of capital movement from Poland to Palestine. Due to mostly negligible re-emigration, transfers in the other direction were rare.⁴

Migration also created a second channel for moving money. Families in Poland would send funds to Palestine, helping their relatives survive in the new environment. As immigrants established themselves in the mandate, money started flowing in the other direction.⁵ The Great Depression significantly undermined the livelihood of many Polish Jews, and these transfers became increasingly important (their role was emphasised by the Revisionist leader, Ze'ev Jabotynski).⁶ Statistics of bank transfers and postal orders indicate that, starting in the early 1930s, the balance shifted

3 *Archiwum Akt Nowych* (hereafter: AAN), Ministerstwo Spraw Zagranicznych (hereafter: MSZ), 6270, Z. Kurnikowski to MSZ, 4 May 1936, p. 29; AAN, MSZ, 6275, MSZ to Komitet Ekonomiczny Rady Ministrów (hereafter: KERM), 23 April 1936, p. 114; AAN, MSZ, 6275, Internal MSZ note, 1934, pp. 81–2; AAN, MSZ, 6275, J. Wojstomska's note, 14 Nov. 1934, p. 102; AAN, MSZ, 9496a, S. Łukaszewicz to Ministerstwo Przemysłu i Handlu (hereafter: MPiH), 18 Jul. 1936, pp. 538–9.

4 Palestine Department of Immigration Annual Report 1934 (Jerusalem 1935); M. Mossek, *Palestine Immigration Policy Under Sir Herbert Samuel: British, Zionist and Arab Attitudes* (London 1978), p. 38; T. Segev, *One Palestine, Complete. Jews and Arabs Under the British Rule* (London 2001), p. 226; E. Samuel, *A Lifetime in Jerusalem: The Memoirs of the Second Viscount Samuel* (Jerusalem 1970), pp. 84–5; B.J. Smith, *The Roots of Separatism in Palestine. British Economic Policy, 1920–1929* (Syracuse 1983), p. 79; AAN, MSZ, 2309, P. Nawratzki, Memorandum. Bemerkungen zu gewissen Vorschlägen des Berichtes der Royal Commission, Hajfa, Juli 1937, p. 31.

5 M. Kula, *Autoportret rodziny X. Fragment żydowskiej Warszawy lat międzywojennych*, (Warsaw, 2007), pp. 71, 186, 190, 203, 209–10, 250; Z. Landau and J. Tomaszewski, *Bank Polska Kasa Opieki S.A. 1929–1999* (Warsaw 2002), p. 19; H. Szoszkies, 'Komunikacja lotnicza z Palestyną', *Palestyna i Bliski Wschód*, 2 (1933), 1, p. 4; *The National Archives*, London (hereafter: TNA), Colonial Office Papers (hereafter: CO) 733/360/2, p. 15.

6 L. Weinbaum, *A Marriage*, p. 105; AAN, Ambasada RP w Londynie (hereafter: ARPL), 948, Z. Kurnikowski to MSZ, 3 Oct. 1935, p. 266.

in favour of transfers to Poland, and amounted to a few million Polish złoty per year.⁷

There were other channels of capital transfers, but they either played a smaller role, or are difficult to differentiate from the two mentioned above. Jewish charities gathered money for use in Palestine, as did official Zionist funds (Keren Kajemet LeIsrael, Keren HaJesod, later the Revisionist Keren Tej Chaj), but their Polish branches were famously inefficient, particularly in the 1920s.⁸ Rich Jews from Poland made direct investments in Palestine, and moved their business operations. This was mostly done within migration-related transfers of capitalists.

A number of estimates concerning the quantitative side of flows between Poland and Palestine survive to this day. Since most their components went unrecorded, the estimates are not very reliable. They range from around 10 million to 20 million £P. The high estimate was provided by Kurt Nevratzki, an expert in Palestinian economy and representative of Danzig and Gdynia in the mandate. According to his calculations, capital from Poland constituted around 25 per cent of all flows into Palestine.⁹

The Poles had three basic goals in their economic relations with the mandate. First, they wanted to push as many Jews out of Poland as possible. Prioritised throughout the period, this became a key issue in Polish politics after the death of Józef Piłsudski in 1935. Second, the government was

7 Landau and Tomaszewski, *Bank*, pp. 57–8; L. Lewite, ‘W sprawie komunikacji lotniczej między Polską a Palestyną’, *Palestyna i Bliski Wschód*, 3 (1934), 10, p. 271; ‘Ruch pocztowy między Polską a Palestyną’, *Palestyna i Bliski Wschód*, 5 (1936), 9, pp. 471–2; Statystyka Pocztowa, Telegraficzna i Telefoniczna Rzeczypospolitej Polskiej za rok 1926 (Warsaw 1927), pp. 14–22; Statystyka Pocztowa, Telegraficzna i Telefoniczna Rzeczypospolitej Polskiej za rok 1927 (Warsaw 1928), pp. 10–22; Statystyka Pocztowa, Telegraficzna i Telefoniczna Rzeczypospolitej Polskiej za rok 1928 (Warsaw 1929), pp. 10–22; ‘Statystyka Pocztowa, Telegraficzna i Telefoniczna Rzeczypospolitej Polskiej za rok 1930’, *Kwartalnik Statystyczny*, 8 (1931), 3, pp. 934–6.

8 A. Chojnowski and J. Tomaszewski, *Israel* (Warsaw 2001), p. 25; J. Tomaszewski (ed.), *Najnowsze dzieje Żydów w zarysie (do 1950)* (Warsaw 1993), p. 218; J. Walicki, *Ruch syjonistyczny w Polsce w latach 1926–1930* (Łódź 2005), pp. 116–7, 423; E. Mendelsohn, *Zionism in Poland: the formative years, 1915–1926* (New Haven/London 1981), pp. 216–211, 330–3.

9 AAN, MSZ, 2309, P. Nawratzki, Memorandum. Bemerkungen zu gewissen Vorschlägen des Berichtes der Royal Commission, Hajfa, Juli 1937, p. 31.

anxious to promote Polish exports to Palestine, particularly after 1932, when Poland's insistence on deflationary monetary policies forced it to seek a favourable trade balance. The third and final goal was connected with capital flows and evolved slowly.

As the Grabski *aliyah* blossomed in 1925, Polish officials in Jerusalem sent a report to Warsaw,¹⁰ alarming the Ministry of Foreign Affairs that capitalist migration was causing a high level of capital outflow from Poland. The Economic Committee of the Presidium of the Council of Ministers (*Komitet Ekonomiczny Prezydium Rady Ministrów*) tried to reduce these transfers without slowing labour and dependent migration. Starting on 1 August 1925, an administrative decision removed 'capitalists' from the legal category of emigrants from Poland. As a result, rich Jews no longer had the right to receive free emigrant passports and had to apply for normal, prohibitively expensive travel documents (up to 500 zł per capita in 1925, the equivalent of a high monthly salary). The Committee's decision was a practical way of reducing capitalist emigration, but had little legal basis. It didn't stay in force for long.¹¹

After the decision had been announced, the Palestine Office in Warsaw sent a memorandum to the Polish Emigration Office (*Urząd Emigracyjny*),¹² a key governmental institution dealing with the problems of emigration. The memorandum remains a fascinating document, mixing truths with half-truths and outright fabrications. Trying to convince the government that the level of capital transfers was low, the Zionists claimed that capitalists constituted no more than 25 per cent of Polish emigrants to Palestine (statistics show the number to have been around 45 per cent between January and August 1925), and that they mostly settled in farms (in fact – mostly in Tel Aviv). The authors then claimed that at most 40–60 per

10 I wasn't able to locate a copy of the report at the archives.

11 AAN, MSZ, 9930, Ministerstwo Pracy i Opieki Społecznej to Prezes Rady Ministrów, 23 Dec. 1925, p. 9.

12 AAN, MSZ, 9930, Centralny Syjonistyczny Wydział Palestyński to Urząd Emigracyjny, pp. 47–8.

cent of funds transferred by Polish migrants had come from Poland: the rest had been sent directly from the USA. They suggested that an average family moving to Palestine on a single capitalist permit consisted of six people, including four adults (another claim challenged by Polish consuls and available data: in the 1930s the number was quoted as two adults). We do not possess factual information to assess all the provided data, but when we do, it is easy to find the memorandum questionable. Surprisingly, the document was quoted verbatim during an inter-ministerial conference in September 1925, which revoked the special treatment of emigrating capitalists. It was decided that no restrictions should be placed on Jewish emigration to Palestine ('nie powinny być czynione żadne ograniczenia emigracji ludności żydowskiej do Palestyny').¹³ This suggests that Polish officials not only supported Jewish emigration, but also trusted Zionist sources. Surprisingly, the Polish consulate in Jerusalem had not been consulted before the decision was taken – and this did not change until the following year, when consul Otto Hubicki was also instructed to monitor transfer levels.¹⁴ He was immediately able to refute most of the document's claims, using nothing more than freely available Jewish Agency statistics, and promptly alarmed the Ministry of Foreign Affairs.¹⁵ Tadeusz Zażuliński, his subordinate in Jerusalem, considered the matter even more important. As can be understood from his correspondence, he was in conflict with Hubicki, and considered the latter's actions to be detrimental to Polish interests. Zażuliński sent his own reports, avoiding official diplomatic post, to alert the Ministry of Foreign Affairs to huge capital outflows from Poland. He attacked the memorandum, but his reports,

13 AAN, MSZ, 9930, Ministerstwo Pracy i Opieki Społecznej to Prezes Rady Ministrów, 23 Dec. 1925, pp. 10–1.

14 AAN, ARPL, 122, MSZ to O. Hubicki, 15 Mar. 1926, p. 2.

15 AAN, MSZ, 9930, O. Hubicki do MSZ, 14 May 1926, pp. 25–34.

with their own questionable claims, can be put on the other end of the spectrum.¹⁶

The Grabski *aliyah* coincided with a certain change in the Polish relationship with the Jews and the Zionists in particular. Some concessions to the latter found their way to the anti-climatic ‘*ugoda*’ of 1925,¹⁷ but the first major declaration of support came in the form of a letter from the minister for foreign affairs Aleksander Skrzyński to Nahum Sokolow in June 1925.¹⁸ The minister for home affairs, Kazimierz Młodzianowski, repeated it after Piłsudski’s coup, on 27 May 1926, as did other officials in the following years.¹⁹ In this new climate, an inter-ministerial conference convened on 7 October 1926 with representatives from the Ministries of Treasury, Internal Affairs and Foreign Affairs, as well as the Emigration Office. Their goal was to address the transfer situation as described in Zaźuliński’s and Hubicki’s reports. We possess two minutes from the conference – their content so different, that they could have almost come from two different meetings. One stresses the role played by transfers, while the second tries to make it seem less important (in line with the Treasury’s position). Both minutes agree however, that limiting capitalist emigration had been deemed very difficult within the legal framework existing at the time, and that the government would try to convince Zionists to give

16 AAN, MSZ 9930, T. Zaźuliński to Polish Consul in Ostrava, 8 Jun. 1926, pp. 55–7; AAN, MSZ 9930, T. Zaźuliński to MSZ, pp. 58–9; AAN, MSZ, 9930, T. Zaźuliński to MSZ, 18 Nov. 1925, pp. 3–4.

17 J. Tomaszewski, ‘Władysław Grabski wobec kwestii żydowskiej’, *Biuletyn Żydowskiego Instytutu Historycznego*, 43 (1992), 1 (161), pp. 45–59; Tomaszewski, *Najnowsze dzieje*, p. 221; J. Tomaszewski, ‘Polskie dokumenty o ‘ugodzie’ polsko-żydowskiej w 1925 roku’, *Biuletyn Żydowskiego Instytutu Historycznego*, 51 (2000), 1 (193), pp. 61–76; J. Tomaszewski, ‘Rozmowy w sprawie ‘ugody’ w 1925 (notatki uczestnika)’, *Biuletyn Żydowskiego Instytutu Historycznego*, 52 (2002), 2 (198), pp. 222–8; Walicki, *Ruch syjonistyczny*, pp. 46–50.

18 Walicki, *Ruch syjonistyczny*, p. 53.

19 Walicki, *Ruch syjonistyczny*, pp. 48, 138, 111, 113–4; 151; J. Tomaszewski, *Rzeczpospolita wielu narodów* (Warsaw 1986), p. 192; Tomaszewski, *Władysław Grabski*, p. 47; Z. Lubomirski, ‘Polska-Palestyna’, *Palestyna i Bliski Wschód*, 3 (1934), 4–5, p. 5; AAN, MSZ, 10546, Z. Lubomirski’s speech on 8 Jan. 1934, pp. 2–3; A. Hartglas, *Na pograniczu dwóch światów* (Warsaw 1996), p. 232–3.

Polish Jews more labour certificates. This approach was indeed taken as migration grew in the 1930s.²⁰

Ministry of Treasury estimates from the conference were based on the assumption that it had the power to approve all foreign transfers as a result of the exchange control regime, which was in force in Poland before 1927. While the Ministry of Social Security had given the Palestine Office limited permission to conduct small transfers, Treasury officials believed that it was done on a small scale. These assumptions were proven false by the case of Mosze Dawid Goldstein. An elderly emigrant, in 1926 he tried to transfer 500 £ through the Palestine Office. After failing to receive the money in Palestine, he contacted the Polish consul and to the surprise of Polish authorities, his transfer had not been reported by the Office. Governmental auditors soon moved in, but without much success. The original ministerial permit required all bookkeeping of the Office to be done in Polish. Auditors were only able to find books in Hebrew – practically uncontrollable. This was part of a country-wide Zionist policy. When possible, Zionists kept their books in Hebrew and each year sent them to Palestine, so that no information would be available, should Polish authorities send their officials. This scheme worked surprisingly well. Interestingly enough, the Goldstein case arose soon after a huge financial scandal shook the Palestine Office in Warsaw.²¹

As migration stopped in the wake of the Palestinian economic crisis of 1926–1927, so did discussion concerning capital flows. The issue was still monitored by the Emigration Office, and appropriate figures were

20 AAN, MSZ, 9930, Minutes, 7 Oct. 1926, pp. 69–71, 81–2; AAN, MSZ, 9930, Internal MSZ note, 15 Jun. 1926, pp. 15–6; AAN, MSZ, 9930, O. Hubicki to MSZ, 11 May 1926, pp. 24–5.

21 AAN, MSZ, 9930, M. D. Goldstein to Konsul Generalny w Jerozolimie, p. 96; AAN, MSZ, 9930, Ministerstwo Skarbu (hereafter: MS) to MSZ, 10 Oct 1927, p. 110.

published in various semi-official Polish balance of payments estimates,²² but it stopped being a front page question. This changed in the early 1930s with the beginning of the fifth *aliyah*. Looking at the remaining archival sources, one can identify at least five different institutions, which tried to gauge the level of capital flows to Palestine including various ministries, institutes and Polish consuls in Jerusalem and Tel Aviv. The gradient of opinions was similar to that of the 1920s. Sources in Palestine were alarmed and the Ministry of Foreign Affairs mostly agreed with their claims. On the other end of the spectrum was the Ministry of Treasury, which regularly understated the role of these transfers. Other estimates can be placed between these two extremes.²³

Migration peaked in 1935, as did the transfer discussion. This coincided with another shift in the government's Jewish policy. In 1935 all Jewish matters were put under the supervision of the Consular Department in the Ministry of Foreign Affairs led by the rather antisemitic Wiktor Tomir Drymmer.²⁴ Despite debates, in 1935 there was no legal way of tackling the problem of transfers. During the Great Depression, Poland followed an orthodox monetary policy and joined the Gold Bloc. As a result, money flowed to Palestine freely.

Even though nothing could be done to limit transfers, facilitating money orders from Palestine to Poland was a viable way of influencing the balance of payments. This is what the Polish government tried to do

22 J. Piekalkiewicz, 'Bilans płatniczy Polski w 1923', *Kwartalnik Statystyczny*, 2 (1925), 2, p. 320; J. Piekalkiewicz, 'Bilans płatniczy Polski w 1924', *Kwartalnik Statystyczny*, 3 (1926), 3, p. 371; P. Sokołowski, 'Bilans płatniczy Polski za rok 1925', *Kwartalnik Statystyczny*, 4 (1927), 2, pp. 284–6; P. Pszczołkowski, *Bilans płatniczy Polski w latach 1923–1926* (Warsaw 1927), pp. 51–2; S.Z. Rutkowski, 'Bilans płatniczy Polski za rok 1926', *Kwartalnik Statystyczny*, 5 (1928), 2, pp. 564–5; R. Seidler, 'Bilans płatniczy Polski za rok 1927', *Kwartalnik Statystyczny*, 6 (1929), 1, p. 51.

23 AAN, ARPL, 500, S. Łukaszewicz to MSZ, 24 Oct. 1934, p. 109; AAN, MSZ, 5208, MSZ Economic Advisor note, 13 May 1936, p. 15; AAN, MSZ, 6275, Numerous minutes and dispatches, pp. 15, 78, 81–2, 85, 88, 90–1, 100–4; AAN, MSZ, 9496a, S. Łukaszewicz to MPiH, 18 Jul. 1936, pp. 538–9; Instytut Polski i Muzeum im. gen. Sikorskiego in London, Poselstwo RP w Kairze, A.50/122, Press report, 12 Jul. 1934.

24 A. Chojnowski, *Koncepcje polityki narodowościowej rządów polskich w latach 1921–1939* (Wrocław 1979), p. 225, Weinbaum, *A Marriage*, p. 7–9.

from the beginning of the fifth *aliyah*. First, in 1929 it co-founded The Immigrants' Bank Palestine-Poland Ltd. The enterprise proved to be less than satisfying. Inadequately managed by Polish Jews, it long failed to raise enough capital to find a spot on the market. A positive change came with an influx of capital in the mid 1930s, which made the bank independent from Poland.

Second, seeing the slow start of The Immigrants' bank, Polish officials decided to start another unit in Palestine, by opening a branch of Bank P.K.O. S.A. in Tel Aviv in 1933 and two years later in Haifa. Bank P.K.O. S.A. had been founded as a state-owned bank in 1929, in order to service the Polish diaspora (or Polonia). Its Palestinian branches successfully managed transfers, until exchange control regulations in Poland made their offer unattractive. They also tried to gather the savings of Polish Jews in Palestine, but achieved only modest success, with less than 1 per cent share of the market.²⁵ In general, the appearance of Polish-funded banks made transfers to Poland easier, but they failed to make a greater impact on the balance of payments. It seems that most customers used Łódzki Bank Depozytowy, then controlled by the Anglo-Palestine Bank Ltd.²⁶

The situation changed in April 1936, when Poland introduced exchange control. In order to take part in foreign currency transactions, entities other than Bank Polski needed special permits, granted by the minister of treasury. Likewise, new regulations forbid all trade in gold or foreign securities, and their transfer over Polish borders; citizens leaving the country were allowed to carry no more than 500 zł. These regulations immediately provoked a run on the Tel Aviv branch of Bank P.K.O. S.A.. A month later, in May 1936 a similar system was set up for international trade, with each transaction requiring consent of the minister of industry and commerce. The new legal situation allowed Polish authorities to strictly control gold

²⁵ N.Landau and Tomaszewski, *Bank*.

²⁶ AAN, Ministerstwo Skarbu (MS), 4340, Polski Instytut Rozrachunkowy to MS, 23 April 1937, p. 6.

and devisen transfers, and thus directly interfere with capital transfers to Palestine.²⁷

While transfers had been stopped, the new situation posed a threat to emigration since the Jewish Agency awarded certificates to countries, which brought the most capitalists to the mandate. In the 1930s impoverished Polish Jews found it hard to procure the necessary funds, while richer strata of the Jewish community were less interested in migration. Now the situation worsened. Both Polish and Zionist officials understood that a new solution was needed, and studied the German system known as *Ha'avarah* as a successful model for such an arrangement.

Within *Ha'avarah*, which had been created in 1933, emigrating German Jews would transfer their assets to a central agency, which used them to finance exports of German products to Palestine. Emigrants would then receive money from the sale of these products, losing on average about 35 per cent of their initial capital payments. This allowed German goods in Palestine to be sold below market prices, and their exports surged. The system provoked a serious debate both in the Jewish diaspora, and in the *jishuv* (the Jewish society in Palestine). It was created at roughly the same time as the boycott movement, initiated by European Jews, and aimed at limiting imports from Nazi Germany. Jews in Europe felt betrayed. Despite its moral and political ambiguities, *Ha'avarah* proved to be an economic success. It allowed some 20,000 people to come to Palestine, bringing with them around six million £P.²⁸

27 J.P. Wisłocki, *Nowe przepisy dewizowe* (Warsaw 1936), pp. 5–8; C. Leszczyńska (ed.), *Bank Polski 1924–1939, wybór tekstów Z. Karpińskiego* (Warsaw 1988), p. 82; Z. Landau and J. Tomaszewski, *Gospodarka Polski międzywojenne*, vol. IV, *Lata interwencjonizmu państwowego* (Warsaw 1989), pp. 348–55.

28 A. Barkai, 'German Interests in the haavara-Transfer Agreement 1933–1939', *Leo Baeck Institute Yearbook*, 35 (1990), pp. 245–66; Y. Bauer, *Jews for Sale? Nazi-Jewish Negotiations, 1933–1945* (New Haven 1994), pp. 5–28; F.R. Nicosia, *The Third Reich and the Palestine Question* (London 1985); P. Polkehn, 'The Secret Contacts: Zionism and Nazi Germany, 1933–1941', *Journal of Palestine Studies*, 5 (1976), 3/4, pp. 54–82; T. Segev, *The Seventh Million. The Israelis and the Holocaust*, (New York, 1993), pp. 16–34; M. Weber, 'Zionism and the Third Reich', *The Journal of Historical Review*, 13 (1993), 4, pp. 29–37; Y. Weiss, *The Transfer Agreement*.

As early as May 1936, a Palestinian delegation came to Poland to negotiate a transfer agreement. It included two former Polish MPs: Fiszal Rottenstreich and Icchak Grünbaum. The third member of the delegation – Dr. Salheimer – was particularly interesting, since his home institution, the Anglo-Palestine Bank, was responsible for the Palestinian part of *Ha'avarah* operations. The situation soon became more complicated. Jozua Farbstein, another former Polish MP and erstwhile head of the Department of Industry and Commerce of the Jewish Agency Executive, came to Poland at the same time. The press was rife with speculation and accused Farbstein of attempting to negotiate with the Polish government on his own account. I found no traces of this in Polish archives. Farbstein was not the only Palestinian guest in Poland at the time: Moussa Chelouche, head of the Palestinian-Polish Chamber of Commerce in Tel Aviv, was another. Chelouche, an important figure in the Ashrai Bank and the Immigrant's Bank Poland-Palestine Ltd, allegedly tried to dissuade the Polish government from accepting the Anglo-Palestine Bank as a major component of the new transfer. Again, I was not able to find any confirmation of these actions, beyond allegations in the Palestinian press. Finally, Poland was in negotiations over their 'marriage of convenience' with the revisionist movement. Both sides had to tread lightly.²⁹

After Rottenstreich's anti-Polish speech in August 1936 the Poles refused to talk to him. Further negotiations were thus concluded with Grünbaum alone.³⁰ Grünbaum was no novice. An important figure in Jewish interwar politics in Poland, he had been one of the creators of the minority bloc in the Sejm. At the same time, institutions in Palestine – including the Anglo-Palestine Bank and the Executive of the Jewish Agency – tried to influence Polish officials through their representatives in Palestine. Since

29 AAN, MSZ, 6270, Z. Kurnikowski to MSZ, 13 May 1936, pp. 46–7; AAN, MSZ, 6270, Z. Kurnikowski to MSZ, 4 May 1936, pp. 27–35; AAN, MSZ, 9496, Z. Kurnikowski to MSZ, 15 May 1936, p. 249–50; AAN, MSZ, 7530, Z. Kurnikowski to MSZ, 2 Sep. 1936, p. 128; AAN, MSZ, 7530, Z. Kurnikowski to MSZ, 26 Nov. 1936, p. 251.

30 AAN, MSZ, 6275, Note from 12 Aug. 1936, p. 221.

Bank P.K.O. was a plausible Polish choice for the main bank of the new transfer system, particular pressure was put on this subject. The director of its Tel Aviv branch, Tadeusz Piech, was told that his bank was too small, and reminded that it had only survived the banking runs in 1935–1936 with the help of the Anglo-Palestine Bank.³¹

Palestinian Jews insisted that the new arrangement should not threaten *Ha'avarah*. Since the list of Polish and German goods competing on the Palestinian market was fairly long, a successful agreement with Poland could hurt *Ha'avarah*. Many considered it crucial for the development of the *jishuv*: it guaranteed a substantial flow of capital combined with a relatively low level of capitalist immigration: an outcome which went hand in hand with ruling Zionist ideology. Polish consuls noted that the Jews' insistence on the role of the Anglo-Palestine Bank was a sure sign that the *Ha'avarah* was considered more important than a possible agreement with Poland (although this logic seems a bit flawed). It was probably understood in Palestine that Poland would not be able to provide the amount of capital the Jews needed (and which they were getting from Germany). Moreover, with the *Ha'avarah* playing such an important role, there was no place for a particularly strong rise in Polish exports.³²

Polish authorities were supposedly presented with as many as 68 different transfer proposals. However, as the government had a much stronger negotiating position, it was able to force its own draft of the clearing arrangements onto Grünbaum. It had been prepared by the Ministry of Industry and Commerce, and later accepted by an inter-ministerial conference on 25 September 1936.³³ A much more important

31 AAN, ARPL, 500, Z. Kurnikowski to MSZ, 21 Sep. 1936, pp. 223–7; AAN, ARPL, 500, E. Levantine to P. Hoofien, 20 Sep. 1936, pp. 229–30; AAN, MSZ, 6275, MSZ to Z. Kurnikowski, 12 Sep. 1936, p. 234.

32 J. Thon, 'Analiza handlu polsko-palestyńskiego w roku 1936', *Palestyna i Bliski Wschód*, 6 (1937), 3, p. 102; AAN, MSZ, 6275, Z. Kurnikowski to MSZ, 1 Jul. 1936, pp. 207–8.

33 AAN, MSZ, 6275, Note on clearing, 25 Oct. 1936, pp. 229–31; AAN, MSZ, 7530, Z. Kurnikowski to MSZ, 22 Jul. 1936, pp. 18–9; AAN, MSZ, 7530, Z. Kurnikowski to MSZ, 2 Sep. 1936, p. 128–131; AAN, MSZ, 7530, Z. Kurnikowski to MSZ, 26 Nov. 1936, p. 251.

conference, headed by Wiktor Tommir Drymmer, took place ten days later on 5 October 1936. Apart from important figures from the Ministry of Foreign Affairs, all other interested ministries sent their representatives: the Ministry of Interior, of Social Help, and of Industry and Commerce. The conference dwelled on many topics connected with the transfer and its minutes remain a fascinating read. Negotiations with the revisionist movement were entering into a decisive stage. Officials attending the conference considered them more important than any potential transfer agreement with the Jewish Agency. The Agency itself was deemed too weak to significantly influence Polish trade in the region. The minutes hint that while a transfer system based on a unilateral Polish declaration had been considered, it had been ultimately rejected before the conference. At least one of the reasons for this decision was clear: as negotiations with the revisionist movement were held in secret, the Poles considered talks with Grünbaum a very handy cover ('pożądana przykrywka'). In this light, the true goal of a possible transfer agreement was to force the Jewish Agency into giving Poland more immigration certificates – preferably around 60 per cent of the global annual number. This was considered particularly important as German Jews were given a rising percentage of certificates.³⁴

When it came to details of the future agreement, Poland was determined to become the stronger partner. In particular its officials decided – proving Zionist fears true – that the clearing in Palestine would be managed by Bank P.K.O.'s Tel Aviv branch. Wanting to avoid giving the Jewish Agency a prestige boost, the government also decided to relegate the signing of the agreement to a lower-tier governmental agency, perhaps the Polish Institute for Settlements (PIR, *Polski Instytut Rozrachunkowy*), responsible for managing other clearing arrangements. Finally, an internal Ministry of Foreign Affairs meeting was held in late October 1936. Among its participants was Tadeusz Zażuliński – now a department head in the

³⁴ Weinbaum, *A Marriage*, pp. 170–2; AAN, MSZ, 6275, Conference minutes, 5 Oct. 1936, pp. 244–6.

ministry. He might have considered this his personal triumph: exactly ten years after his point of view on Jewish transfers had been rejected, a system was being set up to address the issue. During the meeting it was concluded that:

‘While the Jewish Agency cannot be considered the sole or indeed the final partner, benefits in emigration and trade make signing an agreement with the Jewish Agency expedient.’³⁵

Before the agreement could be signed, the mandatory ruler of Palestine had to be consulted. Great Britain had signed two trade treaties with Poland: in 1923 and 1935. They forbade all discriminatory barriers for imports of British and colonial goods. Not sure whether they allowed a transfer agreement, the Poles asked the Foreign Office. This provoked a discussion within the British government. Treasury officials stressed that Polish firms were often late in their payments to their British partners. Any agreement, even in the form of a clearing arrangement with a British mandate, which resulted in faster Polish payments to the United Kingdom by slowing other transfers, was deemed beneficial. As a result, Britain gave the agreement the green light.³⁶

With both Poland and the Jewish Agency determined to use the clearing agreement to further their own goals, it comes as no surprise that the system was inefficient, and worked more to limit transfers than to encourage them. Negotiations lasted into 1937. There were a few major points of disagreement between the Poles and the Palestinians. Grünbaum insisted that all transactions within the system should require acceptance of

35 ‘Jakkolwiek Agencji Żydowskiej nie można uznać za jedyngo albo też ostatecznego kontrahenta, ze względu na korzyści emigracyjne i gospodarcze należy uznać zawarcie umowy z Agencją Żydowską za celowe’; AAN, MSZ, 6275, MSZ Economic Advisor note, 24 Oct. 1936, p. 255.

36 M. Fularski, *Aktualne problemy turystyki zagranicznej* (Warsaw 1938), p. 14; AAN, MSZ, 6275, Foreign Office (FO) to ARPL, 16 Nov. 1936, pp. 135–6; AAN, MSZ, 6275, Note from 24 Oct. 1936, p. 253; TNA, CO 852/64/4, FO to ARPL, 14 Nov. 1936; TNA, CO 852/64/4, CO to His Majesty’s Treasury, 12 Aug. 1936; TNA, His Majesty’s Treasury Papers (HMT) 160/727, Internal note, 30 Jul. 1936; TNA, HMT 160 727, MHT to FO, 29 Jan. 1937.

the Jewish Agency. This notion fell through early, as did the Polish request of a guaranteed allotment of immigration certificates. Moreover, the Jews did not let the agreement only apply to 'Polish citizens, living in Poland'. On the other hand, the Poles did not agree to give priority to migration-related transfers, and forced a provision, which gave them the power to decide the order of payments within the system. The final agreement was signed on 4 March 1937.³⁷

The agreement made PIR and the Tel Aviv branch of Bank P.K.O. S.A. responsible for everyday management of the clearing, as well as all trade-related transfers, for which they took 0.5 per cent of the value of each payment. A Special Commission (*Komisja Specjalna*) was created in Warsaw to control the clearing – out of its 13 members, five came from the Jewish Agency, six from PIR, one from Bank P.K.O. and one from the Polish-Palestinian Chamber of Commerce in Warsaw. The Commission had an advisory committee in Palestine, with two members nominated by the Jewish Agency, and one each by the Palestinian-Polish Chamber of Commerce in Tel Aviv, the Tel Aviv branch of Bank P.K.O. S.A. and PIR (the last institution nominated the committee's chairman). The composition of these bodies was largely a success of Grünbaum – the original project allotted the Jews significantly less power.³⁸

While small non-trade transfers were performed automatically by PIR, a Jewish-controlled agency was set up to manage larger ones. Headquartered in Jerusalem, it was called '*Halifin*', and operated through a branch in Warsaw (*Towarzystwo dla Rozwoju Stosunków Wymiennych Pomiędzy Polską a Palestyną* '*Halifin*' Sp z o.o.). It worked somewhat similarly to *Ha'avarah*: around seven per cent of funds paid into the agency was then used for export premiums. This was important, as in 1936 Poland revoked

37 AAN, MSZ, 6276, Note from meeting between Nieduszyński and Grünbaum, 6 Oct. 1936, p. 120; AAN, MSZ, 6275, Internal MSZ note, 21 Oct. 1936, p. 248; AAN, MSZ, 6275, I. Grünbaum to MSZ, 25 Nov. 1936, p. 260.

38 'Okólnik Komisji Dewizowej nr 44 z dnia 29 IV 1937', *Palestyna i Bliski Wschód*, 6(1937), 5–6, p. 218; 'Polska-palestyńska umowa clearingowa', *Palestyna i Bliski Wschód*, 6 (1937), 4, p. 161.

many of the premiums that helped Polish exports to Palestine flourish. Through synecdoche the entire agreement was sometimes called *Halifin*.³⁹

Funds put into the clearing in one country were paid out in the other, when a corresponding payment had been made in the other direction. In this way, Palestinian imports from Poland were supposed to ‘unblock’ migration quotas, in particular money required for capitalists. The list of goods that were able to do it was limited, as the Poles excluded a number of important articles of mutual trade such as wood and metal products.⁴⁰ This suggests that limiting transfers (and not promoting exports) was the real Polish goal.

There was a crucial difference between *Halifin* and *Ha'avarah*, which affected their efficiency. *Ha'avarah* worked because Jews were willing to pay a heavy price for the possibility to emigrate from Nazi Germany. As a result, both Germany and Jews in Palestine were able to profit from the emigrants’ plight: Germany thanks to surging exports, and the *jishuv* thanks to low prices of *Ha'avarah*-sponsored wares. In comparison, *Halifin* took too small a percentage of the emigrants’ assets to finance significant export premiums. In the Polish system, Palestinian Jews were expected to bear the cost of migration of their Polish brothers (by having to buy relatively expensive Polish goods). This outcome must have seemed rather unlikely, which confirms my point, that the transfer was designed to limit capital flows, rather than profit from emigration.

In 1937 the Polish government gave official support to an alternative transfer solution, proposed by Michał Glazer, a Polish-Jewish economist. His system was more along the lines of the *Ha'avarah*: with emigrants

39 ‘Informacje dla przekazujących do Palestyny należności z tytułów nietowarowych (emigracja, zakup i spłata działek gruntowych, studia, zapomogi, turystyka itd.)’, *Palestyna i Bliski Wschód*, 6 (1937), 5–6, p. 224; ‘Zerwano o clearing polsko-palestyński?’, *Codzienna Gazeta Handlowa*, 2 Aug. 1938, p. 2; L. Lewite, ‘Działalność Izby Handlowej Polsko-Palestyńskiej w 1938 na tle ogólnej sytuacji w Palestynie’, *Palestyna i Bliski Wschód*, 8 (1939), 5–6, p. 85.

40 L. Lewite, ‘Polsko-palestyńska umowa clearingowa’, *PiBW* 6 (1937), 5–6, p. 187; ‘Zmiany w przepisach polsko-palestyńskiego układu clearingowego’, *Palestyna i Bliski Wschód*, 6 (1937), 7, pp. 282–4; AAN, ARPL, 949, W. Hulanicki to MSZ, 9 Jun. 1937, p. 165; AAN, ARPL, W. Hulanicki to MSZ, 16 Jun. 1937, p. 174; AAN, MSZ, 2305, W. Hulanicki to MSZ, 21 May 1937, pp. 196–197.

losing 15–25 per cent of their funds and the difference being invested in special governmental agencies. The Ministry of Foreign Affairs supported Glazer in his efforts to present his project to major powers, including the United States and Great Britain. Copies were also sent to various embassies in Warsaw. Archival sources suggest that it wasn't the technical solution to the transfer problem which earned Glazer the support, but rather the way in which he explained Polish-Jewish relations. In depicting them as the logical result of a historical and social process, his proposal fell in line with the official Polish interpretation, presented in diplomatic fora. In this way, support given to Glazer can be understood as a way of strengthening the official doctrine, with the economic arguments mostly ignored.⁴¹

During the first year of its operation some 4.5 million zł went into the system in Poland, and was met by only around three million zł in Palestine. As a result, some 1.5 million zł became blocked. This situation confirmed the importance of the provision giving Poland the power to decide the order of payments. It allowed Polish authorities to push their exports and at the same time limit transfers. There was another problem with the agreement: in all its calculations, it used the official Warsaw pound sterling exchange rate, c. 25 zł/£, while in Palestine the market exchange rate slowly moved up to as much as 40 zł/£.⁴²

The situation resulted in abysmal capitalist emigration and negligible transfers. During the 15 months before the clearing agreement was scrapped, only ten capitalist families managed to make it to Palestine within the system – and even then only thanks to Bank P.K.O. S.A., which tried its best to make the process faster.

41 M. Glazer, 'Analiza projektu o Finansowaniu Emigracji żydowskiej z Polski oraz Uwagi i Wnioski', unpublished typescript held in Biblioteka Narodowa in Warsaw, dated 1937; Weinbaum, *A Marriage*, p. 18; AAN, MSZ, 2304a, The Jewish Problem and British Policy; AAN, MSZ, 10005, Internal MSZ note, p. 39.

42 'Zerwano o clearing', p. 2; Z. Łopieński, 'Rozrachunek i kompensacja', *Bank* 6, (1938), 8, pp. 166–9.

In 1938 negotiations with revisionists reached a different stage and the clearing in its original, inflexible form offered Poland no advantages. Thus in May 1938 Poland unilaterally renounced it. Palestinian reaction was hostile: much blame was put on the *Halifin* branch in Poland for not adequately promoting the transfer. The Polish side, on the other hand, blamed the Jewish Agency, claiming that it had done nothing to increase Palestinian imports from Poland.⁴³ Both sides were right to a degree: the agreement did not work properly, because neither party wanted it to work. It can be argued however, that the Polish decision to significantly limit capital transfers had, by far, the greatest impact.

The Jewish Agency sent a new delegation to Poland: this time Icchak Grünbaum was accompanied by Dr. Werner Feilchenfeld, an expert from *Ha'avarah*. The subsequent negotiations were very telling. Jewish representatives wanted *Halifin* to take more money from emigrating Jews, so that it could be used to finance more imports from Poland, with Łódzki Bank Depozytowy as the only official bank.⁴⁴ In other words, they wanted a system more like the *Ha'avarah*, which allowed higher emigration, while at the same time profiting the *jishuv*.

After two months, negotiations came to a halt and on 9 August 1938 the transfer agreement expired. Soon afterwards, on 13 September 1938, Poland unilaterally introduced a new transfer system via a governmental declaration.⁴⁵

The new, declaration-based clearing came into force on 15 September 1938. According to Polish consul Tadeusz Piszczkowski, it aimed to achieve an absolute balance of payments between Poland and Palestine.⁴⁶ Under its

43 L. Lewite, 'Działalność Izby ... 1938', p. 86; Weinbaum, *A Marriage*, p. 173; AAN, ARPL, 500, T. Piszczkowski to MSZ, 31 May 1938, pp. 219–20; AAN, ARPL, 500, T. Piszczkowski to MSZ, 21 May 1938, p. 217–18; TNA, HMT 160/727, H. Kennard to Lord Halifax, 8 Jun. 1938.

44 AAN, PIR, 118, Memo 'Linie wytyczne układu w przedmiocie zmiany umowy clearingowej' by I. Grünbaum and W. Feilchenfeld, 14 Jun. 1938.

45 'Zerwano o clearing', p. 2; TNA, Foreign Office Papers (FO) 371/21810, H. Kennard to Lord Halifax, 11 Jul. 1938, p. 108; TNA, FO 371/21810, H. Kennard to Lord Halifax, 6 Aug. 1938, p. 110.

46 AAN, MSZ, 6276, T. Piszczkowski do MPiH, 21 Mar. 1939, p. 9.

rule, the Foreign Currency Commission in Warsaw (*Komisja Dewizowa*) had to confirm all non-trade capital transfers to Palestine. If its decision was positive, the commission could take one of two actions. The transfer could simply be allowed to proceed (and would then be registered on a special PIR account). More interestingly however, the Commission could deem the transfer important enough to go through 'PIR settlement' ('*rozrachunek PIR*'). This settlement system worked similarly to the previous clearing agreement, although on a much more limited scale. Transfers to Palestine were executed only after certain goods of a corresponding value had been imported from Poland. The Ministry of Industry and Labour controlled the list of these 'unblocking' goods, and it remained very limited,⁴⁷ including mostly food, cement, furniture, various paper-related goods and leatherwear. Citrus-trade operated separately, but was also controlled by PIR.

Poland achieved full control over legal transfers to Palestine in a much more flexible system than the agreement from 1937. As the declaration excluded most trade from the settlement, it made Polish exports independent. The fact that standard, small transfers were made easier promoted migration, while the possibility of moving transfers of a higher value to the settlement system made sure that the outflow of funds wasn't too big. On the other hand, archival reports suggest that the settlement system came to a halt with limited trade in related goods. Consul Piszczkowski blamed the Jewish Agency, pointing out their complete *désintéressement* in increasing imports from Poland.⁴⁸ But why would the Agency pander to Polish claims?

In early 1939 another Polish Jew, Dr. Emil Shmorak, became the new director of the Department of Trade and Industry of the Jewish Agency's

47 'Wykaz artykułów, których eksport dopuszczony jest do odmrażania należności zablokowanych w Polskim Instytucie Rozrachunkowym w Warszawie', *Palestyna i Bliski Wschód*, 7 (1938), 9, p. 235; L. Lewite, 'Działalność Izby ... 1938', p. 90.

48 L. Lewite, 'Działalność Izby Handlowej Polsko-Palestyńskiej w 1937 r. na tle ogólnej sytuacji w Palestynie', *Palestyna i Bliski Wschód*, 7 (1938), 5–6, p. 111.

Executive. Shmorak was one of the Jews who had blamed the Agency, rather than Poland for the meagre results of the first clearing agreement. He was seeking rapprochement with Poland and wanted to negotiate a new deal.⁴⁹ In February 1939 the Economic Adviser (*Radca Ekonomiczny*) of the Polish Ministry of Foreign Affairs urged his government to adopt a new economic policy towards Palestine,⁵⁰ one based on the free flow of foreign exchange in mutual trade and unhindered by clearing regimes. In his opinion, only the transfer of capital by capitalists should continue to be controlled via a *Ha'avarah*-like system, with proceeds used for export premiums. Such a system, his note explained, would spur migration and help with the balance of payments. Between the adviser and Shmorak, a new solution seemed imminent.

Despite these rather sensible proposals, the arrangement between Poland and Palestine remained unchanged, primarily because of the Ministry of Treasury and Drymmer's Department. In April 1939 the latter's officials declared in a memorandum that there was nothing to be gained from any agreements with the Jewish Agency, itself too weak to affect anything in Palestine. The abysmal emigration situation during the Arab uprising had led them to believe that the framework of the unilateral declaration gave Poland greater flexibility and was completely adequate. They stressed that Polish policy had been expressed most fully in a declaration by viceminister Jan Szembek: while Poland did not aim to get devisen from Palestine, it would not agree to any loss in this regard.⁵¹ The situation remained unchanged. It should be stressed that this strict approach was not limited to Polish relations with Palestine, as the Sanacja government fought to keep the economy afloat. For example, in late 1938 it launched a campaign against tourist agencies in a bid to limit the outflow of capital.

49 AAN, MSZ 9936, T. Piszczkowski to MSZ 22 Feb. 1939, pp. 3–5.

50 AAN, MSZ, 9936, MSZ Economic Adviser note, 24 Feb. 1939, pp. 17–9.

51 AAN, MSZ, 9936, Departament Konsularny MSZ note, 4 Apr. 1939, p. 6.

Sources point to a very low effectiveness of the Polish-Palestinian system and significant delays in payments, although the effects varied depending on the type of transfer. Private (non-settlement) transfers fared fairly well: 0.8 million out of one million zł was transferred before September 1939. Similarly, citrus trade closed with 6.2 million zł transferred out of 8.5 million zł paid by Polish importers. Other results were much worse. It seems that not a single złoty from the charity-private institutions account (mostly used by Keren Kajemet LeIsrael and Keren HaJesod) made it to Palestine. The 'PIR settlement' account proved equally ineffective, as did other, less important ones. In total, only 2,500 out of a total of 724,400 zł was transferred.⁵² The outbreak of the war made any further changes impossible. At least one Palestinian company was not discouraged by German tanks in Warsaw, and in October 1939 demanded compensation from the Polish government-in-exile (then in France). Unsurprisingly, considering the situation, none was given.⁵³

Over 20 years of mutual relations the Polish government changed its stance on capital transfers to and from Palestine. In the 1920s and early 1930s, they were considered less important than emigration. It can be argued that this was possible for two reasons: first, Poland was still able to afford a relatively small outflow of capital (a few tens of millions of Polish złoty a year, while in the 1920s the global annual figure of imports reached 2–3 billion zł). Second, Palestine was able to take in a relatively large number of immigrants (even if much less than the United States before the first world war), and Poland accepted capitalist migration as long as it meant the departure of a significant number of Jewish labourers. Both of these circumstances changed in the late 1930s, and Polish policy followed suit. The Great Depression undermined Poland's financial position, and if the outflow of capital to Palestine in 1935 amounted to the estimated

52 AAN, MSZ, Polskie Towarzystwo Handlu Kompensacyjnego Sp. z o.o. to MSZ, 30 May 1939, p. 45.

53 AAN, AAN, PIR, 143, Remanent wpłat w Polsce, 31 Dec. 1939; AAN, PIR, 147, passim; AAN, PIR, Mill Products Ltd to Polish Government in France, 15 Oct. 1939.

value of 80–100 million zł, then it was equivalent to some ten per cent of total Polish exports in that year. Political changes in Palestine resulted in a much smaller allotment of migration certificates by the British. At the same time, *Ha'avarah* played an important role in the economic life of the *jishuv*, making a new, rival transfer system less attractive to Palestinian Jews, especially if it was less likely to bring comparable advantages. When emigration seemed unlikely, limiting the outflow of capital became the primary goal of Polish politics in Palestine. These points arguably explain both Polish actions in 1925–1926, and the changing clearing situation in the late 1930s, which limited transfers to Palestine more than promoting them.

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Cross-Border Activities of Banking Institutions – Present Day and History



DUTCH BANKING IN OVERSEAS TERRITORIES: DIFFERENT WAYS OF ENTRY AND EXIT

PIET GELJON & TON DE GRAAF

Abstract

This article begins with an overview of the phenomenon of overseas banking, followed by a brief introduction to Dutch overseas banking. We then look at the three Dutch banks that were active in overseas banking: the Nederlandsche Handel-Maatschappij in the Dutch East Indies/Indonesia between 1880 and 1960; the Nederlandsche Bank voor Zuid-Afrika in South Africa from 1888; and the Nederlandsche Bank voor Zuid-Amerika/Hollandsche Bank-Unie in South America. All three banks were established in the nineteenth and early twentieth centuries; but the motivation for their creation was different in each case. For various reasons the overseas operations all ceased in the period of 1960 to 2008. The article ends with a number of concluding remarks.

Introduction

Overseas banking – an important aspect of the conference theme, ‘Foreign Financial Institutions & National Financial Systems’ – has a long history. It mainly took the form of banks with a head office in one (mother) country and a branch network operating in another country, the latter being a colony or other territory with special relations with the mother country and mostly situated far away from it. With the very poor communications of earlier times, the management of a business on another continent

was problematic and conflicts often arose between the head office and the workers in the field. Mira Wilkins called this type of organisation, which existed not only in the banking sector, but also in agriculture and mining, a free-standing company.¹ Writing from a British point of view and only with regard to banking, one of the first authors on this subject, Baster, made a distinction between imperial banks, which operated within the British Empire, and international banks working in other territories.² Otherwise the phrase overseas bank is generally used.

The origins of overseas banking lie in Great Britain in the second quarter of the nineteenth century.³ Apart from the Provincial Bank of Ireland (London, 1825), the first overseas bank was the Bank of Australasia (London, 1835). It was followed by institutions for Canada, the West Indies and – curiously – the Ionian Isles.⁴ Later, London-based banking operations were started in other overseas territories. The Chartered Bank of India, Australia and China (1853) was intended to have a broad sphere of activity, including Japan and the Dutch East Indies. According to the strict definition, the Hongkong and Shanghai Banking Corporation (1864) was not an overseas bank, because it was based in Hong Kong; nevertheless, because of its substantially British character, it is usually thought of as an overseas bank. South Africa's first overseas banks appeared in the early 1860s and included the Standard Bank of British South Africa (1862), later

1 M. Wilkins, 'The free-standing company, 1870–1914: an important type of British foreign direct investment', *Economic History Review*, 41 (1988); M. Wilkins and H. Schröter (eds.), *The Free-standing Company in the World Economy 1830–1996* (Oxford 1998).

2 A.S.J. Baster, *The International Banks* (London 1935); A.S.J. Baster, *The Imperial Banks* (New York 1977).

3 This section is based in particular on G. Jones (ed.), *Banks as Multinationals* (London/New York 1990); G. Jones (ed.), *Multinational and International Banking* (Aldershot 1992); G. Jones, *British Multinational Banking 1830–1990* (Oxford 1993). Many particulars can also be found in the memorial volumes published by overseas banks and in M. Pohl and S. Freitag (eds.), *Handbook on the History of European Banks* (Aldershot 1994). See also T. de Graaf, J. Jonker and J.J. Mobron (eds.), *European Banking Overseas, 19th–20th century* (Amsterdam 2002); P.L. Cottrell, 'Conservative abroad, liberal at home', in: S. Battilossi and J. Reis (eds.), *State and Financial Systems in Europe and the USA* (Farnham 2010).

4 P.L. Cottrell, *The Ionian Bank. An Imperial Institution, 1839–1864* (Athens 2007).

renamed the Standard Bank of South Africa. A number of institutions began operating in South America and Mexico at about the same time.

All these banks were independent institutions operating under a royal charter or later on as limited liability companies. They were engaged in financing international trade, but also developed local banking businesses, attracting deposits and granting credits. As most of these territories had no central bank, the overseas banks were allowed to issue their own bank notes. Many of these ventures did not survive the hardships and financial troubles of their host countries, but quite a number developed into respectable banks in London. Their head offices looked after the credit policy, the liquidity and the staff policy. In a later phase, overseas banks were established as subsidiaries or affiliates of banks in the mother country, but also as subsidiaries or affiliates of other entities, such as shipping companies or trading houses. Governments also stepped in, as in the case of the Imperial Bank of Persia (1889). In countries other than Great Britain – Germany, France, Portugal – governments encouraged their emerging banking systems to expand overseas, or even took the lead. Germany's Deutsche Übersee Bank (1886, later on Deutsche Überseeische Bank) is an example.⁵

The heyday of overseas banking was in the early twentieth century. In 1913, there were thirty-one British overseas banks with more than 1,300 branches all over the world, while other European countries also had banks with branch networks in their overseas territories. After the First World War, a period of decline set in. War and depression took their toll, trade and foreign exchange restrictions hampered their operations and the general banks began to expand overseas. Some overseas banks failed outright, while mergers and takeovers also caused the number of overseas banks to decline. The first moves were amalgamations of banks operating in the same area, for example in Australia and South Africa. In South

5 R.E. Breuer, J. Fitschen, W. Plumpe and H. Wallich, *Deutsche Bank in East Asia/Deutsche Bank in Ostasien* (Munich 2004); M.L. Müller and R. Frost, *Woven in. 125 Years of Deutsche Bank in Latin America* (Munich 2012).

America, a new element appeared with the involvement of a clearing bank. In 1918 Lloyds Bank acquired the capital of one of the institutions there, merging it with another bank into the Bank of London and South America (Bolsa), which ultimately became the only British bank on that continent. Meanwhile, Barclays Bank had also entered the field with Barclays DCO (Dominion, Colonial and Overseas). By 1940, a total of fifteen independent overseas banks remained.

The Second World War and the decolonisation that followed further undermined the position of overseas banks. Opposition to foreign banks, always latent in many countries, now came into the open, resulting in nationalisation by governments or in acquisition of the banks by local shareholders. From the 1970s, the consolidation process intensified and practically all overseas banks became part of big multinational banking groups. That pattern was seen throughout the sector, not only in British overseas banks. The only names that still echo the long and often dramatic history of overseas banking are Standard Chartered Bank and HSBC.

I. Dutch Overseas Banking

Against the international background described above, let us now turn to Dutch overseas banking. With its large overseas possessions – particularly in the Dutch East Indies (present day Indonesia), but also in the Caribbean region – the Netherlands followed the general pattern already outlined, but also displayed some distinctive characteristics. It was, of course, quite natural that banks should be established in the Dutch colonies, and from the 1860s the first colonial banks came into being. However, the Dutch started banking operations in various other areas as well. After the independence of the South African Republic (Transvaal, 1881) feelings of kinship with the Boer population and economic prospects led to the creation of two Dutch banks in that country. A few decades later (around

1920), Dutch commercial banks expanded in other areas, one of which was South America. Not only were there differences in the ways in which banking activities in these various regions started, but also in the ways they ended: by nationalisation after political conflicts; by agreed separation of the business; and by a takeover by another bank. Developments in the various regions referred to above are described in the following sections.

II. Indonesia

Until 1798, certain parts of the Dutch East Indies (now Indonesia) were controlled by the Verenigde Oostindische Compagnie (Dutch East India Company, or VOC, founded in 1602). Although the VOC was primarily a trading company, it also exercised colonial authority, employed its own soldiers and sailors, conducted trade and founded colonies. Following the VOC's insolvency in 1798, the Batavian Republic (the Netherlands) took over government of the Dutch East Indies. When Napoleonic France blockaded Britain, the British seized the Dutch colonies, because the Batavian Republic in 1811 was an ally of France. Dutch authority was restored in 1814, however.

Willem I became Dutch king in 1815 and quickly set about reasserting Dutch control over its East Indian possessions and promoting trade with the region. Trade with the Far East had recovered after the period of French hegemony, to the point where it even exceeded that seen at the height of the VOC era. However, much of it was by this time controlled by the British and the Americans. Both important figures in the Dutch East Indies and King Willem I feared that British and American involvement could eventually undermine Dutch political power in the colony. The king was determined to prevent that happening and therefore backed the formation of a new company, for political as much as commercial reasons.

So it was that, on the initiative of King Willem I., that *Nederlandsche Handel-Maatschappij* (Netherlands Trading Society, or NHM) was established in The Hague in March 1824. The company's role was to encourage, facilitate and drive Dutch import-export trade with the East Indies. The company's object was defined very broadly, so that NHM could take over some of the activities previously carried out by VOC.⁶

At the outset, the geographical sphere of activity defined for the new company covered a large part of the world. It became clear that this was over-ambitious. Following heavy trading losses, King Willem I decided to intervene in 1827. He assumed the right to appoint the company's president and directors and the sphere of activity was restricted to the Dutch East Indies. In 1826, an East Indian branch of the company, called *De Factorij* (the Factory) opened in Batavia (modern Jakarta).

From 1830, the 'cultivation system' was introduced to the Dutch East Indies, and NHM was given an important role in its administration. Under the system, the East Indian government obliged the local communities to cultivate certain produce – coffee, sugar, indigo and later also tea – and to give a proportion of their produce to the authorities. Within the system, NHM acted as the Dutch government's banker, commission agent and shipping agent. Transportation of the produce to the Netherlands and its sale in Amsterdam and Rotterdam were also overseen by NHM. One drawback for NHM was that it was obliged to extend credit to the Dutch state. By the late 1830s, the state owed NHM so much that parliament had to be informed and responded by bringing the practice to a halt.

From the early 1850s, NHM began financing plantations in the Dutch East Indies. The finance schemes took the form of harvest cash advances,

6 This section is based on the *History of Nederlandsche Handel-Maatschappij*, published last year. Because the publication is in Dutch, no specific references to its text are included. The book includes a comprehensive English-language summary and conclusion; see T. de Graaf, *Voor Handel en Maatschappij. Geschiedenis van de Nederlandsche Handel-Maatschappij, 1824–1964* (Amsterdam 2012), pp. 441–469.

mortgage loans and capital participations. In 1858, an agency was established in Singapore, to support activities in the Dutch East Indies.

Other banks were active in the Dutch East Indies during the nineteenth century. In 1828, Javasche Bank was founded in Batavia: the bank of issue, which developed into more of a commercial bank from the late nineteenth century. In 1857, again in Batavia, Nederlandsch-Indische Escompto Maatschappij (Dutch East Indian Escompto Company) was set up. That was followed in 1863 by Nederlandsch-Indische Handelsbank (Netherlands India Commercial Bank), which was based in Amsterdam with its main agency in Batavia. Although these banks were to some extent active in the same fields as NHM, each of them had its own fields of specialisation as well. With a view to maintaining the direction of this paper, it was decided that this section should focus exclusively on NHM, the biggest and most influential commercial bank of the Dutch East Indies.

Until approximately 1870, NHM was not a true bank in the current sense of the word. Before that date, a large proportion of its profits came from the commission earned on state commodity trading. Gradually, however, the state adopted a more liberal policy towards the Dutch East Indies, leading ultimately to, amongst other things, liquidation of the cultivation system. That deprived NHM of an important source of revenue, resulting in smaller dividends and declining profitability. A new direction was needed. NHM was already involved in providing credit to the state and others, such as sugar refiners, plantations in the Dutch East Indies and business associates in Japan. So the upscaling of its banking activities was an obvious choice.

In 1880, the banker Balthazar Heldring joined NHM's board: a carefully considered appointment that reflected the intention to change direction and to withdraw from commodity trade. That withdrawal was not in fact fully realised: NHM continued trading in and selling the produce of its own plantations and business associates, and trading on behalf of the state.

After 1880, the policy emphasis was mainly on plantation finance, such as credits on consigned produce (consignment credits), participations in plantation ventures, plantation start-ups and the issue of shares in plantation companies. The policy was pursued cautiously. NHM's own plantation enterprise was thoroughly reorganised from 1879, enabling it to endure the 1884 sugar crisis with relative ease. That was not the case everywhere: various financial institutions and plantations got into serious difficulties or even failed. Alongside cultivation activities, De Factorij began developing a foreign exchange business. Although it had previously been active in foreign exchange, it was only after 1880 that it became a major line of business. Other activities included securities transactions, telegraphic transfers, the issue of documentary credits and the financing of Dutch East Indian imports. The diversification into banking was mainly through De Factorij and the Singapore agency.

NHM had a third group of activities, which were linked to its *crédit mobilier* role: participating in the foundation of industrial companies and shipping lines, building and operating railways, mining, operating its own port and bunker station on Sumatra and so forth. Such activities focused mainly on the Dutch East Indies and/or represented a 'national' interest, according to the board. Around the turn of the century, NHM also tried to set up a bank in South Africa.

NHM was therefore a very varied undertaking. As well as being a trading company, it was a bank, an investment bank and a venture capital company. In other words, it had all the characteristics of a *crédit mobilier*. NHM had a position and role unlike any other Dutch bank. Around 1900, NHM became involved in banking within the Netherlands as well. By about 1914, it had already established itself as one of the country's five biggest banks.

However, by the turn of the century, the competition had recovered from the damage caused by the sugar crisis. In the Dutch East Indies NHM's main competitors in the early twentieth century were Nederlandsch-Indische

Handelsbank (NIHB), Nederlandsch-Indische Escompto Maatschappij (NIEM) and, in particular, Javasche Bank. The presence of these rivals had the effect of squeezing margins in banking and exchange activities. Competition for NHM's new issues business in this area was nullified in 1912 by a cartel agreement with NIHB and NIEM. Because De Factorij did not want to be dependent on Javasche Bank in an emergency, part of NHM's capital was set aside to serve as a buffer in times of crisis. After 1900, new agencies were established in the Dutch East Indies and South-East Asia.

The same period saw an increase in the number of sugar companies owned by NHM. The company was able to safely build up its involvement in sugar growing, because the 1902 Brussels Convention brought stability to cane sugar prices. The expansion of plantation activities also reflected the board's belief in a multi-track policy, as opposed to reliance on banking. NHM also acted as a guardian of 'national interests' in the Dutch East Indies. The role brought considerable financial benefit: income from the sale of the company's port and bunker station ultimately made a healthy contribution to profits in 1914.

In 1916, the multi-track policy continued to bear fruit. The element of the company's portfolio that was regarded as fundamental to NHM's financial health was its plantation business. If the banking business was to gain in significance, it would have to be as a complement to the plantation and trading businesses, rather than as an alternative to them. In 1916, the banking business in the Netherlands was considerably expanded by an alliance with Geldersche Credietvereniging (Gelders Credit Union), which was eventually taken over in 1936.

In the period 1900 to 1916, NHM found itself facing increasing competition in the Dutch East Indies, and the situation only intensified after the First World War. Besides new Dutch banks, Chinese, Japanese and American competitors established footholds in the Dutch East Indies. The Great Depression that began in 1929 hit NHM harder than

Nederlandsch-Indische Handelsbank and Nederlandsch-Indische Es-compto-Maatschappij. NHM's losses were higher and the bank had to close more branches during the Depression than the two other banks. The disproportionate difficulties that affected NHM were due to the interlinked nature of its banking and plantation activities. Following the 1884 sugar crisis, Nederlandsch-Indische Handelsbank had created a subsidiary – Nederlandsch-Indische Landbouw Maatschappij (Dutch East Indian Agricultural Company, or NILM) – in order to separate its banking and plantation activities and thus reduce the impact of the crisis for both NIHB and NILM. While global market prices for plantation produce were strong, NHM's multi-track policy was successful. Nevertheless, after the 1929 crisis, the weakness of the policy was revealed: if one part of the business got into difficulty, it was liable to bring the other down with it. NHM's plantation activities were not any harder hit than those of other similar organisations. NHM was quite willing and able – with its East Indian banking business and its business in the Netherlands – to make major cutbacks in its East Indian plantation business. However, NHM's proposals for rationalisation and output reduction were felt by some competitors as going too far, and NHM was pressed into accepting less effective compromise arrangements.

Heavy losses incurred by the plantation business necessitated drastic, across-the-board reorganisation of NHM in 1934. The company's capital was cut by three quarters (from *f* 80 million to *f* 20 million) and new shares to the value of *f* 15 million were issued shortly afterwards.

Reorganisation brought the book value of the plantation business back into line with its economic value. Drastic cuts in costs were made in both the Netherlands and the Dutch East Indies, thus bringing expenditure back under control. The crisis of 1934 was the biggest in the history of NHM. However, no one on the executive board or the supervisory board ever questioned the multi-track policy. During the thirties, the Netherlands remained in recession for longer than other European

countries; the economy began to recover only once the government left the gold standard and devalued the guilder in September 1936.

Following devaluation, both the plantation business and the banking business in the Dutch East Indies finally returned to profitability. The structural overproduction of sugar was addressed by slimming down the production, and the product became competitive on the export market once more. In purely economic terms, prospects for recovery and growth in the Netherlands and in Asia looked good. However, the political situation was far from stable in either Europe or Asia. In May 1940, the Netherlands was invaded and occupied by Germany. NHM responded by moving its registered office to Batavia and then, in 1942, to Paramaribo in Surinam. During the war, the company's Dutch and overseas businesses were separated.

The banking business in Asia was closed following the Japanese invasion of February 1942. In the Dutch East Indies, the banking branches went into liquidation, but the liquidation was never completed, meaning that operations could relatively easily be resumed after the liberation in August 1945. During the years of Japanese occupation, management of the plantations was quickly taken over by the invaders. Production consequently fell, and some of the businesses either ceased operating or took on other roles.

Japanese occupation of the Dutch East Indies had much more far-reaching consequences for NHM personnel in that region than German occupation of the Netherlands had for the company's staff in its homeland. In the Dutch East Indies, the European staff were interned or sent to work as forced labourers on railway construction projects, both of which implied very harsh conditions. Consequently, 104 of the company's Asian personnel lost their lives during the war, compared with nineteen in the Netherlands.

Postwar recovery in the Dutch East Indies did not go smoothly, partly because NHM had lost a number of key managerial personnel. Many plantations had also suffered extensive damage and – crucially – Indonesia had

declared independence on 17 August 1945. As a result, Japanese capitulation did not end warfare in the area; it merely ushered in a new phase of conflict, as the Netherlands sought to restore its authority. The Dutch military offensives of 1947 and 1948 brought many plantations back under Dutch control, but at a high price, because of the scorched earth tactics adopted by the retreating Indonesians.

Despite the political uncertainty – Indonesia gained independence in December 1949 – the board decided to restore the damaged plantations. The company remained wedded to the multi-track policy, with a banking business, a plantation business and a venture capital business – through which NHM participated in attractive-looking ventures and companies, including Dutch aeroplane manufacturer Fokker – all operating side by side.

From 1950, however, independent operations in Indonesia became increasingly difficult, partly because of tensions between the Netherlands and Indonesia over New Guinea. The island had remained under Dutch control following Indonesia's independence, but the new nation refused to recognise Dutch sovereignty. Business activities were further complicated and profitability adversely affected by various new regulations imposed by the Indonesian government. Because the transfer of profits to the Netherlands was also made difficult, it was decided that some of the earnings should be used to restore the plantations.

Not only was the situation on the production side very different after the war – the cost of production rose several hundred per cent – but the postwar market for plantation produce was also quite changed, as decolonisation led to the disappearance of traditional export markets. NHM's struggles in Indonesia were brought to an end in May 1959, by the nationalisation of its plantation business. The banking business – the last Dutch business in Indonesia – followed in December 1960.

Alternatives to nationalisation, such as the sale of the banking business in Indonesia or its transfer to a joint venture, were considered during

the 1950s, but rejected as unrealistic. Sale of the plantation business as a whole was not feasible, because no private Indonesian parties had sufficient capital. NHM had to part with its assets for knock-down prices, and even those were never paid in some cases. Well before nationalisation, the book value of the plantations was a mere *f* 1, so the 1959 nationalisation did not have far-reaching accounting consequences.

Naturally, nationalisation also had implications for the Asian branch offices, whose main line of business was the financing of imports and exports to and from Indonesia. As early as the late 1940s, therefore, the company decided to expand its network in Asia, Africa and North and South America, subject to the condition that a reasonable degree of political stability prevailed in the countries concerned. The strategy proved successful: whereas in 1949 NHM had thirty-eight overseas agencies, by 1964 it had forty-five, despite having lost its Indonesian offices in the interim.

The loss of the Indonesian offices also had consequences for the company's profit and loss position. Prior to nationalisation, the majority of NHM's profits were generated in Indonesia and the other overseas branches. After nationalisation, the bulk of the profits came from the Dutch business, partly because the latter became much more profitable following the opening of numerous new branches and the introduction of new products.

NHM also looked for other locations where it could continue its plantation business. Ethiopia was considered but rejected. Eventually, NHM acquired interests in two existing companies: one in French Equatorial Guinea and one in Peru. Nevertheless, when the Indonesian plantation business was nationalised in 1959, the company was forced to accept that plantations were no longer in keeping with the product portfolio of a general bank. In the early 1960s, the participations in Africa and South America were accordingly wound up. Naturally the final step in the process was the sale of the Suriname-based Mariënborg sugar company in early 1964.

When it became apparent that nationalisation of the business in Indonesia was imminent, the company recognised that it had to change. Talks were accordingly held with two overseas banks: first Hollandsche Bank-Unie (Holland Banking Union, or HBU) in 1954 and then Nederlandse Overzee Bank (Netherlands Overseas Bank, or NOB) in 1960. In that period, the priority for the NHM board was expansion of the overseas business. Negotiations with HBU and NOB yielded no material results, however.

By early 1964, both NHM and Twentsche Bank had reached the point where there was little choice but to seriously consider a merger. The possibility had been on the table for some years, but the plans had always foundered. Finally, however, the two companies' boards were able to work around the personal interest issues that had previously formed a barrier to progress. The merger of NHM and Twentsche Bank – in reality NHM's takeover of Twentsche Bank – was announced in June 1964, leading to the creation of Algemene Bank Nederland (General Bank of the Netherlands) in October 1964. Thus ended the independent existence of Nederlandsche Handel-Maatschappij and a presence in Indonesia stretching back almost 140 years.

III. South Africa

The story of Dutch banks in South Africa is quite different, and a little bit of previous history is needed to understand it. Since 1652 the Cape had been governed by the Dutch East India Company (VOC), but in 1806 the area was taken over by the British. Many of the white inhabitants of Dutch origin – called *Boers* or later on *Afrikaners* – disliked the British colonial government, because it was not sensitive to their traditions or religious beliefs. During the Great Trek (1836–38), they left the Cape in great numbers to settle in the interior, where they founded their own

independent republics, Transvaal and Orange Free State. Threatened by the original black inhabitants and opposed by the British, strong nationalistic feelings developed. These incited the Boers to revolt against the British annexation of Transvaal and in the first Boer War (1880–81) they regained their independence. In the Netherlands, which up to that point had paid little attention to South Africa, the conflict stirred enormous sympathy for their kinsmen. Support actions were organised on a large scale and Dutch teachers and civil servants went to South Africa to help build up the new state. The business community also became interested in what the country had to offer, all the more so when large gold deposits were discovered on the Witwatersrand. Foreign capital was needed, particularly to develop a railway system and to establish a national bank. The Transvaal government was prepared to give concessions for these purposes, but did not like the idea of becoming dependent on a single country, even the Netherlands. The railway company, although formally a Dutch enterprise, was partly financed by German capital. After ten years of wrangling, in 1891 a National Bank was set up by a consortium of Dutch, German and English financiers.

In addition to the new National Bank, with its special privileges, various private banks entered the South African Republic, as Transvaal was officially called. As early as 1877, during the British occupation, Standard Bank of South Africa opened a branch and it continued to do business in the new republic. After the promising gold finds in 1886, other overseas banks followed, both from the Cape and one from Natal, another British colony. Swept along by the warm feelings for South Africa and attracted by the prospect of new commercial opportunities, a new, Amsterdam-based Dutch bank was established in 1888 to engage in credit activities in and with South Africa.⁷ This company, *Nederlandsche Bank voor Zuid-Afrika* (Netherlands Bank for South Africa, NBvZA), was a consortium of South

⁷ For the sources used for the following section, see the appendix.

African sympathisers and Amsterdam financiers.⁸ The latter put their stamp on the bank, in the form of very prudent banking policies. Although the bank in Transvaal attracted local deposits, it was mainly financed by its own capital provided from Amsterdam. In the highly speculative environment in Transvaal, deposits were not a stable basis for expansion, nor was the issue of banknotes. The new bank also refrained from involvement in gold mining and from financing the gold trade. As a result, it was able to withstand the various bank crises in the last decade of the nineteenth century and to pay regular dividends up to 1899. The same holds true for its mortgage banking subsidiary, which was financed by mortgage bonds issued in Holland. Nevertheless, the bank had to cope with severe problems. Connections with Amsterdam were slow (four weeks by boat and a week from Cape Town to Pretoria), staff was difficult to recruit and, after the early years, new capital was hard to attract. As a result, expansion had to be slow, with just three branches opened, in addition to the main agency in Pretoria.

Ten years after the creation of NBvZA, a second Dutch bank for South Africa was established: Transvaalsche Handelsbank (Transvaal Commercial Bank, THB).⁹ It was founded as a trading firm by two Dutchmen who had come to Transvaal in the early days of the republic. In 1898 it was transformed into an Amsterdam-registered bank with two branches in Transvaal. The rough South African trading climate in which this bank had its roots made it more adventurous than its counterpart; so too was its affiliated mortgage bank, which did not declare any dividends in its first ten years of existence.

The outbreak of the Anglo-Boer War (1899–1902) ushered in a difficult period for the Dutch banks. Although the fighting caused neither of them any great direct damage, a government decree was issued, limiting the

8 The original name was *Nederlandsche Bank-en Credietvereniging voor Zuid-Afrika*, which was changed in 1903. For reasons of simplicity, only the new name is used here.

9 Originally called *Tranvaalsche Bank-& Handels-Vereeniging*, previously Baerveldt & Heyblom. The personal names and the word *handel* (trade) reflect its origin as a trading firm.

amount of interest that could be recovered on outstanding debts. After the British victory, the two Boer republics were annexed, so that all four regions in South Africa – Cape, Natal, Transvaal and Orange River Colony – were brought under British rule. The annexation was particularly threatening to NBvZA, because it had always maintained good relations with the old Transvaal government of President Kruger. There were fears that working under a British regime would be very difficult, if not impossible. However, after the peace treaty of 1902, the bank was able to resume its normal business. Initially, there was a strong economic recovery, from which both banks benefited. NBvZA soon opened branches in Cape Town and London, while THB established a presence in Hamburg, to facilitate their overseas trade financing business. Soon, however, a severe recession started, depressing banking activity until about 1910 and causing losses to the banks. Capital reconstruction was ultimately required to eliminate the losses. Things began to improve after 1910, when the four regions joined to form the Union of South Africa, providing better opportunities for banks.

General developments in the banking sector did not favour the small Dutch institutions. Nearly all local banks had disappeared in the previous decade, and from 1910 there was further concentration amongst the bigger banks. In particular, the old Transvaal National Bank started an expansion drive, absorbing three other banks in the space of a few years (National Bank of the Orange River Colony in 1910, Bank of Africa in 1912 and Natal Bank in 1914). Standard Bank did not respond until 1920, when it took over African Banking Corporation. From then on, two big banks – National Bank and Standard Bank – dominated the field, the first being an indigenous institution, the second a British imperial bank. The small Dutch banks were no match for them. The following figures illustrate the relative strength of the various institutions around 1920: Standard and National had capital and reserves of £ 5.1 million and £ 4.3 million respectively. Both had more than three hundred branches throughout the Union.¹⁰

10 S. Jones, *The Great Imperial Banks in South Africa* (Pretoria 1996), pp. 182–92.

NBvZA had twelve branches and a capital and reserves of £ 290,000. THB had slightly less capital and only one office, in Johannesburg.

Clearly, the Dutch banks had little room for manoeuvre. However, they were not prepared to give up their independence, because they valued their Dutch identity highly. Their activities were concentrated in the Dutch (Afrikaans) speaking population and business community, and they were afraid of losing that market if they amalgamated with one of the other banks. They did not have the means to expand their branch networks, because for most of this period there was little scope for raising additional capital in the Netherlands, partly because the Dutch ceased to feel a special affinity with South Africa after the British annexation. The Dutch banks were also wary of offering better conditions to clients than their big competitors, for fear of provoking potentially disastrous retaliation. Indeed, the Dutch banks welcomed the agreement on interest rates and other conditions first concluded amongst the banks in 1912, because it removed the risk of a tariff war, in which they were unlikely to prosper. NBvZA therefore joined the agreement,¹¹ although it sometimes tested the limits of what its partners were prepared to accept, and even got a concession on rates for certain types of deposits, because of its small branch network.¹² The bank's policy was to deliver a good service to its customers and to operate in a cautious and prudent manner. The continued importance of such a strategy became clear when National Bank got into difficulties as a result of its reckless expansion policy. Assistance from Barclays Bank in London was required to save National, which was taken over by the British bank in 1925. Barclays brought together National Bank and two

11 THB was not involved, because it attracted very few local deposits.

12 G. Verhoef, 'Strategies for market monopolisation. The Register of Co-operation and the Imperial Banks in South Africa, ca 1920–1980', paper World Economic History Congress (Stellenbosch 2012).

banks in other territories to form Barclays DCO (Dominion, Colonial and Overseas).¹³

Small as it was, NBvZA was a respected institution in the Union. Its managers were active in various banking associations and in a personal capacity acted as advisors to the authorities on financial policy matters. NBvZA's status is illustrated by the protracted process that led to the establishment of a central bank. As early as 1912, an NBvZA official pleaded for the creation of such an institution, but it was not until the early 1920s that action was taken. At hearings of a special government committee, NBvZA again spoke in favour of a central bank. Standard Bank, which always had recourse to its London head office, did not see the need for a central bank. The government decided to establish a Reserve Bank and when this started operating in 1921, a former manager of NBvZA was appointed vice-governor. He was succeeded by another NBvZA manager, who in 1932 was chosen as governor.¹⁴

The 1920s and 1930s were turbulent years for the South African economy. After a short recovery a new depression set in, followed by renewed growth up to 1929. In 1931, South Africa did not follow Britain when it left the gold standard, which caused a substantial deterioration of its competitive position, adding to the difficulties of the Great Depression. Substantial capital flight, however, forced the government to abandon gold parity in December 1932. The consequent rise in gold prices favoured the gold mining industry in particular, but in its wake the economy as a whole started to improve and South Africa did rather well in the remaining years before World War II. For THB, however, the situation remained precarious. Until 1920, it still had to cope with earlier losses on property and mining investments and for more than a decade was unable to pay dividends. It ultimately lost its independence, being taken over by NBvZA in 1925. The

¹³ Jones, *The Great Imperial Banks*, pp. 42–50; J. Crossley and J. Blandford, *The DCO Story. A history of banking in many countries* (London 1975), pp. 1–17.

¹⁴ G. de Kock, *A history of the South African Reserve Bank (1920–52)* (Pretoria 1954), pp. 4, 17.

latter fared better and from 1910 up to 1939 it regularly paid dividends of four to seven per cent, with the exception of 1932 when the depreciation of the South African pound caused a loss. The affiliated mortgage banks, however, did not survive the depression years and had to be liquidated.

Meanwhile, various socio-political developments occurred, which were to have important consequences for NBvZA in the long run. The bank was affected not so much by the gradual growth of the black opposition movement (ANC 1912) against the policy of 'separate development' that was introduced in those years – after the Union agreement had already denied political rights to blacks – but by the rising tide of Afrikaner nationalism. Although the British had defeated the Boers militarily, within the Union the Boers or Afrikaners gradually became stronger and gained the upper hand politically. In 1924, an outspoken Afrikaner became prime minister for the first time. He succeeded in gaining a more independent position for South Africa within the British Empire and internally he strengthened the Afrikaners' position by formalising a preference for white labour and businesses. Nationalist sentiments reached a high in 1938 when the centenary of the Great Trek was celebrated with much enthusiasm. Participation in World War II was a subject of fierce disagreement between the British-minded and the extreme Afrikaners. Then, in the 1948 elections, the nationalist parties won power, ushering in half a century of nationalist government. As is well known, the National Party took the policy of separate development to the extreme ('apartheid'), despite growing opposition both internally and from the outside world.

In parallel to the struggle for political power, the Afrikaners started to organise themselves culturally – supported by the churches – and economically. The economy was still dominated by the country's English-speaking community and by British capital, and the banking industry reflected that overall picture. Because the Boers had relatively little capital, they started with small initiatives. First a little cooperative fund was established, followed in 1918 by a trust company and an insurance company.

Understandably, Barclays' entry to the market in 1925 was greeted with suspicion by the Boer community, who regarded Barclays as a foreign bank. It was another ten years, however, before the first Afrikaner bank was founded: Volkskas.¹⁵ The new institution started slowly, but received growing support from the Afrikaner population. The bank was followed by a finance company and an investment company.

Volkskas was not a direct threat to NBvZA, but it had the potential to become a strong competitive force in the Afrikaner segment of the banking market. Furthermore, some within NBvZA were in favour of the local management having more independence from the Amsterdam head office. Amsterdam was not opposed to the idea and, before World War II discussions about the possible incorporation of the South African business had already started. The rationale behind the proposal was to make the bank more flexible and more popular among the Afrikaners. During the Second World War, ties between Amsterdam and the bank in South Africa (and its London branch) were cut, obliging the South African business to operate autonomously. It did rather well, albeit under a government supervisor, because the head office was located in enemy territory. During the war years, Volkskas continued to grow and saw its market share increase. Those developments, together with the growing sense of Afrikaner identity, strengthened the desire for greater independence, with a separate South African company as a first step and a South African majority as the ultimate goal. In 1946, a new general manager was appointed in Amsterdam: someone who had had worked as assistant general manager in Pretoria for nine years, including the war years. He was therefore sympathetic to South African sentiments and became the central figure in discussions between South Africa and Amsterdam. A particular issue was that South Africa needed more capital for its expansion, but

15 G. Verhoef, 'Afrikaner Nationalism in South African Banking: The Case of Volkskas and Trust Bank', in: S. Jones (ed.), *Financial Enterprise in South Africa since 1950* (Basingstoke/London 1992), pp. 115–50.

Amsterdam also had plans to develop its own business. Pending further negotiations, a share issue took place in 1946 to raise money for both purposes. In principle, Amsterdam was willing to grant more autonomy to South Africa and to form a local company to which the bank's South African activities would be transferred. However, efforts to realise such an autonomous arrangement in cooperation with another bank came to nothing. Volkskas was interested in a link-up, but its more extremist stance was not acceptable to the management in Amsterdam; it would only accept parties that were friendly to the Dutch. In the Netherlands, *Nederlandsche Handel-Maatschappij* was interested in participating in the bank or in a new venture, but the South Africans were not happy with that idea, because it would imply a new and even more powerful foreign party assuming control.¹⁶ The participation of other South African institutions was also difficult to accept, since they would have their own agenda and might try to overrule Dutch wishes.

In the end, it was decided that a separate South African company with a Dutch majority should be established and governed by a board consisting of friendly directors. The next question was how large the African participation should be. The South African banking authorities demanded at least 50 per cent, but this was rejected by Amsterdam. The management there was not even prepared to commit to relinquishing its majority in the future, so this question was left open. Initially, 25 per cent of the capital would be made available to South African parties, on the understanding that they would be acceptable to the bank. The make-up of the board of directors was a thorny question, because many of the capable people in South Africa already had other interests. It was therefore agreed that the experienced and trusted general manager in South Africa would be chairman of the board, while the two Amsterdam managers would become members (with deputies in the Union). Of the seven board members, four would be Dutch nationals. On this basis, the new South African company

¹⁶ See also De Graaf, *Voor handel en maatschappij*, p. 398.

was established on 2 January 1951 and registered as a bank on 15 January. It was named *Nederlandse Bank van Suid-Afrika beperk* (Netherlands Bank of South Africa Ltd), the Dutch parent company retaining the old name of *Nederlandsche Bank voor Zuid-Afrika*. The fact that the institution in South Africa became Netherlands Bank of South Africa, rather than Netherlands Bank for South Africa may have been a small change, but was a significant one in South African eyes. Of the share capital of £2 million, £ 500,000 was reserved for South Africa; the latter part was issued – and well received – in March. So the result was that the parent company in Amsterdam had a 75 per cent interest in the South African bank, the rest being held domestically.¹⁷

It was a compromise that both sides could live with for the time being, although it had been a long and complicated process reaching it, involving many more technical and legal problems – including foreign exchange regulatory issues – than have been mentioned here. Cooperation between the two institutions went quite well, but developments in the two countries began to diverge and it gradually became more difficult to accommodate both in a single concern. The bank in South Africa grew quickly, gaining market share by opening more branches and introducing innovative products.¹⁸ It also expanded into neighbouring countries. It consequently needed more and more capital, which was not always easy for the parent company to provide. The latter was focused on expansion in the Netherlands, which it pursued by taking over several smaller banks and securities firms, while also taking interests abroad. This process was accelerated in 1954 by a merger with *Amsterdamsche Goederen Bank* (Amsterdam Commodity Bank), an institution specialising in commodity

17 G. Verhoef, *Die geskiedenis van Nedbank, 1945–1973* (Johannesburg 1986), pp. 3–56; J.L.A. Pfundt, *Reports and Records (AAAHD)*, pp. 358–80; H.W.J. Bosman, ‘The Separation of Nedbank, South Africa, from the Parent Institution in the Netherlands’, in: S. Jones, *Banking and Business in South Africa* (Basingstoke/London 1988), pp. 69–79.

18 G. Verhoef, ‘Aspects of Nedbank’s International Activities 1945–73’, in: Jones, *Banking and Business in South Africa*, pp. 81–103.

financing and the clearing of commodity futures contracts. The name of the new bank, *Nederlandse Overzee Bank* (Netherlands Overseas Bank, NOB), could be interpreted as indicative of a shift in interest from South Africa to other regions. The last step in this diversification and expansion process was its amalgamation with the old firm of Mees & Hope in 1969. The new name, *Bank Mees & Hope*, had no echo of the old specialisation in overseas banking. It was now a fully fledged bank in the Netherlands with an American shareholder and affiliates in a number of other countries.

In the course of this process, which was stimulated by the creation of the European Economic Community in 1958, the relations with South Africa began to weaken, also because new managers were not acquainted with the South African business. Moreover, the situation in that country became tenser as the policy of apartheid was continued with more vigour. The riots in Sharpeville in 1960 could be seen as a warning signal. All these elements ultimately led to a complete separation of the South African bank from the parent company. In 1957 there was still no question of the Dutch participation being reduced, and NOB participated in a share issue by its subsidiary, thus maintaining its 75 per cent stake. Within a few years, however, the situation had changed. It was then deemed advisable for the parent-subsidiary relationship to be superseded by a more equal relationship. There was a further share issue in South Africa, in which NOB did not participate. It even sold part of its existing shareholding, as a result of which its participation was reduced to 49 per cent – a minority position, in other words. The South African bank, on the other hand, acquired 12 per cent of the capital of the Dutch company, with a view to participating in developments in the EEC. In 1964, NOB sold more of its participation, thus reducing its holding to 25 per cent. When *Bank Mees & Hope* was formed in 1969, the new bank did not see holding a stake in a South African bank as consistent with its strategy and the shares were accordingly disposed of. That move was followed in 1974 by the sale of the South

African participation in the Dutch institution, thus severing the last of the longstanding ties between the Netherlands and South Africa.

It will be noted that the question of apartheid played no role in the process of the separation, certainly no public role. It was mainly the growing Afrikaner movement that continued to press for greater independence; the Dutch management was happy to accommodate the South Africans' wishes, because increasing separation fitted in with developments in the Netherlands. The strong inter-racial tensions in South Africa, the extreme nationalistic policy of the Union, and the growing resistance from other countries to South African policy (leading ultimately to boycotts) all date from a later period. Those developments finally forced Standard and Barclays to divest their interests in South Africa towards the end of the 1980s, having already reduced their holdings to comply with government regulations. By comparison, the separation of the Dutch and the South African banks was quite a smooth and amicable process.

IV. South America

Hollandsche Bank-Unie (Holland Bank Union, HBU) first established a presence in South America in the early twentieth century. The continent was perceived as offering boundless opportunities, being blessed with enormous natural riches, which had barely been exploited, due to chronic shortages of labour, knowledge, capital and capital goods. In that era, Europe was the primary source of the means of production. A steady flow of immigrants from Southern and Eastern Europe provided the manpower and expertise for the development of agriculture and industry, while Britain often provided the finance. People in the Netherlands also began to recognise the economic potential of South America. Staple produce, such as wheat, tobacco, maize and coffee were imported in increasing quantities, for domestic consumption, for onward shipment to other countries,

and for processing to make other products. The goods were frequently transported across the Atlantic by Dutch shipping lines. Such activities quickly generated a demand for the advance financing and subsequent financing of commercial transactions between the Netherlands and South American countries, as well as for information and support for importers and exporters trading with the region.¹⁹

Hollandsche Bank voor Zuid-Amerika (Bancolanda) was founded in Amsterdam in March 1914 by Rotterdamsche Bankvereniging (Rotterdam Bank). A number of trading houses were also involved. In South America, the bank originally traded under the name Banco Holandés de la América del Sud (Dutch Bank of South America), opening a branch in Buenos Aires in October 1914. Several branches soon followed in Brazil, in Rio de Janeiro (1916), Santos (1917) and São Paulo (1919). In November 1919, the bank's capital was increased to allow the expansion of activities to Hamburg and Santiago (Chile). In the course of 1920, however, the South American branches encountered problems. In response, the management thoroughly reorganised operations, closing the branches in Chile and Germany.

In 1924, Rotterdam Bank withdrew from Bancolanda because of an internal financial crisis. From 1925, the bank was headed up by N.E. Rost Onnes, under whose leadership the reforms and reorganisations previously set in motion were implemented, paving the way for the rapid growth seen in later years. Nevertheless, Bancolanda was perceived to have insufficient geographical coverage. To address that issue, it was agreed in June 1933 that the bank should take over Hollandsche Bank voor de Middellandsche Zee (Midzee), which had a branch in Istanbul. Following the takeover, the name of the bank was changed from Hollandsche Bank voor Zuid-Amerika to the Hollandsche Bank-Unie (Holland Banking Union, HBU).

19 This section is based on T. de Graaf and J.J. Mobron, *Van Rio tot Rotterdam. Negentig jaar geschiedenis Hollandsche Bank-Unie* (Amsterdam 2004). Since that publication is in Dutch, no specific references to its text are provided.

In March of the following year, Hollandsche Bank voor West-Indië (Dutch Bank for the Dutch West Indies, or Westbank) – which had sub-branches in Willemstad (Curaçao) and Caracas (Venezuela) – was also acquired.

HBU's activities remained concentrated largely in South America, where the bank was engaged primarily in import and export financing, the provision of credit and securities services, the financing of international commodities trading and the settlement of foreign currency transactions and arbitration. In the Netherlands, the bank expanded by making acquisitions in Rotterdam (1939) and The Hague (1941).

Despite their serious effect on the lives of countless Dutch people, the Second World War and the German occupation of the Netherlands had no direct consequences for the activities of most Dutch banks. Overseas banks such as Hollandsche Bank-Unie formed an exception, however. Occupation of the Netherlands in May 1940 made the legal status of HBU's various overseas branches very unclear, because of the company's headquarters being in enemy territory. One particular consequence was that HBU's assets with banks in New York and London were frozen and the branches around the globe were barred from making international transactions. To resolve these difficulties, the company's registered office was moved from Amsterdam to Curaçao in June 1940. It was eventually transferred back to Amsterdam in October 1945, a few months after liberation of the Netherlands.

The United States' entry into the war in December 1941 triggered a major expansion in inter-American trade – from which HBU's branches in the western hemisphere benefited greatly. The turnover of those branches was further boosted by the intensification of the commodities trading amongst the various South American countries, which became more reliant on each other for agricultural and industrial products because of the turmoil in Europe. After 1945, expansion of HBU's overseas branches gathered greater pace. The postwar economic boom and flourishing world trade generated more and more business in all the regions where HBU was

active. HBU businesses in various countries were able to profit from the economic expansion, and numerous additional overseas branches were opened in the postwar years. In the period 1946 to 1950, new offices opened on Aruba in San Nicolas, city agencies were established in Willemstad on Curaçao, and a presence was established in Maracaibo (Venezuela) and Tel Aviv (Israel).

During this phase of expansion, HBU repeatedly found itself in competition with another Dutch bank with a large overseas network: *Nederlandsche Handel-Maatschappij* (NHM). In 1949, at the request of the Dutch government, HBU investigated the possibility of opening a branch in Paramaribo, in collaboration with *Surinaamsche Bank*. Quite unexpectedly, NHM then made a successful bid for the shares of *Surinaamsche Bank*, thus scuppering HBU's plans. The eventual appearance of an HBU office in Paramaribo in 1957 has to be seen against the background of that manoeuvring. The minutes of the HBU board record that the motivation for having a branch in the city was to reinforce the bank's prestige relative to that of NHM; the board recognised from the outset that a Paramaribo office would generate a negligible income. In Uruguay, by contrast, HBU was able to get the better of NHM. Only one banking licence was available to a Dutch bank in that country, and HBU moved a little more quickly than NHM, establishing a Montevideo branch in 1952.

Although they had their tussles, there was also amicable contact between HBU and NHM. Postwar expansion demanded a great deal of HBU, both organisationally and in terms of capital requirements, prompting the bank's management to consider whether a merger might expedite progress. Cautious, informal merger talks between NHM and HBU began in 1951, but the time was not ripe for the two banks to join forces. Fresh discussions were held in 1954: HBU's strong South American presence was regarded as a good fit for NHM's Asian and African network. Although the 1954 merger talks ultimately came to nothing, negotiations ended amicably. In February 1960, Chase in New York expressed an interest in acquiring a

majority stake in HBU, on account of its South American network. These overtures too led nowhere. In the early 1960s, further South American branches opened, in Ecuador and Brazil, and in 1963 HBU acquired 50 per cent of the shares in the Brazilian finance company Cia. Aymoré de Creditos, Investimentos e Financiamentos.²⁰

It would be an exaggeration to say that Hollandsche Bank-Unie had two faces. Nevertheless, it is clear that the bank had both progressive and conservative characteristics – possibly reflecting the personality of its chief executive, Rost Onnes. The bank was ahead of other Dutch banks in terms of PR and the marketing of its business and its products. The HBU used newspaper advertising well before the Second World War, for example. One product that was actively promoted was the bank book, introduced in 1935. HBU bank book holders received significantly more interest on their deposits than the savings banks paid. Yet, where the credit market was concerned, the bank showed a different side to its character. Personal loans (PLs)– introduced to the Netherlands in 1958 by Twentsche Bank – were not available from HBU until after Rost Onnes' death in 1964. The chief executive had always fiercely opposed the new form of consumer credit, which he regarded as involving unacceptable risk, even though it was known that PLs generated a lot of spin-off business. Onnes' successors clearly did not share his reservations about innovative financial services.

Until the 1950s, HBU's overseas business generated the lion's share of the company's profits, with Argentina and Brazil in the lead. From the fifties on, however, the Dutch business became an equally significant contributor. Foreign exchange dealing proved particularly lucrative in this period, and the volume of credit provided to the Dutch business community also increased. One of HBU Rotterdam's clients was the shipbuilder Cornelis Verolme. Operating a bank with both a domestic business and an overseas business necessitated the formalisation of many different procedures in an

²⁰ The remaining 50 per cent was acquired in 1970. The company formed the basis for the strong position that HBU, and later ABN AMRO, enjoyed in Brazil's home loan and car loan markets.

operations manual. Against the background outlined above, the extensive and detailed rules and directives laid down for the overseas branches by the head office were quite understandable, but the instincts of Rost Onnes, a lawyer by training, are likely to have been a factor, too.

In 1961, Rost Onnes stepped down as chief executive, but joined the Supervisory Board and remained a member until his death in 1964. Day-to-day management of the bank passed to Onnes' nephew Pieter Willem Rost Onnes (PW), and in 1966 PW's brother Albert Willem was also appointed to the Executive Board. After the death of chief executive and proprietor N.E. Rost Onnes in 1964, some of his HBU shares, representing about 30 per cent of the company's value, were acquired by investors. Between 1965 and 1967, discussions were held with three overseas banks about possible alliances or takeovers. Once HBU had disposed of its two branches in Israel, a takeover of HBU by Algemene Bank Nederland (ABN Bank) was announced in December 1967, ahead of implementation at the end of January 1968. The merger was advantageous to both banks. HBU lacked the capital to continue its overseas expansion, while ABN Bank stood to benefit from uniting its own overseas networks in the Arabic world and the Far East with HBU's networks in South America and around the Mediterranean. The amalgamated bank had a more balanced and comprehensive geographical distribution than either bank had on its own. Another advantage was that the merger removed the need for HBU to add to its domestic network in order to support the overseas branches. HBU's existing city sub-branches in the Netherlands were either absorbed into the ABN Bank branch network or closed. After the takeover, HBU became a wholly owned subsidiary of ABN Bank, but continued to operate under its own name. Indeed, HBU went on opening new branches – some deliberately using HBU's name, such as the branch opened in Taipei, Taiwan, in 1980 (so as not to compromise ABN Bank's relations with the People's Republic of China).

When ABN Bank merged with Amro Bank in September 1991, the new bank's management wanted to streamline its overseas activities under a single ABN AMRO label. Hence, HBU's overseas activities were gradually transferred to ABN AMRO during the period 1992 to 1995. The final branches to be relabelled were those in Argentina, Ecuador, Paraguay, Uruguay and Istanbul, leaving HBU with a single branch in Rotterdam.²¹

V. Concluding Remarks

The history of overseas banking covers a period of approximately 150 years. It ended, on the one hand, in the disappearance of institutions focused on particular countries or regions; on the other hand, in the emergence and growth of large multinational banking corporations. With all the individual differences, a strongly localised focus proved to be a significant disadvantage, which was aggravated by economic and political developments in the countries where the banks were active. After 1970, the rise of multinational groups was clearly not to be halted. The history of the Dutch institutions covered by this article is illustrative of such industry-wide developments. From 1860, banks began to appear alongside *Nederlandsche Handel-Maatschappij* in the Dutch East Indies, to be followed in due course by banks in South Africa. The banks of the period were independent institutions, unlike the later overseas banks, which were allied to larger banking groups. NHM was always a broad-based organisation that traded commodities and operated plantations before providing banking services, first in the Dutch East Indies and elsewhere in Asia and then in the Netherlands. The breadth of the NHM's activities enabled it to adapt to changing circumstances (albeit with some difficulty), and thus ultimately to secure a

21 Following the takeover of ABN AMRO Bank by Royal Bank of Scotland, Fortis and Banco Santander in October 2007, ABN AMRO's South American branches were transferred to Banco Santander in 2008.

prominent position in the Dutch banking industry. By contrast, the other Dutch banks active in the Dutch East Indies eventually foundered, mainly as a consequence of political developments during and after the Second World War. The Dutch banks in South Africa had nowhere near the mass of the large British institutions. Furthermore, NBvZA's history was shaped by the strong nationalist sentiments of the era, which generated a desire for greater Afrikaans' control. After 1945, that desire and the wish of the Dutch management to expand the domestic business led to increasing distance between the South African and Dutch businesses, culminating in formal separation in 1974. In the Netherlands, further independent growth was initially achieved under the name Bank Mees & Hope, but that institution was ultimately obliged to seek a union with a larger entity, namely ABN Bank. By that stage, ABN Bank had also absorbed HBU – itself an amalgamation of once independent banks for South America, the Dutch West Indies and the Mediterranean region – which had run into the buffers in terms of independent growth. The outcome of those developments was that ABN Bank became a truly multinational institution, with centres of activity in Europe, the USA and South America. For some years, ABN Bank (and ABN AMRO as it became) enjoyed continued growth, but in the early years of the twenty-first century it encountered serious difficulties, leading to the disposal of large parts of its overseas business. So ended the global expansion of the Dutch banking industry, which had begun in 1850.

Appendix: A Note on Sources

The authors have refrained from directly quoting archival sources, because most are in Dutch. For his research into *Nederlandsche Handel-Maatschappij*, Ton de Graaf made extensive use of the company's archives, which are kept in the National Archive in The Hague (NA 2.20.01). The

little that remains of the archives of *Nederlandsche Bank voor Zuid-Afrika* is kept in ABN AMRO Art & History Department in Almere (AAAHD). The remaining documents include a complete set of annual reports of the two Dutch banks, which formed an important information source for Piet Geljon's survey of those banks. The archives of the South African operation remain in South Africa, but are now inaccessible. However, information was previously extracted from them by researchers. Of particular significance in that regard was the work of J.L.A. Pfundt, a former secretary to the bank, who produced an unpublished account entitled 'Reports and records of the *Nederlandsche Bank- en Credietvereniging voor Zuid-Afrika* and the *Netherlands Bank of South Africa 1888-1950*'. A copy of his manuscript is held in AAAHD. In anticipation of Nedbank's hundredth anniversary, a research project on its history was set up by the *Randse Afrikaanse Universiteit*, which resulted in two masters and one doctoral thesis by Joubert, Van der Merwe and Verhoef, listed in the references below. The archives of *Hollandsche Bank-Unie* and its predecessors are preserved in the archives of ABN Bank in AAAHD. The references include only the most important titles from the secondary literature in Dutch.

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ECOLOGICAL SUCCESSION IN FOREIGN OWNERSHIP IN NATIONAL BANKING SYSTEMS

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Abstract

In many countries foreign banks now own the banks that hold in excess of 50 per cent of the assets in the national banking system. The paper argues, using an analogy with ecological succession, that reform and competition among the banks will cause the conditions that attracted the foreign banks to erode and the domestic banks to be able to grow more rapidly. Therefore, in subsequent decades many foreigner owners are likely to sell their subsidiaries to local banks and investors. Over time the ratio of assets in foreign-owned banks to total banking system assets should decline, even in the absence of government policies that aim for that result.

I.

In many countries, especially in Eastern Europe, foreign banks now own the banks that hold in excess of 50 per cent of the assets in the national banking system. This often gives rise to a concern in these countries over foreign domination, that is, a concern that foreigners control the banking system.

More than 40 years ago, a pioneering paper on foreign direct investment in banking distinguished three markets for multinational banking:

wholesale, corporate, and retail.¹ Wholesale and corporate banking are the mainstay of international and national financial centres. However, the issue this paper is concerned with is the evolution over time of the share of the retail banking market in the hands of banks owned by banks foreign to the jurisdiction in question.

Foreign domination of corporate or wholesale markets is rarely a political issue in host countries. In fact, the domination is frequently the result of the host country explicitly trying to attract the foreign banks by holding itself out as a free economic zone, at least with respect to offshore business.² However, a strong foreign presence in the retail market, even if it falls short of domination, frequently causes disquiet. Singapore, while hosting an international financial centre, has used a system of licenses to limit foreign access to domestic retail banking.

Foreign domination of the banking system is not unusual in small countries such as the Pacific Island states.³ Although foreign banks have a smaller role in Argentina, when the percentage of foreign ownership started to climb past 40 per cent, people started to talk of *extranjerización*, and some locally-owned banks featured their local ownership in their advertisements. While some of this may contain an element of xenophobia, the disquiet of regulatory authorities is understandable.

An influx of foreign banks complicates regulators' task. There is an asymmetry as a foreign bank's operations in any country may represent a minor position to the foreign parent, but a major position to the host-country regulators. The foreign banks, even when they acquire local banks are also likely to have a different mix of activities than purely local banks. Foreign banks may, therefore, react in different ways to the authorities'

1 H. Grubel, 'A Theory of Multinational Banking', *Banca Nazionale del Lavoro Quarterly Review*, No. 123 (1977), pp. 349–63.

2 H. Grubel, 'Towards a Theory of Free Economic Zones', *Weltwirtschaftliches Archiv* 118 (1982), pp. 39–61.

3 A.E. Tschoegl, 'Foreign Banks in the Pacific: A Note', *Journal of Pacific History* 40, (2) (2005a), pp. 223–235.

strictures than will local banks. Furthermore, foreign banks dissatisfied with domestic regulators' policies may appeal to their home governments for support, escalating the dispute into the realm of international diplomacy. However, I will use a qualitative model to argue that foreign domination is a self-obsolescing phenomenon, though admittedly the process may be of long duration.

The biological phenomenon of ecological succession provides us with an analogy that is the basis for our argument that the financial system will eventually return to predominantly domestic control.⁴ Ecological succession is a dynamic model that posits that when the first plants arrive in clear or disturbed soil, they create opportunities for successor species by stabilising the soil and changing light conditions. The successor species in turn provide opportunities for yet other species. The mix of plant and animal species continues to evolve until the system reaches the final steady state of a climax forest. Of course, when fire, flood, volcanic action or landslide clears a patch, the process starts again in that patch. In observing the process at a moment in time, one should not mistake a temporary phase for the ultimate steady state.

When one thinks of the foreign banks as the first plants that arrive in the clear or disturbed soil, this model implies that eventually most foreign banks will gradually be relegated to the margins of retail banking in their host countries, or disappear from this segment altogether, unless a later disturbance draws them again. As the foreign banks compete with each other by introducing new products and squeezing intermediation margins, etc., they remove the conditions that drew them. Some foreign banks will stay, particularly the efficient ones, but many will reassess their host-country operations as they no longer find retail banking interesting. Even foreign banks making a normal return on capital may choose to redeploy their

4 K. Koford, A.E. Tschoegl, 'Foreign Banks in Bulgaria, 1875–2002', in: E. Klien (ed.), *Capital Formation, Governance and Banking* (Hauppauge 2005); A.E. Tschoegl, 'Financial Crises and the Presence of Foreign Banks', in: P. Honohan and L. Laeven (eds.), *Systemic Financial Distress: Containment and Resolution* (Cambridge 2005b).

capital to areas where they can earn above normal returns. Those banks are going to sell their subsidiaries to host-country banks and entrepreneurs. The banks the foreigners owned won't disappear; their ownership and control will simply transfer to domestic hands.

Like all biological analogies, or even metaphors in general, including mathematical models, ecological succession has its limitations. Still, we believe that the metaphor can facilitate understanding of the trajectory of foreign ownership of banks in many countries, especially in Eastern Europe. As Geary has put it, 'Metaphorical thinking is the way we make sense of the world.'⁵

II.

The simple textbook story of ecological succession explains how forests develop on previously uninhabited landforms, such as in previous glacial regions in North America and Western Europe after the last Ice Age. The story begins with primary succession as pioneering species of small plants first colonise the available terrain. As these pioneering plants increase in size and influence, competition between them and the changes they cause in soil and light conditions facilitates secondary succession, and the establishment and survival of succeeding plants better adapted than the pioneering species to the changing conditions. Eventually, a final self-maintaining community, such as a climax forest, emerges.⁶ Secondary succession may also follow the abandonment of once cultivated land or disturbances that have cleared a space.⁷ In either case, succession culminates in a steady-state in which the forest replicates itself.

5 J. Geary, *I is an other: The secret life of metaphor and how it shapes the way we see the world* (New York 2012).

6 B.D. Collier, G.W. Cox, A.W. Johnson and P.C. Miller, *Dynamic Ecology* (Englewood Cliffs 1973).

7 F.H. Bormann, G.E. Likens, 'Catastrophic Disturbance and the Steady-State in Northern Hardwood Forests', *American Scientist* 67 (6), (1979), pp. 660–669.

Further research has specified four non-exclusive mechanisms: competitive hierarchy, tolerance, facilitation, and reverse interference. The climate then determines how important each mechanism is.⁸

In the competitive hierarchy mechanism, late succession species start to arrive as members of the early succession species reach the end of their life-cycle and die out.

In the tolerance mechanism, early succession species do not affect the rate of recruitment, growth or survival of later species. The early species grow more quickly. Later species can grow during the early succession phase but better tolerate the more limited resources available as competition increases.

In the facilitation mechanism, one species prepares the way for the second. This is the situation where the presence of the early species leads to earlier arrival or greater success of later species.

Lastly, reverse interference is the direct opposite of the competitive hierarchy mechanism. Late succession species interfere with the continuation of early succession species. (If early succession species impeded late succession species at the limit, succession would not occur.)

'Weeds' are prominent among the pioneering species. I do not use the term weeds in any pejorative sense. Instead, the term simply refers to opportunistic plants that invade disturbed soil; typically they evolved to fill the minor role of secondary succession.⁹ As succession proceeds, weeds lose ground but some remain in place here and there, ready for the next disaster.

The ecological succession model has two striking characteristics. First, the process means that species that are most prevalent in the early stages of the process become far less prevalent later. Until the system reaches its steady-state, the nearer the observation of the process to the start of the process the poorer the observation is as a predictor of what the system will

8 D. Botkin, *Forest Dynamics: An Ecological Model* (Oxford 1993).

9 C.S. Elton, *The Ecology of Invasions by Animals and Plants* (London 1958).

look like at the end. Second, tolerance and facilitation, whether augmented or not by reverse interference, mean that the success of the pioneering species leads to their relegation to the margins. As the pioneers succeed, they change conditions in ways that permit other species to gain a foothold and, in time, to dominate.

The argument in this paper is that the history of the presence of foreign banks in many countries exhibits a pattern like that of ecological succession. First foreign banks appear; one can think of this as the arrival of the first weeds. Second, competitive turmoil emerges, with some foreign banks closing down and others merging with each other or with existing domestically-owned banks. At the same time, new domestic competitors emerge. Lastly, we get steady-state climax, where the bulk of the banking system is in domestic hands.

Some countries exhibit only primary succession; foreign banks arrived and initially constituted much or even the entire banking system. In time, a local banking system grew up with the foreign banks being relegated to the margins. Ultimately most withdraw. Without knowing much about the history of the Canadian banking system, I suspect that it provides an example, though with the operation of reverse interference and some foreign entry in the early 1980s after the liberalisation of that entry.

Banking in some other countries such as Bulgaria, Japan, and Mexico, for instance, has undergone both primary and one or even two cases of secondary succession. Foreign banks established the domestic banking system but ultimately became minor participants, only to return in response to disturbances, before again being relegated to a more peripheral role.

III.

One can think of the share of banking system assets in foreign banks relative to total banking system assets as the fast responding plants' share of the system's biomass. The ecological succession process involves both a numerator and a denominator effect, where the numerator consists of the assets in the foreign banks, and the denominator is the total assets in the banking system, foreign and domestic. Thus we can track the process by observing the market share (the market being defined in terms of assets or deposits) of the foreign banks.

The behaviour of the foreign banks themselves has a large effect on the numerator. Over the long term, the response of the domestically owned banks will have a large effect on the denominator. Obviously, when a domestic bank buys a foreign bank, this reduces the numerator, while leaving the denominator unchanged.

Initially, as the foreign banks enter, especially when they acquire host country banks in privatisations, rescues, recapitalisations and rehabilitations, the numerator grows more rapidly than the denominator. The reason the foreign banks enter is the opportunities the situations present, now that the banks are free to enter. One source of opportunity can be the foreign banks' efficiency relative to that of the domestic banks. In the Czech Republic and Poland foreign-owned banks were more efficient than domestic-owned banks and this was not due to scale differences or the structure of activities.¹⁰ Foreign banks are more pervasive in countries where banking is more profitable,¹¹ such as in a previously closed market, and where the banking sector is smaller relative to GDP, as in many

10 L. Weill, 'Banking efficiency in transition economies: The role of foreign ownership', *Economics of Transition*, Vol. 11 (3), (2003), pp. 569–592.

11 L.G. Dopico, J.A. Wilcox, 'Openness, Profit Opportunities and Foreign Banking', *Journal of Financial Markets, Institutions, and Money*, Vol. 12 (4–5), (2002), pp. 299–320.

developing countries such as Mexico.¹² Conversely, in mature, competitive markets foreign banks tend to have a more limited presence. In industrial countries foreign banks tend to have lower margins and profits than domestic banks; the opposite holds in developing countries.¹³ Even so, a market opening, as occurred in Norway in the mid-1980s, may result in a period of entry, followed by turmoil, and a reduced presence.¹⁴

In the long-run, foreign banks generally do not have a comparative advantage in retail banking over host country banks. This is especially the case in rural areas and in extending banking to the unbanked. Even if the foreign banks are better than local banks in wholesale, corporate banking and retail banking, local banks will still have a comparative advantage in retail banking. Even when foreign banks initially dominate all three sectors, domestic banks will come to dominate retail banking. The foreign banks will concentrate on foreign and corporate banking as local competitors emerge and grow, even if the foreigners do not completely exit retail banking. Still, often a foreign bank will sell its retail activities to a local bank while retaining a branch in the national financial capital so that it can continue to engage in corporate and wholesale banking. For instance, when in 1991 Chase Manhattan Bank reduced its presence in Puerto Rico that it had had there since 1934, it sold its retail branches to Banco Roig, a leading local bank, but maintained its main branch in San Juan.

The markets that draw the foreign banks tend to be ones that are growing, under-banked or uncompetitive, but the point is that foreign banks' entry changes these markets. The literature on the effect of foreign banks on host country banking systems suggests that the effect is precisely

12 F. Lopez-de-Silanes and G. Zamarripa, 'Deregulation and Privatization of Commercial Banking', *Revista de Análisis Económico* 10 (2), (1995), pp. 113–164.

13 A. Demirgüç-Kunt, H. Huizinga, 'Determinants of Commercial Bank Interest Margins and Profitability: Some International Evidence', *World Bank Economic Review*, Vol. 13 (2), (1999), pp. 379–408.; S. Claessens, A. Demirgüç-Kunt, and H. Huizinga, 'How Does Foreign Entry Affect Domestic Banking Markets?', *Journal of Banking and Finance*, Vol. 25 (2001), pp. 891–911.

14 A.E. Tschoegl, 'Entry and Survival: The Case of Foreign Banks in Norway. 2002', *Scandinavian Journal of Management* 18 (2), (2002a), pp. 131–153.

to undermine the conditions associated with the presence of foreign banks. In developing countries, foreign entry is associated with shrinking margins, but this is not necessarily the case in developed countries.¹⁵ In the Philippines foreign competition compelled domestic banks to be more efficient, to focus operations, and to become less dependent on relationship-based banking practices.¹⁶

This means that over time, measured in decades, the foreign banks will find the conditions that drew them have eroded, and some will withdraw, selling their subsidiaries to locally-owned banks. The histories of particular banks or of banking systems in particular countries suggest four factors that operate to reduce the foreign presence. First, some foreign banks leave when they find they are not competitive. Second, some foreign banks may find themselves in difficulty at home and sell the foreign operation as part of a restructuring. Third, others sell out to local investors and banks when host country markets are depressed and the foreign owners see little benefit from staying. Lastly, some simply sell out to local banks growing by acquisition.

All four factors have operated in the case of the eight subsidiaries that Japanese banks established in California between 1952 and 1978; three remain, the rest having disappeared through merger into the survivors or by sale. Assets in California subsidiaries of Japanese banks peaked in the early 1990s and have fallen since, though the largest, Bank of Tokyo-Mitsubishi's Union Bank of California, continues to grow.¹⁷

With respect to the first factor, there are many examples of foreign banks leaving when they have found that they were not competitive and could not grow to a scale where they might be competitive. Recent

15 R. Lensink, N. Hermes, 'The short-term effects of foreign bank entry on domestic bank behaviour: Does economic development matter?', *Journal of Banking and Finance* 28 (3), (2004), pp. 553–568.

16 A.A. Unite, M.J. Sullivan, 'The effect of foreign entry and ownership structure on the Philippine domestic banking market', *Journal of Banking and Finance* Vol. 27, (2002), pp. 2249–2271.

17 A.E. Tschoegl, 'The California Subsidiaries of Japanese Banks: A Genealogical History', *Journal of Asian Business* 20 (2), (2004a), pp. 59–82.

examples include Banco Bilbao Vizcaya Argentaria (BBVA) and Lloyds in Brazil, and Santander in Colombia, and Lloyds in New Zealand. (In the case of Lloyds, both operations dated back to the middle of the nineteenth century.)

Credit Lyonnais provides an individual example of the second factor: problems at home. In the mid-1990s, the European Commission imposed severe limitations on the bank as a condition of permitting the French government to bail it out. In particular, the bank had to curtail its international activities and sell many of its foreign subsidiaries. Japan provides an example of a case where home country problems involved several banks. For instance, Japanese banks curtailed their activities in Australia, among other markets, following the collapse of the real estate bubble in Japan in 1989-90.¹⁸

Argentina provides an example of the third factor, problems in the host market. In the mid-1990s, foreign banks rushed to acquire banks in Argentina, to the point where the assets in foreign-owned banks reached some 50 per cent of banking system assets. However, as the Argentina's economic situation worsened, many turned over their banks to the government or sold out to local banks.

Lastly, sometimes foreign banks exit simply because they have been offered a good price by a local bank seeking to grow by acquisition. In 1993, Barclays sold its shares in Barclays Discount Bank to Israel Discount Bank, which changed the bank's name to Mercantile Discount Bank. Similarly, in 1980 In Lebanon, Banque Indosuez sold its shares in Fransabank to local shareholders.¹⁹

Denominator effects complement numerator effects to reduce the ratio of assets in foreign-owned banks to total assets in the banking system. The

18 B. Williams, 'Determinants of the Performance of Japanese Financial Institutions in Australia 1987-1992', *Applied Economics* 28 (9), (1996), pp. 1153-65.

19 A.E. Tschoegl, 'Financial Integration, Dis-integration and Emerging Re-integration in the Eastern Mediterranean, c.1850 to the Present', *Financial Markets, Instruments and Institutions* 13 (5), (2004b), pp. 244-284.

conditions that constrain foreign firms in a country may also constrain host country firms.²⁰ When the conditions constrain host country firms more than they do foreign firms, the foreign firms may increase their ownership of assets in the host country. However, the liberalisation and regulatory reform that accompany the entry of the foreign firms benefits domestic firms as well. It will take time for the domestic firms to overcome their administrative heritage from the earlier environment, but once they do, one can expect them to grow rapidly. Liberalisation and regulatory reform may also make it easier for entrepreneurs to create new domestic firms that will target niches that foreign firms ignore. The result will be an increase in the numerator, and a decline in the ratio, even without denominator effects.

Although one should expect to see foreign banks exit retail banking, not all will. Small- to medium-sized host country firms may prefer to be an important client to the small local operation of a foreign bank than an unimportant client to a large domestic bank. Although the foreign bank may be no more capable than its host country rival, the quality of service it offers will be greater. Also, firms and wealthy individuals domiciled in countries with weak banks or in countries with unstable policies with regards to capital flows may prefer to route payments through foreign banks domiciled in an economically stable country.

Some particularly well-run foreign banks may retain a presence for a long time. For some years, HSBC strived to become, in the words of its slogan, 'the world's local bank'.²¹ However, managements change and so do their strategies. Currently both HSBC and Citibank are reassessing the markets they are in. Citibank announced in December 2012 that it is closing its consumer businesses in Pakistan, Paraguay, Romania, Turkey, and Uruguay; more closures may follow. Mike Corbat, Citibank's new chief

20 Y. Huang, W. Di, 'A Tale of Two Provinces: The Institutional Environment and Foreign Ownership in China', *China Finance Review*, 1, 1, (2007), pp. 1–24.

21 A.E. Tschoegl, 'The world's local bank: HSBC's expansion in the US, Canada and Mexico', *Latin American Business Review* 5 (4), (2004c), pp. 45–68.

executive, said that in markets where the bank had a very low return on assets and there was no clear path to acceptable returns, '[...]we intend to significantly scale back or exit certain business lines'.²²

One factor that could lead to a long-run presence of foreign banks has to do with ethnic banking. One reason banks go somewhere is to serve their home country customers that have located in the host country.²³ A particularly important function is facilitating remittances to family left behind in the home country.²⁴ So long as this immigrant community retains its separate identity, perhaps by being periodically refreshed by more immigrants, foreign banks serving this community may not be subject to the selection pressures that face other foreign banks.²⁵ This is arguable though, as host country banks may contest the ethnic niche; this is happening in the United States, though apparently not with the Turkish immigrant community in Germany.²⁶ A second curtailing force may be the growth of host-country banks originating in the ethnic community.²⁷ Lastly, foreign banks may grow out of their ethnic niche and then they will

22 T. Braithwaite, 'Citi looks to rein in global network', *Financial Times* No. 38, 177, (6 March 2013), p. 14.

23 C.P. Kindleberger, 'International Banks as Leaders or Followers of International Business', *Journal of Banking and Finance* 7 (1983), pp. 583–595; D. Nigh, Cho K.R. and S. Krishnan, 'The role of location-related factors in United States banking involvement abroad: an empirical examination', *Journal of International Business Studies* 17 (1986), pp. 59–76; L.C. Goldberg, D. Johnson, 'The determinants of US banking activity abroad', *Journal of International Money and Finance* 9 (1990), pp. 123–37.; N. Yamori, 'Do Japanese banks lead or follow international business? An empirical investigation', *Journal of International Financial Markets, Institutions and Money* 7 (1997), pp. 369–382.

24 T. Hamashita, Takesi, 'Overseas Chinese Remittance and Asian Banking History', in: O. Checkland, S. Nishimura and N. Tamaki (eds.), *Pacific Banking, 1859–1959* (London 1994).

25 G. Dymski, W. Li, 'Financial globalization and cross-border comovements of money and population: foreign bank offices in Los Angeles', *Environment and Planning A*, Vol. 36 (2004), pp. 213–240.

26 D. Armstrong, P.R. Haiss, 'Ethnic banking: identifying the capacity and future implications of the ethnic banking market', electronic version, Oxford Business & Economics Conference, proceedings (2007); P. Shanmuganthaan, M. Stone, B. Foss, 'Ethnic Banking in the USA', *Journal of Financial Services Marketing*, 8 (4), (2004), pp. 388–403.; D.A. Armstrong, 'Ethnic Banking: Turkish Immigrants in Berlin', 8th Global Conference on Business & Economics (Florence 2008).

27 W. Li, Y. Zhou, G. Dymski, M. Chee, 'Banking on social capital in the era of globalization: Chinese ethnobanks in Los Angeles', *Environment and Planning A*, Vol. 33 (2001), pp. 1923–1948.

lose their special status; this was the case of the surviving Japanese banks in California, alluded to earlier.

New Zealand is anomalous among OECD countries. There, four Australian banks account for well over 90 per cent of banking system assets. Two of the Australian banks arrived in the nineteenth Century; ANZ dates its presence in New Zealand to 1840 and Westpac to 1861. However, the other two were New Zealand institutions that the Australians acquired in 1992 and 2005 and that dated from the same period as the arrival of ANZ and Westpac.²⁸ The local and foreign banks competed with each other for about a century and a half before it was the local banks that succumbed rather than the foreigners. The reason for this contradiction of ecological succession is not clear but may represent nothing more than a limited liability of foreignness due to cultural similarities between home and host, and a small numbers situation.

Again, the metaphor of ecological succession metaphor models the evolution of a banking system from a start, either an initial beginning or a new beginning after a disturbance. It does not model the role of foreign banks in large, mature, stable banking systems. Such banking systems are already at the end-stage of ecological succession. In mature banking systems foreign banks stick primarily to wholesale and corporate banking while avoiding retail banking. Generally, competition from domestic banks and the 'liability of foreignness' leads foreign banks to avoid a situation where they have no comparative advantage.²⁹

All this suggests that in countries that have a mature banking system but that do not host financial centres, foreign banks will find themselves relegated to small market shares. In a market such as the US, foreign banks generally specialise in niches and engage in wholesale and corporate

28 H.M. To, D.W. Tripe, 'Factors influencing the performance of foreign-owned banks in New Zealand', *Journal of International Financial Markets Institutions and Money*, Vol. 12 (4-5), (2007), pp. 341-357.

29 S. Zaheer, E. Mosakowski, 'The Dynamics of the Liability of Foreignness: A Global Study of Survival in Financial Services', *Strategic Management Journal* 18 (1997), pp. 439-64.

banking.³⁰ There are exceptions. Some Spanish banks (e.g., BBVA and Santander) and some Canadian banks (e.g. RBC and TD Bank) do have large subsidiaries (large absolutely, not relatively) in the United States. This seems to be more a function of a search for growth that anti-trust considerations deny them at home.³¹

Some studies of foreign banks in the United States have found that foreign-owned banks were not as profitable as their domestic peers.³² Foreign-owned banks tended to be less cost-efficient than their domestic peers; the lack of profitability stemmed from the foreign banks' dependence on purchased funds.³³ Earlier research looking at foreign banks' performance in the 1970s reached similar conclusions.³⁴ Looking over a longer period, research showed that the poor performance of foreign bank subsidiaries was not a result of the acquisition but that the banks' problems predated the acquisition. The foreign banks were generally simply unsuccessful at raising the acquired banks' performance levels to those of their domestic peers.³⁵

30 A.E. Tschoegl, 'Foreign banks in the United States since World War II: A useful fringe', in: G. Jones and L. Gálvez-Muñoz (eds.), *Managing Foreign Business in the US* (London 2001), pp. 149–168.

31 A.E. Tschoegl, 'Who Owns the Major US Subsidiaries of Foreign Banks? A Note', *Journal of International Financial Markets, Institutions & Money* 14 (3), (2004d), pp. 255–266.

32 R. Seth, 'Profitability of foreign banks in the United States', *Federal Reserve Bank of New York research Paper* no. 9225 (1992); D.E. Nolle, 'Foreign bank operations in the United States: Cause for concern?', in: H.P. Gray and S.C. Richard (eds.), *International Finance in the New World Order* (London 1995), pp. 269–291.

33 R. DeYoung, D.E. Nolle, 'Foreign banks in the United States: Earning market share or buying it', *Journal of Money, Credit and Banking* 28 (1996), pp. 622–636.

34 B.B. Hodgkins, and E.S. Goldberg, 'Effects of foreign acquisitions on the balance sheet structure and earnings performance of US banks: Trends and effects', in: R.F. Dame (ed.), *Foreign Acquisitions of US Banks* (Richmond 1981), pp. 401–430.; J.V. Houpt, 'Foreign ownership of US banks: trends and effects', *Journal of Bank Research* 14 (1983), pp. 144–56.

35 J. Peek, E.S. Rosengren and F. Kasirye, 'The poor performance of foreign bank subsidiaries: Were the problems acquired or created?', *Journal of Banking and Finance* 23 (1999), pp. 579–604.

IV.

There are few opportunities for primary succession today; its heyday was the nineteenth and early twentieth centuries. Its functioning, though, has been noted. Goldsmith, in his discussion of financial systems outside Europe and North America in this period, observed that foreign banks initiated the development of financial systems but that the rise of local banks displaced the foreigners.³⁶

What seems to have mattered in the emergence of an indigenous banking sector was both the availability of western law, either imposed by the colonial regime or adapted from western models, and expertise. For both of these factors foreign banks played a role. In general, the foreign banks were 'free-standing companies' that had their headquarters in their home country's metropolitan centre, and their operations in their destination, be it a colony or, as in the case of Latin America, a foreign country.³⁷ These banks were of two types, British overseas banks and what one might call the banks on the French model, those from France, Belgium and Portugal.

The British overseas banks, and by extension overseas banks from Belgium, France, and Portugal, as well as those from The Netherlands, had to have a presence in the metropolitan centre to engage in foreign exchange transactions and to finance trade between home and host.³⁸ Also, being incorporated in the national financial centre, with its head office and board of directors there and operating under the national laws and courts, enabled the overseas bank to raise equity and debt capital for deployment overseas.³⁹ The British overseas banks' internal organisation and product

36 R.W. Goldsmith, *Financial structure and development* (New Haven 1969).

37 M. Wilkins, 'The Free-Standing Company Revisited', in: M. Wilkins and H.G. Schröter (eds.), *The Free-Standing Company in the World Economy 1830–1895* (Oxford 1998).

38 G. Jones, *British Multinational Banking 1830–1990* (London 1995).

39 J.-F. Hennart, 'International Financial Capital Transfers: A Transactions Cost Framework', *Business History* 36 (1994), pp. 51–70.

range were similar to those of the new joint banks emerging in Britain. However, the British overseas banks followed the Scottish practice of being branch rather than unit banks; the continental overseas banks similarly were branch banks.

The structure of the overseas banks, like those of the free-standing companies in general, facilitated international flows of debt and equity capital.⁴⁰ By contrast, host-country entrepreneurs wishing to found a bank, if there were any, faced thin or non-existent local equity markets in which to raise capital and frequently a lack of banking law, and had little or no access to capital markets in the United Kingdom or Europe. The foreign banks, by their presence, in time gave rise to a demand for banking law and helped the development of local capital markets.

The French-model banks were substantially modified versions of the Bank of France. These banks' strategy was to pursue both an extensive participation in public finance and one in commercial business. Examples of these banks include the Anglo-French Banque Imperial Ottomane (Imperial Ottoman Bank), the Banco Franco-Egyptienne, the Banque Russo-Asiatique, the Banque d'Indochine, the Banque Nationale de Bolivie, and the Banque Nationale d'Haiti.⁴¹ Examples from other countries include the Portuguese Banco Nacional Ultramarino and Belgium's Banque du Congo Belge.⁴² Similarly, in Argentina, Brazil, and Chile, government-owned banks on this model with mixed central, development and commercial banking functions dominated from the nineteenth century.⁴³

40 J.-F. Hennart, 'Transactions Cost Theory and the Free-Standing Firm', in: M. Wilkins and H.G. Schröter (eds.), *The Free-Standing Company in the World Economy 1830–1895* (Oxford 1998).

41 C. Marichal, 'The experience of Banamex: French bankers and banking models in Mexico, 1884–1900', XIV IEHA World Congress (Helsinki 2006).

42 A.E. Tschögl, 'Banque du Congo Belge to Belgolaise: The evolution to its demise of a colonial bank', unpublished paper (2013).

43 C. Marichal, 'Nation building and the origins of banking in Latin America, 1850–1930', in: A. Teichova, G. Kurgan-van Hentenryk and D. Ziegler (eds.), *Banking, Trade and Industry: Europe, America and Asia from the thirteenth to the twentieth century* (Cambridge 1997).

The Bulgarska Narodna Banka was another bank on this government-owned model.⁴⁴

In Asia, initially the British Exchange banks—the Hongkong and Shanghai Banking Corporation (HSBC), the Mercantile Bank (now part of HSBC) and the Chartered Bank (now Standard Chartered Bank), dominated the scene. These banks dealt with trade, the government, firms from the home country and possibly wealthy indigenes. In many cases they had the right of note issue as well.

Local merchant houses established the first indigenous banks in Japan in the 1880s, which by 1900 had eclipsed the foreign banks that had come in 1864 and which represented the first banks in Japan.⁴⁵ Governments or local merchants created the first locally-owned banks around 1900–1910 in China, Hong Kong, Singapore and Thailand. Most of these local banks were small and insignificant. They dealt with the general indigenous population and intermediated for them with the British banks.⁴⁶ The expertise in the indigenous banks seems to have come from two sources: the hiring of westerners to set up the local bank (e.g. Siam Commercial Bank) or provide training, or from locals who had experience with western banking either as employees of such banks or as compradors.

In the Middle East, Islam, with its prohibitions on *riba* (interest under most current interpretations of the Koran) and gambling, to include insurance, arguably impeded the emergence of domestic modern banks. Other important factors were Islamic law's treatment of commercial partnerships, which limited enterprise continuity, the Islamic inheritance system, which restrained capital accumulation, the *waqf* system, which inhibited resource pooling, and Islam's traditional aversion to the concept

44 Koford and Tschoegl, *Foreign Banks in Bulgaria* (2005)

45 A.E. Tschoegl, 'Foreign Banks in Japan. Bank of Japan, Institute for Monetary and Economic Studies', *Monetary and Economic Studies* 6 (1), (1988), pp. 93–118.

46 S.Y. Lee, *The Monetary and Banking Development of Malaysia and Singapore* (Singapore 1974), pp. 34–50.

of legal personhood.⁴⁷ The first Middle Eastern banks founded by Moslems, for instance, didn't show up until the 1920s (Banque Misr and Türkiye Ȳp Bankasý) or 1930s (Arab Bank),⁴⁸ although the Greeks, Sephardi Jews, and Armenians and other Levantine Christians had founded private banks in Alexandria, Cairo, Constantinople and elsewhere fifty or more years earlier. These communities were able to use the Ottoman capitulations to escape the limitations of Islamic commercial law.⁴⁹ Members of these communities were also important in the professional ranks of foreign banks such as the Imperial Ottoman Bank. In Cyprus the banking system was entirely in foreign hands in the late 1800s. The early 1900s saw the emergence of local banks, and by the 1950s, the banking system was almost entirely in Cypriot hands.⁵⁰ In Saudi Arabia and Oman the process started later, and in the case of Saudi, government policy sped up the process.⁵¹

In Australia a number of local banks appeared in the 1810s and 1820s in Australia. With the notable exception of the Bank of New South Wales (now Westpac), founded with government support in 1817, few of these banks survived the sharp recession of the 1820s. British investors quickly responded to the opportunity by creating overseas banks.⁵² Deploying greater capital and superior managerial and banking skills, the British banks quickly came to dominate the Australian market until late into the century.⁵³ Around mid-century more English banks arrived in Australia;

47 T. Kuran, 'The logic of financial westernization in the Middle East', *Journal of Economic Behavior & Organization* Vol. 56 (2005), pp.593–615.

48 Tschoegl (2004b), *Financial Integration*.

49 T. Kuran, 'The Islamic Commercial Crisis: Institutional Roots of Economic Underdevelopment in the Middle East', *Journal of Economic History*, Vol. 63, No. 2 (2003), pp.414–466.

50 K. Phylaktis, 'Banking in a British colony: Cyprus, 1878–1959', *Business History* 30 (4), (1988), pp. 416–431.

51 A.E. Tschoegl, 'Foreign Banks in Saudi Arabia: A Brief History', *Transnational Corporations* 11 (3), (2002b), pp. 123–154.

52 S.J. Butlin, *Foundations of the Australian Monetary System 1788–1851* (Melbourne 1953). S.J. Butlin, *Australia and New Zealand Bank: The Bank of Australasia and the Union Bank of Australia Limited 1828–1951* (London 1961).

53 D.T. Merrett, 'Paradise lost? British banks in Australia', in: G. Jones (ed.), *Banks as Multinationals* (London/New York 1990), pp. 62–84.

Australians established a far greater number of domestically-domiciled banks in the second half of the century. By the mid-1900s commercial banking was almost entirely in Australian hands.

I have already discussed New Zealand, where by contrast primary succession never arrived. In the rest of Oceania foreign banks now dominate retail banking in the territories and nations of the Pacific Islands, which have become divided into three spheres of influence: the French, Australian and American. Local governments in Fiji, Papua New Guinea, and the Solomon Islands, in the Australian sphere of influence, created government-owned banks on the base of the operations of the Commonwealth Bank, itself owned by the Australian government, but all of these banks are now in foreign hands. Local government ownership proved to be disastrous.⁵⁴

In Latin America the development of banking and the banking sector often began with the arrival of foreign banks. Brazil, especially after the reforms of 1905, shows a pattern consistent with the ecological succession metaphor.⁵⁵ Similarly, in Mexico, the first banks were foreign-owned. In 1864, the London Bank of South America and Mexico, which by the late 1880s became Banco de Londres y México (BLM) with one-third Mexican share participation, arrived.⁵⁶ Then in 1881, French, British, and German financiers under the leadership of Banque Franco-Egyptienne, established the Banco Nacional Mexicano with substantial minority Mexican investment. The next year, a rival group of Mexican merchants (most of whom were Spanish immigrants) created the Banco Mercantil Mexicano. Following a banking crisis, these two banks merged in 1884 to form the Banco Nacional de Mexico (Banamex). In 1899, a syndicate of Mexican

54 Tschoegl, *Foreign banks in the Pacific*.

55 G.D. Triner, 'The Formation of Modern Brazilian Banking, 1906–1930: Opportunities and Constraints Presented by the Public and Private Sectors', *Journal of Latin American Studies* Vol. 28 (1), (1996), pp. 49–74; G.D. Triner, 'British Banking in Brazil during the First Republic', unpublished paper (Rutgers Univ. 2002).

56 D. Joslin, *A century of banking in Latin America; to commemorate the centenary in 1962 of the Bank of London & South America Limited* (London 1963).

investors became the majority shareholders of BLM and London Bank of South America retained only 25 per cent ownership. Throughout this period local investors founded federally-chartered banks in a number of Mexican states; by 1911 there were some 47 banks in all.⁵⁷

In Africa primary succession came about via government fiat. The period (1958–81) has been described as ‘the second golden age of banking’.⁵⁸ During this period many banks around the world followed a strategy of international expansion, with the intent to establish global networks of offices, and some such as Citibank and First Chicago, came to Africa, where they joined the existing colonial overseas banks. Much of this costly expansion turned out to be of little value to the banks’ customers and the new entrants left. Most of the resident banks north of South Africa and south of the Sahara were colonial banks such as Banque du Congo Belge, established in 1908 with headquarters in Belgium, Grindlays Bank, Standard Bank of South Africa, Bank of West Africa, and the like. They stayed, but faced nationalisation and nostrification.

In Africa, this ‘golden age’ coincided with what one might call the ‘National Era’. The National Era was a period of decolonisation, nationalism, *Étatism* – state-led industrialisation – and a stigmatisation of private enterprise and especially multinational companies such as banks.⁵⁹ Newly-independent local governments simply took over the colonial overseas banks. For instance, in Kenya the government created Kenya Commercial Bank (KCB) to take over 29 of National and Grindlays Bank’s (NGB) 32 branches. The government owned 60 per cent of KCB, and NGB owned 40 per cent, while NGB also initially maintained a management contract. NGB then incorporated its three remaining branches into National and Grindlays Bank International (Kenya), of which it owned 60 per cent and

57 S. Haber, ‘Industrial Concentration and the Capital Markets: A Comparative Study of Brazil, Mexico, and the United States, 1830–1930’, *Journal of Economic History* 51 (3), (1991), pp. 559–580.

58 S. Battilosi, ‘Financial innovation and the golden ages of international banking: 1890–1931 and 1958–81’, *Financial History Review* 7 (2), (2000), pp. 141–175.

59 R.D. Robinson, *International Business Policy* (New York 1964).

the government the remainder. This arrangement effectively separated corporate banking from retail, with NGB controlling the corporate and the Kenyan government the retail. The only locally-owned and founded bank in all of East Africa, Jetha Lilla, founded by Indians in Zanzibar, closed four years after the 1964 revolution in Zanzibar.⁶⁰ The present day prevalence of locally-owned banks in Africa today is due to similar cases of government acquisition, followed much later by privatisations.

V.

In secondary succession, foreign banks are among the weeds that first respond to the disturbed, hospitable soil that liberalisation, crisis, transition or the aftermath of wars has created. The foreign banks that respond to these opportunities are often willing to enter retail banking as well as traditional international banking and can respond quickly because they are well-capitalised, efficient, and have surplus managerial resources.⁶¹ Even in mature markets, the model has applicability in crises and their aftermath. Although foreign banks in Japan had a minor presence after 1900, they re-entered after World War II and came to hold some nine per cent of banking system assets. By the 1980s, the foreign share was below three per cent. In the aftermath of financial crises in Korea, Japan, and Thailand, foreigners acquired local domestic banks, which they recapitalised. In some cases they have already started to sell these back to local banks and shareholders. In Thailand, despite a doubling of the foreign banks' share of Thailand's banking system's assets, the foreign bank presence remains limited.

60 C. Tominaga, 'Merchants of the Indian Ocean and Jetha Lila-Bankers', in: E. Linnebuhr (ed.), *Transition and Continuity of Identity in East Africa and Beyond: In Memoriam David Miller*, Beirut African Studies Series (Beirut 1987).

61 C.P. Kindleberger, *American Business Abroad* (New Haven 1969); Tschoegl (2004).

It is clear that foreign banks have increased their presence in emerging markets after wars or financial crises.⁶² In Mexico, before the civil war that commenced in 1910, foreign banks had been relegated to a minor role. They returned in the early 1920s after the end of the revolution, before being again a minor force by the 1930s. They returned a second time in the privatisations of 1994. Their market share peaked at about 80 per cent of banking system assets. Foreign banks now probably account for some 75 per cent of assets, though they still number four of the five largest banks in the country. US and Canadian banks rushed into Cuba after the expulsion of the Spanish in 1898. The crisis of 1921–22 led to the failure of some foreign, and most of the indigenous banks, including some of the largest; by the mid-1920s 75 per cent of banking system assets were in foreign hands and slightly more than 50 per cent of banking system assets overall were in the hands of Citibank and Royal Bank of Canada.⁶³ However, by the onset of the Cuban Revolution, the largest bank in Cuba was in Cuban hands and the role of the foreign banks, though still significant, was waning.

In Jamaica, following the crisis in Jamaica in 1996–7, the share of banking system assets went from 43 per cent in 1998 to 99 per cent in 2001. Because it is a small country, the degree to which ecological succession will occur is an open question.

Transition, which arrived after the fall of communism, has resulted in foreign banks having come to dominate the banking systems of countries such as Bulgaria, the Czech Republic, and Hungary.⁶⁴ In Bulgaria, the current situation represents the second case of secondary succession, the first having occurred in the 1920s after the end of World War I.⁶⁵

62 I. Papp, 'Do Banking Crises Attract Foreign Banks?', *Journal of Emerging Markets* 10 (1), (2005), pp. 42–50.

63 L.H. Jenks, *Our Cuban Colony: A Study in Sugar* (New York 1928).

64 Tschoegl, *Financial Crises and the Presence of Foreign Banks* (2005b).

65 Koford and Tschoegl, *Foreign Banks in Bulgaria*, (2005).

The foreign banks seeking to benefit from transition came in three varieties: the bettors, the prospectors, and the restructurers. The bettors took minority positions in host-country banks and sought to benefit from a rising tide lifting all ships. Over time they will exit either because their investments failed, or because they succeeded.

The prospectors are foreign banks that have no particular experience with the host country or clients there, but perceive the existence of a possible opportunity in the unsettled situation following an opening, crisis or deregulation. They are simply engaging in an exploratory foray. One example is Allied Irish Banks. Although it had no other European investments, starting in 1993 it acquired and merged Wielkopolski Bank Kredytowy and Bank Zachodni. It sold its subsidiary to Santander in 2010 (in 2012 Santander absorbed KBC's Polish subsidiary, Kredyt Bank.)

The restructurers acquire a large bank in a privatisation or a rescue and proceed to attempt to fix it. Frequently, restructurers acquired banks in several transition economies, and generally, if one restructurer entered a transition host market, others did so too. Continental banks such as Unicredito (Italy), Erste Bank (Austria), KBC (Belgium), Société Générale (France), have been active in Eastern Europe; Nordic banks have been active in the Baltic; and Greek banks have been active in the Balkans. Unicredito (Italy), Erste Bank (Austria), KBC (Belgium), and Société Générale (France) established five subsidiaries each across nine transition countries, with only Serbia having only one of the four; most markets had two of these banks, and the Czech Republic and Slovakia each had four. The presence of several foreign banks from different countries brings a rivalry to the market for bank services. Most restructurers view their engagement as open-ended. At entry they had no exit plan but instead anticipated retaining ownership into the indefinite future, subject, of course, to profitability.

VI.

Foreign banks have responded to the opportunities that crises, deregulation, wars, or the transition from communism have created. Some part of the entry was foreign banks pursuing normal international banking activity, and these branches and their activities will persist indefinitely, but never be of much quantitative importance. The part that draws the most concern in many countries around the world is foreign majority ownership of large domestic commercial banks. Discomfort can be especially acute when foreign-owned banks come to dominate the banking system. However, one must understand that the foreign banks' initial presence is only the first phase in a process of ecological succession.

The foreign banks' initial success leads over time to the erosion of their predominance in the host banking system. As the banks, foreign and domestic-owned alike, become more competitive, the foreign owners will no longer have a comparative advantage in general retail and commercial banking, even if they retain an absolute advantage. Thus, in time, we can expect that many, if not all, foreign owners will sell their retail banking activities to domestic owners. The foreigners may retain a branch in the national financial centre to conduct corporate and wholesale banking but will leave retail and general commercial banking to local banks. More importantly, the reforms that facilitated the entry of the foreign banks free the domestic banks to compete and grow. The result will be that over time the proportion of banking system assets in foreign-owned banks will decline to a long-run proportion much lower than we observe today.

FOREIGN BANKS IN INDIA: ESTABLISHMENT, OPERATIONS AND CHALLENGES AS REFLECTED FROM THE RECORDS OF THE RESERVE BANK OF INDIA

ASHOK KAPOOR

Abstract

The history of Indian banking was closely associated with the foreign banks as the initiative towards formation of banks in the modern sense was taken by the Europeans in India. Banking in India originated in the last decades of the eighteenth century. The first foreign bank to be established in India was the General Bank of India in 1786 and followed by the Bank of Hindostan. The oldest bank still in existence is the State Bank of India which was established as Bank of Calcutta (1806) by the Royal Charter of the East India Company. Similarly, the Bank of Bombay (1840) and Bank of Madras (1843) were established by the Charter. These three banks were known as the Presidency Banks. India was considered a favoured destination for the foreign banks as establishment of banks in India offered great business opportunities coupled with high profitability. The earliest foreign bank to be established in India was the Chartered Bank of India, Australia and China at Calcutta in 1853 and it was followed by The Comptoire d'Escompte de Paris in Calcutta in 1860, in Bombay in 1862 and branches were also opened in Madras and Pondicherry (a French colony in India). Hong Kong & Shanghai Banking Corporation opened its branch at Calcutta in 1869. Calcutta became a hub of the foreign banks because of trade and commerce of the British Empire.

The history of Indian banking can be conveniently divided into four phases: Phase I (1786–1935) – the foreign banks were established and

referred to as 'exchange banks' and were involved in financing foreign trade and engaged in foreign exchange business. Phase II (1935–69) – from the establishment of the Reserve Bank of India (RBI) to nationalisation of banks. In 1949 the Banking Regulation Act was passed which gave RBI regulatory and supervisory powers. Foreign banks operated in restrictive environment. Phase III (1969–91) – this period covered incident from 'social control' over banks to the pre-liberalisation period. Foreign banks diversified in areas where domestic banks were operating and branch expansion witnessed unprecedented growth so as to reach common man. Phase IV (1991 onwards) – the foreign banks benefitted from the liberalisation of Indian economy and their number increased. The Indian financial system was integrated into the global system.

Until 2004, 31 foreign banks in India with 295 branches accounted for 0.36 per cent of total branch network even though their share in banking assets was 8.53 per cent. Foreign banks are interested in parking their financial resources in an environment which is stable, profitable and with minimal risk. However, the foreign banks had been critical of policies, attitude and approach of the Reserve Bank of India in regards to branch expansion while the domestic banks criticised foreign banks for concentrating on big cities and niche banking. During all these years, the experience gained by foreign and Indian banks had been mutually beneficial to both, resulting in assimilation and diffusion of sound banking practices which made the Indian banking system healthy, transparent, financially viable and integrated into the international financial system.

Historical Background of Foreign Banks in India

The history of Indian banking is closely associated with foreign banks as the first initiative towards the formation of banks in the modern sense was taken by Europeans in India. For a long time banks have been one of the vital instruments for the growth of the economy not only in India but all over the world. Since the beginning of the twenty-first century the principles of transparency, liberalisation, globalisation and innovative information and communication technology in banking have provided a new impetus to the banking system.

In the eighteenth century the borrowing needs of the Indian people were largely met by indigenous bankers and financiers. The concept of borrowing from the public was pioneered by the East India Company to finance its campaigns in the Anglo-French Wars in India. The endeavours of the East India Company to establish government banks was primarily influenced by the necessity of raising long term and short term financial accommodation from the banks. The origin of modern banking in India dates back to the late eighteenth and early nineteenth centuries with the establishment of the European agency houses in the port towns of Bombay and Calcutta. The early traders who came to India in the seventeenth century could not make use of the indigenous bankers because of ignorance of the language as well as local's inexperience with European trade. Therefore, the agency houses started banking, separate from their commercial pursuits. Although the primary business of agency houses was trade, they entered into the sphere of banking to facilitate their trade. The agency houses also served as bankers to the East India Company and since they had no capital of their own they raised deposits, issued currency notes, financed trade and established joint stock banks. The first foreign bank to be established in India was the General Bank of India in 1786, followed by the Bank of Hindostan. Subsequently, some joint stock banks were established in India but agency houses are regarded as a harbinger of modern banking in India.

The oldest bank still in existence is the State Bank of India which was established by the Royal Charter of the East India Company as the Bank of Calcutta in 1806. Similarly, the Bank of Bombay (1840) and Bank of Madras (1843) were established by the royal charters of the East India Company. These three banks were known as the presidency banks and for many years these presidency banks acted partially as the central bank of the country. These banks were merged together to establish the Imperial Bank of India in 1925. Foreign banks in India were established during British rule. India was considered a favoured destination for foreign

banks as the establishment of banks in India offered great business opportunities coupled with high profitability. In 1836 the Bank of India and in 1840 the Bank of Asia were established during the rule of the East India company but they could not make much headway due to the opposition of the agency houses and the East India Company as they feared that their monopoly in foreign remittances and the discounting of foreign bills would be threatened. The earliest foreign banks established in India were British and French banks as they were engaged in stiff rivalry over trade and commerce in India. Both countries had established colonies in the port towns. The earliest banks were opened in Calcutta as it was the financial capital of India and the hub of international trade. The Chartered Bank of India, Australia and China was the first foreign bank to establish its branches at Calcutta, Bombay and Shanghai in 1858. The bank was keen to capitalise on the huge expansion of trade with India and China and other British possessions in Asia, and on the handsome gains it could make from financing the movement of goods from Europe to India. Subsequently, as a sequel to the removal of protectionist policies in trade and commerce by the British and the French, The Comptoir National d'Escompte of the city of Paris (CNEP) established branches at Calcutta in 1860, at Bombay in 1862 and branches were also opened at Madras and Pondicherry (a French colony in India). The antecedents of the Hong Kong and Shanghai Banking Corporation could be traced to India in 1853 with the opening of the Mercantile Bank of India, London and China, which was established at Bombay. It subsequently opened branches in Madras and Calcutta. HSBC has operated in India since 1867 with the opening of its first branch in Calcutta.

During the second and third quarter of the nineteenth century, two events adversely affected the growth of banking in India. The first event was the commercial crisis of 1829–32 which put an end to the business of agency houses until about 1860. The second event was the American Civil War which stopped the supply of cotton from the American states to

Lancashire, England during 1861–65, and many promoters opened banks to finance trade in Indian cotton. In a few years the boom collapsed and with large exposures to speculative ventures many of the banks established during these years failed. The depositors not only lost their money but their trust in the banking system was also lost. Subsequently, banking in India remained the exclusive domain of Europeans for several decades until the beginning of the twentieth century.

It is interesting to note that there was no law providing limited liability and all joint stock banks operated on the basis of unlimited liability. In 1860 legal recognition was given to the limited liability of the banks. Many companies had registered themselves as banks and when they failed, they were included in the statistics of bank failures. With the passage of the Indian Companies Act (1913) a few sections relating to joint stock banks

Year	Presidency Bank		Indian Joint Stock		Exchange Banks		Total
	Total Deposits	No. of Banks	Total Deposits	No. of Banks	Total Deposits	No. of Banks	
1870	118.3	-3	1.4	-2	5.2	3	124.9 (8)
1900	156.9	3	80.8	9	105	8	342.7 (20)
1913	423.6	3	241	41	310.4	12	975.0 (56)
1919	799.9	3	612.7	47	743.6	11	2156.2 (61)
1921	725.8	1	801.6	65	752	17	2279 (83)
1930	839.7	1	986.6	88	681.1	18	2197.3 (107)
1937	2716.7	1	7,337	690	1812.8	15	11,866.6 (706)

Source: Banking and Monetary Statistics of India, Reserve Bank of India (Figures in million Rupees)

were included in it. Before the establishment of the Reserve Bank of India (RBI), there were three types of banks operating in India, namely: (1) presidency banks, which were amalgamated in 1921 as the Imperial Bank of India; (2) foreign-owned exchange banks; (3) and Indian joint stock banks. The compartmentalisation of banking in India prompted Lord Curzon, Viceroy of India, to remark that it seemed we were behind times. The banking system in India was like some old fashioned sailing ship, divided by solid wooden bulkheads into separate and cumbersome compartments.

The history of Indian banking can be conveniently divided into four phases, which will be examined below.

The Early Phase: The Establishment of Small Banks (1786–1935)

During this period small banks were established with a view to finance trade and commerce but their growth was slow and banks faced periodic failures. In 1870, only three exchange banks had established their agencies in India. By 1913 their number increased to twelve out of which more than half had their head offices in London, while the rest belonged to various other countries including Japan, France, Germany, Russia and the USA. Presidency banks and later on the Imperial Bank of India were legally barred from participating in the foreign exchange business and the Indian joint stock banks showed no interest in financing foreign trade. As a result, the field was open for the Europeans to establish near monopolistic control over the foreign exchange business in India.

The war disturbed the proportion of India's foreign trade with various countries and led to the closure of some of the banks of these countries. At the same time, a few countries established new branches of their banks in India. The Deutsche-Asiatische Bank and the Russo-Asiatic Bank closed their agencies in India while five new banks opened branches during

1918–20, of which two were from Japan, two from the Netherlands and one from Portugal. Exchange Banks were engaged in the following areas:

1. Providing foreign exchange for trade and commerce.
2. Financing internal trade especially for the transportation of goods to port towns and the interiors.
3. Taking deposits from the public.

Initially the exchange banks depended primarily on home funds for meeting their additional financial requirements and had to bear the criticism of being unsound and undesirable for the Indian money market. Subsequently, these banks developed an Indian deposit business which gave rise to complaints of unfair competition from the Indian banks! The foreign banks operating in India during this period can be conveniently divided into two groups. In the first group were the British banks, such as the Chartered Bank of India, Australia and China (1853), the National Bank of India (1863), the Mercantile Bank of India (1893) and the Eastern Bank (1910). These banks financed the bulk of finance for Indo-British and Indo-China trade. To some extent they promoted internal trade which indirectly helped their exports to Britain. In the second group were foreign banks which specialised in the trade of their respective countries, such as Comptoir National d'Encompte de Paris, the Yokohama Specie Bank, Deutsche-Asiatische Bank, the Russo-Asiatic Bank, and the First National City Bank.

Two important factors helped the exchange banks to acquire more or less a monopoly in the field of financing the external trade of India. The presidency banks and afterwards the Imperial Bank of India, which was formed by the amalgamation of the presidency banks, had been prohibited from dealing in foreign exchange and from borrowing money from abroad. Some of the banks like the Alliance Bank of Simla and Tata Industrial Bank, which were engaged in this business, did not, however, attain anything like

even a partial success due mainly to their lack of access to the London money market and partly to their comparatively small resources.

The classification of exchange banks: The old classification of these banks was based on the extent of business done by them. According to this, five banks were doing considerable business while the remaining 13 were merely agencies of large banking corporations doing business all over the East. Another interesting classification was according to the nationality of the banks. Eight banks were British while the remaining ten were from Japan, the USA, Holland, China, France, Portugal and Singapore. Business done by the non-British banks was much less significant than that of the British banks. For example, the total deposits and total advances (including bills discounted) in India and Burma of the ten non-British banks were 16 per cent and 19 percent respectively of total deposits in 1935.

The business of the exchange banks can be divided into: (a) exchange business and (b) ordinary banking.

- (a) The exchange business: The bulk of the bills dealt in were export bills. These were purchased by the banks' Indian branches. The bills were held by their London offices until they were retired or paid on maturity. Bills were usually discounted in London, immediately following their acceptance. Exchange banks also financed the import of trade through their head offices and branches outside India. The purchases of export bills by them represented transfers of funds to London. To bring these funds back to India, they used to buy India council bills sold by the Secretary of State for India. Other methods of raising funds were: (i) by cashing import bills; (ii) by selling drafts to Indian students and travellers abroad; (iii) buying rupee notes in London and selling them in India; and (iv) the import of gold and silver.
- (b) The ordinary banking business: Exchange banks also established a majority of their branches in the port towns while

maintaining inland centres in the four provinces of Bengal, Punjab, the United Provinces and North West Frontier Province. Approximately, 75 branches belonged to eight British banks and the remaining 25 per cent belonged to non-British banks. The inland branches played some part in the financing of inland trade mainly on account of goods or produce in transit prior to export or immediately after import. The support, which the piece-goods trade in Delhi and Amritsar and leather trade in Kanpur received from them, was well-known. In Calcutta they made advances against Hessian delivery orders and inland bills or *hundis* (promissory notes), while in Bombay they practically did every type of banking business. Significantly, in Assam, Bihar, Central Provinces & Berar and Orissa the exchange banks had no branches at the ports or in the interior of these provinces.

- (c) The position of exchange banks as revealed from the weekly returns: The statistics regarding the operations of exchange banks were meagre. The 'Statistical Tables relating to Banks in India' was the only source of information regarding banks' deposits and cash, but it hardly provided any information on banks' investments in India.
- (d) Demand and time liabilities: Exchange banks received deposits both in current and savings bank accounts and also received fixed deposits. The rate of interest offered by them was higher than the Imperial Bank of India but lower than those of the Indian joint stock banks. The aggregate deposits of the exchange banks showed a steady rise until 1921. Starting from a meagre Rs. 5.2 million in 1870 and increasing to Rs. 105 million by 1900, Rs. 750 million had been deposited by 1921. During the next 13 years, the deposits of the exchange banks declined, presumably because of the establishment of the Imperial Bank of India and competition from other Indian joint stock banks. The total demand and time liabilities in India and Burma of

the exchange banks on 15 August 1941 amounted to Rs. 954 million. Out of this about Rs. 820 million was accounted for by the eight British exchange banks and about Rs. 90 million by the two US banks. The balance of Rs. 44 million belonged to the remaining ten banks.

- (e) Advances and bills discounted: An absence of information regarding the investments of the exchange banks in India led to a general belief that exchange banks took money out of the country for use elsewhere. The evidence given before the Central Banking Enquiry Committee then proved that there was no foundation for such an assumption. According to the figures collected by them for the year 1929, the advances and bills discounted in India by exchange banks amounted to Rs. 460 million and their investments in government and other securities totalled Rs. 260 million. So the total of these two items was Rs. 720 millions whereas total deposits in India amounted to Rs. 660 million in the same year. Very little was known to the outside public concerning the extent to which they employed their funds in various countries in which they were operating. Their business was so fluid and governed by such a variety of considerations including the trends in international trade, differences in interest rates in various countries, seasonal factors, international political developments, etc. It was difficult to generalise or to correctly judge the matter.
- (f) Provisions for controlling non-national banks in foreign countries and India: Provisions regulating non-national banks were to be found in the laws of various countries. In the USA, Italy, Japan, Belgium and Germany, foreign banks interested in establishing a branch had to obtain a licence from the prescribed authority. In Germany foreign banks, excepting those which had come into existence before 16 January 1920, were prohibited from accepting deposits and security as bails. In Italy, branches of foreign banks were required to make a certain

prescribed deposit as a guarantee for the business transacted in Italy and its colonies. In Japan there was a similar provision requiring a deposit of 100,000 yen in respect of each office or agency doing business there. In Belgium foreign banks had to earmark ten million francs for their business in the country. The authorities issuing banking licences in these countries were empowered to impose specific restrictions with an object to enable them to treat a non-national bank in the manner in which their own institutions were treated in the country from which the non-national bank originated.

Foreign banks had an inherent advantage over the Indian banks in the foreign trade business as they had the support of capital resources, efficient management, access to London money market, and last but not the least, experience in the foreign exchange market. The foreign trade of India was regarded as a very lucrative business and all foreign banks wanted to share a major slice of the watermelon while the Indian traders and exporters had a meagre share of just 15–20 per cent. The Indians had a lot of grievances against exchange banks. Some of these are highlighted below:

1. Exchange banks used their monopolistic position in foreign trade and the exchange business, which was detrimental to the Indian business.
2. Indian customers were required to deposit 10–15 per cent of the value of merchandise with exchange banks in order to open a confirmed letter of credit.
3. Exchange banks discriminated against Indian steamships and insurance companies.
4. Responsible posts were not offered to Indians.
5. Exchange banks were not bound by any legal restrictions in India and were exempt from even limited statutory obligations imposed on Indian joint stock banks.
6. No protection was afforded to Indian depositors.

7. Import bills were drawn in sterling at a relatively high rate of interest.
8. The Indian Central Banking Enquiry Committee Report (1931) pointed out that the entire foreign exchange business was under the monopoly of exchange banks. Furthermore, to a lesser extent these banks accepted deposits and provided loans. With a view to giving the proposed Reserve Bank of India some control over exchange banks, the committee recommended licensing the Indian offices of exchange banks. To obtain a licence the committee also suggested that the banks should be required to furnish the proposed central bank of the country with a statement on their assets and liabilities as well as periodic reports of Indian and non-Indian business handled by them. Other stipulations might be imposed on them from time to time too. The domestic traders and bankers criticised them for favouring the European traders at the cost of Indian business interests.
9. An insistence on having two British signatures as a condition for a rediscount for trading in foreign exchange posed problems for Indian traders.

Keeping in view some of the criticism cited above, the Indian Central Banking Enquiry Committee recommended the extension of foreign connections by Indian joint stock banks and the establishment of an Indian exchange bank, if the Imperial Bank of India was not able to participate in the financing of foreign trade. During the early phase, the number of foreign banks in India increased from three to 18 and they maintained a substantial share of deposits and credits of the total banking system. However, in the absence of any statutory regulation for the banking industry, it would have been unfeasible, unjustified and even inequitable to regulate only exchange banks.

Before the establishment of the Reserve Bank of India, the position of head offices and branch offices of the banks was as follows:

These 1269 head offices and branches of the banks were located in 475 towns. The remaining 2100 towns and all villages in the country had no formal banking facilities. Only 22.62 per cent of the population had access to banking while 77.38 per cent had no access to banking facilities.

Banks	Head Offices	Branches
Exchange Banks	---	98
Imperial Bank of India	3	160
Indian Joint Stock Banks	320	688
Total	323	946
<i>Source: History of Reserve Bank of India, Volume I, (1935-50), p. 168.</i>		

Phase II (1935-69): Establishment of the Reserve Bank of India to Nationalisation of Banks

During this period the Reserve Bank of India was established on 1 April 1935 as the central bank of the country with a share capital of Rupees 50 million as recommended by the Hilton Young Commission. The functions of the reserve bank were as follows: (a) to serve as banker to the government, (b) to issue bank notes, (c) to serve as banker to other banks and (d) to maintain the exchange rate. Besides this, the central bank was endowed with extra powers and manoeuvrability in extraordinary circumstances, which could be exercised with the prior approval of the Governor General in Council or the board of directors.

By the time the Reserve Bank of India (RBI) was established, organised banking had developed to a significant extent and foreign banks or so-called exchange banks were major players in Indian banking. In 1935, there were 17 exchange banks present in the country with 88 branches. The government took major initiatives in the banking sector after the independence of the country in 1947. Seven banks owned by the princely states

were nationalised in 1959 and they became subsidiaries of the State Bank of India. In 1969, 14 national banks in the country were nationalised and again in 1980, seven more banks were nationalised in order to gain social control over them.

Initial steps to regulate exchange banks: After the establishment of RBI some steps were initiated to exercise some control over the exchange banks by asking them to provide some information about their business. Prior to this, the Central Banking Enquiry Committee (1931) had discussed the question of increasing the share of the Indian banks in the foreign business and bringing some necessary control over exchange banks. There was growing criticism of the practices of exchange banks in that they were competing with the Indian banks for business within the country, both in respect of attracting deposits and providing credits, and they continued to discriminate against Indian insurers. RBI was of the view that there could be no discrimination against foreign banks on the principle of reciprocity. According to Section 23 (3) (c) of the Banking Companies Act, foreign banks were allowed to operate in India as long as the countries in which they were incorporated did not discriminate against Indian banks and complied with the requirements of the Banking Companies Act. Exchange banks' easy access to London and other European money markets, their ability to attract deposits in India at low rates, and their early start in the business of financing India's foreign trade, gave them an advantage over Indian banks. While their larger resources and wide connections in different countries had fostered the confidence of their clientele, their efficient business method had no small share in it.

Exchange banks were not required to furnish RBI with any detailed information regarding their assets and liabilities. The only statement they submitted periodically comprised as: (a) the weekly returns under Section 42 of RBI Act; and (b) copies of consolidated balance sheets which did not provide separate figures of their Indian business under Section 277 (3) of the Indian Companies Act. These banks did not come under the purview

of the various provisions of the Indian Companies Act relating to Indian Banking Companies. The central board asked J.B. Taylor, Governor of RBI, to find out how the statistics of the exchange banks about their operations in India could be made as complete as those of the Indian joint stock banks. According to Taylor, the exchange banks were functioning as authorised dealers and were providing RBI detailed information about their daily exchange operations. He felt that obtaining information about their assets and liabilities would only be of statistical interest. The central board was not satisfied with the governor's views and asked him to obtain information regarding investments and the foreign exchange business of the exchange banks. Taylor reported to the central board in February 1942 that the exchange banks were maintaining assets in India in excess of 75 per cent prescribed in the proposed Banking Act. Their resources were distributed as follows: financing of internal trade (33 per cent); cash (16 per cent); government securities (20 per cent); financing of foreign trade (23 per cent); and some other miscellaneous area.

The move towards banking legislation: The exchange banks which were in a privileged position in the matter of statutory legislation were naturally opposed to the proposed Banking Act. Public opinion was in favour of bringing all foreign banks under stricter control by a system of licensing. However, the management of RBI suggested that a clause in the 1944–45 bill prescribed that banks incorporated outside British India or the United Kingdom should obtain a licence from RBI for carrying out business in India. This move would have placed British banks on a superior footing and was vehemently criticised, not only by the Indian banks, but also by the other foreign banks. The *Eastern Economist* (12 January 1945 issue) called this 'politically obnoxious and economically vicious' and added that

'this will not only foster uneconomic competition prejudicial to the growth of national banking institutions, but give rise to presumption, wholly without justification, that the UK banks do not need to

be regulated in respect of their capital, liquidity and other standards of healthy banking’.

The Select Committee Report (February 1947) recognised the validity of the criticism made against the clause as it stood and recommended an extension of the provisions of licensing to all banks incorporated outside India.

Foreign exchange dealings of the exchange banks: All foreign banks were eligible for licences to deal in the foreign exchange business. A few authorised dealers were given licences to deal only in sterling. Following the footsteps of the Bank of England, RBI also followed a restricted policy of issuing licences to deal in foreign exchange. The list of banks dealing in foreign exchange remained the same until 1943, except that in 1941, three Japanese banks’ licences were cancelled on the grounds that they were banks originating from an enemy country of India. The licensed banks were allowed to transact business at the rates prescribed by the Exchange Banks’ Association. During this period an expansion and development of the Indian banks took place and some of them were keen to start business in foreign exchange. RBI liberalised the policy to enable Indian banks to undertake business in foreign exchange and licences were provided under the following conditions:

- The bank enjoyed a good reputation and standing.
- It showed good chances of attracting foreign exchange business and appointed agents overseas.
- It had appointed managers with experience in foreign exchange.

Some banks not able to fulfil the aforesaid conditions were given a licence to initially deal in sterling and after they developed adequate experience a general licence was given. The following remarks of Shri C.D. Deshmukh, Governor of RBI, on one application for a licence, showed the paradigm shift in the policy.

‘Even if the operations were not large they may yield experience both to the bank concerned and ourselves. These questions are bound to arise as soon as the preoccupations of the War are over and no charge should be laid at our door that we have thwarted Indian bank’s efforts to enlarge their experience, unless we have very good reasons of public interest. These do not appear to exist and I would grant the licence applied for.’ (August 1943)

The foreign trade business dealt with by the Indian banks always remained very small and even in 1948, it was just 16 per cent of total business. The central board of RBI was of the view that RBI could be of little assistance to the banks, which regarded their exchange business merely as a side line, and the issuance of licences to deal in foreign exchange as a symbol of prestige.

The move towards the regulation of foreign banks: The Banking Companies Act from 1949, also known as the Banking Regulating Act was the single most vital legislative initiative. It was instrumental in repainting the whole banking canvas including the position and function of foreign banks in India. The Act brought domestic and foreign banks on an equal footing. The Banking Companies Act and its subsequent amendments gave RBI substantial and far-reaching powers to regulate foreign banks in India. The following changes were applied to foreign banks:

- The bank was in a position to pay its present or future depositors in full as their claims accrue.
- Banks’ affairs were not or were not likely to be conducted in a manner detrimental to the interest of present or future depositors.
- In the case of banks incorporated outside of India, the government or the law of the country in which the bank was incorporated did not in any way discriminate against banks registered in India and complied with all the provisions of the law.

- Banking companies already in existence at the commencement of the act were not prohibited from carrying on business until it was informed by RBI that the licence could not be granted to it.
- Minimum capital for all banks functioning in India was prescribed. For banks incorporated outside India the minimum value of paid up capital and reserves was fixed at Rs. 1.5 million in any part of the country, excepting Bombay and Calcutta, where it was Rs. two million.
- RBI was empowered to issue, cancel and forfeit banking licences.
- RBI was empowered to inspect, supervise and call for reports and returns.
- RBI was to issue directives to the banks to maintain a certain portion of assets and liabilities in India.
- The banks were required to stipulate and change their lending policies.
- Supervision and inspection of foreign banks started in 1959.

Commenting on the powers and responsibilities vested in RBI under this act, the Eastern Economist wrote,

‘The detailed narration of the duties and powers of Reserve Bank have been given deliberately to impress upon the public the colossal burden that a single institution is being called upon to have in policy making as well as day to day administration of the country’s banking system. It is a responsibility which may not weigh on the old lady of the Thread Needle Street. But Reserve Bank is by no means an old lady or even elderly one. It is, in fact, a very young maiden – just fifteen years old – possibly sure of its ability, as young things usually are, but not yet very sure of its experience in a difficult world.’

The Act was amended a number of times to include provisions for bringing efficiency in its operation, to create uniformity in practices to be followed by all banks and to establish effective control over banks by regulation and

supervision. An amendment of the Act in 1959 authorised RBI to inspect foreign banks, provide guidelines for lending and to stop business activities which were against the economic interest of the country.

Strengthening capital funds and raising liquidity requirements of the bank: RBI had a meeting with the representatives of the banking associations in December, 1961, in which the following decisions were taken:

- All banks should transfer a minimum 20 per cent of their declared profits to their reserves until such time as the paid-up capital and reserves reach six per cent of their deposits;
- All banks should maintain a minimum over-all liquidity ratio of 25 per cent of their deposit liabilities, which represents an increase from the present legal minimum of 20 per cent. In this connection the Bombay and Calcutta Exchange Bank Associations had asked for certain facilities in the event that RBI implemented the liquidity requirement. These associations had suggested that RBI should allow exchange banks to deposit sterling securities with RBI, London, to the extent of two and a half percent of their deposits towards the asset requirement. RBI was of the view that as branches of international institutions, these exchange banks stood on a special footing and most maintained high liquidity ratios. Hence their requests were agreed to.

Deposit Insurance Corporate Act and foreign banks: The Deposit Insurance Act was brought into force on 1 January 1962 when the Deposit Insurance Corporation came into existence. Under the Act, all functioning banks, including foreign banks, were categorised as insured banks. Insurance protection to a depositor was limited to Rs. 1500 or the amount deposited, whichever was less, and the premium was fixed at Rs. 0.05 per Rs. 100 of total deposits in India less some specified deposits.

The policy of social control and foreign banks: In a meeting with the representatives of foreign banks on 28 November 1967, the Governor

of RBI informed them about changes which the government of India wanted to bring about as part of social control. The objective of RBI was to persuade foreign banks to conform as closely as possible to the pattern prescribed for Indian banks. Emphasis was laid on the following points:

- The Governor pointed out that the local board of foreign banks should not be set up for public relations but should actively participate in directing the operations of the banks.
- The local boards should have more powers than the chief executive officers of the banks.
- The chairmen of the local boards should be Indian.
- The local boards should have representatives from banking professions, industrialists, agriculture, co-operatives and small scale industries.
- All the members of the board should be Indians while the chief executive officer, even if a foreigner, could be member of the board.
- The foreign banks were required to submit information on the amounts of foreign funds deployed.
- Banks were to prepare a programme regarding Indianisation and to indicate to RBI a bank's rate of Indian recruitment and how much further progress towards Indianisation would be made in the next five years.
- Foreign banks were to take increasing interest in lending to the agricultural sector.

Phase III (1969–1991): The Nationalisation of Banks to Pre-Liberalisation Period

This period witnessed the nationalisation of 14 commercial banks in the country (1969) and seven more banks were nationalised in 1980 with the objective of providing a major thrust to banking in rural and semi-urban areas. The branch expansion programme witnessed unprecedented

growth and an effort was made to provide basic banking facilities to the common man. In contrast the business of foreign banks suffered during this period and their share in total assets, deposits and credits witnessed a steep fall. Foreign banks diversified in the areas where they enjoyed an edge over domestic banks i.e. foreign currency loans, investment banking, portfolio management, derivatives and other market related activities. In retail banking they focused on high net worth customers.

Foreign banks and social control: In the beginning of the 1960s most of the banks in India were concentrated in metropolitan cities and major urban and rural areas were 'unbanked'. This led to the conclusion that banks were not tapping rural savings nor were they providing credit to the agricultural sector. Besides, there was a general feeling that the banking system in India was catering to the demands of the urban areas and was insensitive to the needs of society. There was a demand in political circles for state intervention, which ultimately gave birth to the concept of 'social control' over the banks. Describing the late 1960s, the *History of the Reserve Bank of India*, Volume III, states:

'Those were the years when the things were heating up politically and when banking became the focus of political attention. The focus ultimately culminated in the nationalisation but not before the Bank (RBI) had fought some rearguard action to force commercial banks to expand to poorly served areas.'

In 1969, Indira Gandhi, Prime Minister of India, in her address to the newly appointed custodians of the nationalised banks declared,

'Banks being closely linked with the development of our economy cannot remain entirely uninfluenced by the needs of the political situation. The political situation in our country demands that banking facilities should be extended in increasing measure to backward areas, to agriculture, to small scale industries and so on, and banking operations should be influenced by a larger social purpose.'

In 1965 RBI liberalised branch licensing norms and it was decided that the focus should be on rural areas. Shri L.K. Jha, Governor of RBI, in his address to the Bombay bankers on 18 August 1967, suggested, 'slowing down the branch expansion in urban areas'. The bankers told the governor that they would welcome this so that their competitors as well as foreign banks were kept in check. The Governor observed, 'The foreign banks were obliged to confine themselves to the port towns only', to make profits. The thinking of RBI at that time was that so far as port towns were concerned no new licences should be given for opening new branches of the foreign banks excepting those banks which did not have a branch in the port towns. Some foreign banks such as those who had one or two branches in the country like the Japanese, the French and the Dutch banks benefited as they had an opportunity to open some additional branches in port towns.

Foreign banks operated in port towns and other big cities and were allowed to open new branch offices only if the foreign exchange situation was found to be relatively comfortable. This restrictive policy was followed since 1962 and some foreign banks found it discriminatory. While the branch licence issue was being discussed, Mr. C.H. Babha, chairman, Central Bank of India, wrote to the governor of RBI: 'For peculiar reasons, foreign banks and other service organisation claim it as their birth right to expand in the developing countries like ours. Also, I am afraid our authorities, without deeper consideration and thought, facilitate that.'

RBI responded that because of the restrictions on bringing in funds from abroad, foreign banks wanted to open new branches in metropolitan/port cities so that they could augment their resources. The central board of RBI, which met in 1967, did not consider it necessary to suggest any tightening of restrictions on the branch expansion of foreign banks and allowed the existing policy to continue. Mr. Babha wrote to Mr. Moraraji Desai, deputy prime minister, that foreign banks were at a comparative

advantage over Indian banks as they enjoyed certain exemptions. To quote Mr. Babha,

‘In certain quarters there is lurking suspicion as to whether in the matter of issuing licences to foreign banks for opening new branches in India, the general criteria contained in Section 23(2) of the Banking Regulation Act, 1949 have been applied as meticulously as in the case of Indian banks, or whether there has been any bias in favour of some foreign banks.’

By then Mr. L.K. Jha had become the governor of RBI and he pointed out that since 1962, of 91 applications received from nine foreign banks, RBI had permitted only 43 offices while, in the same period, 2,367 new offices were opened by Indian banks. This showed, in the governor’s opinion, that the licences were not given liberally and without scrutiny. Jha, in his letter to the additional secretary, minister of finance, presented his frank opinion about the foreign banks in the following points:

- Foreign banks were not necessary for the Indian economy.
- RBI’s policy towards foreign banks should be directed to ensure a proper discipline in respect of their activities and not squeezing them out. He was of the view that,

‘Even recently when the entire future of banking system in a sense being considered afresh, the view we took in respect of the foreign banks was not that they should be told to pack up, but they should bring in foreign exchange on a long term basis. If we accept the policy of allowing foreign banks to operate in the country, then clearly we cannot freeze their operations. As the economy grows and the banking system develops, they must increase their activities and participation though clearly not to the extent of Indian banking system.’

- RBI was to continue putting steady pressure on foreign banks to fall in line with its policies and follow the policy of Indianisation as well as to ensure that they did not get any kind of unfair advantage because of their foreign ownership.

Morarji Desai, deputy prime minister, in his letter to Babha, dated 19 October 1968, echoed similar feelings: 'I assure you that the branch licensing policy in regard to foreign banks has been restrictive and will continue to be so.'

The policy of diversification in opening branches: In a letter from I.G. Patel, governor of RBI to Manmohan Singh, finance minister, dated 7 February 1979 emphasis was laid on the policy of diversification in respect of foreign banks. To quote from the letter:

'In a meeting with the Deputy Prime Minister and Finance Minister it was confirmed that RBI should continue to follow restrictive policy in allowing foreign banks to open branches in India and within that restrictive policy, aim should be to diversify the presence of the international community in India. The USA and UK banks will not be encouraged to enlarge their presence and we should prefer opening of new branches in India by banks from countries not already represented in India but where Indian banks have branches. This principle of reciprocity will be major consideration in dealing with such cases.'

This policy led to the opening of branches from countries which were hitherto unrepresented in India.

Liberalisation in opening representative offices of foreign banks: While restricting the branch expansion policy, RBI took a generally liberal view in respect of the opening of representative offices of foreign banks which would act as liaison offices but not transact any banking business. The main consideration for giving permission for opening liaison offices was the international standing of the bank, its global affiliations and the benefits that would accrue to India through the opening of representative offices.

New policy measures for foreign banks: The following new measures were introduced in the foreign banking sector from 1988–89:

- A start-up capital of Rs. 150 million was prescribed for new entrants.

- Lending to priority sectors was made obligatory and the banks were required to achieve a level of 10 per cent of total lending by the end of March 1989; 12 per cent by the end of March 1990; and 15 per cent by the end of March 1992.
- 20 per cent of the disclosed profit was to be retained in Indian books.

Foreign banks were unhappy with the RBI's new policy requiring them to lend to the priority sector which was financially risky and to some extent unprofitable.

Phase IV (1991–2005): The Post-Liberalisation Period

This period witnessed far-reaching changes in the banking sector in India as a result of the economic reform process unleashed by the government coupled with the transformation of global banking. In India the banking system was liberalised in accordance with the recommendations of the Narasimham Committee Report. With the liberalisation of the banking sector, the country was flooded with foreign banks and ATMs. There was a quantum jump in the number of foreign bank offices, which increased from 145 in 1990 to 245 in 2005. Foreign banks in India were given all the privileges given to domestic banks; the regulatory regime adopted by RBI was non-discriminatory by global standards; a single class of banking licences was provided to foreign banks; no restrictions were placed on their scope of operations; insurance deposit coverage was uniformly available at the same rates as domestic banks; the repatriation of profit was allowed; and similar prudential norms, capital adequacy and asset classifications were made applicable for domestic and foreign banks. In 1991 India embarked on the process of financial reforms which were necessitated by various internal and external factors. Manmohan Singh, Finance Minister, in his address on 5 July 1991 said, 'The time has come to act now, if we have to

ensure India is not marginalised in the comity of nations.' Singh added that the need of the hour was strict fiscal discipline, the curbing of wasteful expenditure and the need to free the economy from the shackles of unnecessary control. The country was moving from one disaster to another with regard to its balance of payments position. If the government had not acted fast, the country could have become bankrupt any day.

The Narasimham Committee Report I: The Narasimham Committee was appointed by the government in August 1991. It recommended far-reaching reforms in the Indian banking sector. The committee's recommendations were centred on transforming the Indian banking system from a highly regulated to a more market-oriented system. It provided a road map for financial sector reforms. The following banking sector reforms were recommended:

- A reduction phased in over five years, in the statutory liquidity ratio to 25 per cent, synchronised with the planned contraction in the fiscal deficit.
- A progressive reduction in the cash reserve ratio.
- Gradual de-regulation of interest rates.
- All banks, including foreign banks, to attain capital adequacy of eight per cent in a phased manner.
- Banks were to make substantial provisions for bad and doubtful debts.
- Profitable and reputable banks were allowed to raise capital from the public.
- The establishment of new private sector banks, subject to RBI norms.
- Banks were to classify their assets into four broad groups, e.g. standard, sub-standard, doubtful and loss.
- RBI was to be primarily responsible for the regulation of the banking system.
- New guidelines were issued for income-recognition, asset classification, and provisioning requirements.

- The report emphasised that a proper system of income-recognition and provisioning was fundamental to the preservation of the strength and stability of the banking system. Accordingly, it recommended the adoption of the international practice of treating an asset as 'non-performing' when interest was overdue for at least two quarters.

The introduction of such norms was aimed at ensuring greater safety and soundness in the financial system, imparting transparency and accountability in operations, and thereby restoring credibility and confidence in the financial system as a whole. The capital adequacy standards of the Basel Accord were adopted to bring India's regulatory framework closer to international standards. By the end of 2000 almost all the banks had achieved the prescribed capital to risk-weighted assets ratio (CRAR) of nine per cent. To strengthen the loan recovery process, the Debt Recovery Tribunal was set up. For a quicker and inexpensive adjudication of customer complaints against deficiencies in banking services, the banking ombudsman scheme was introduced in June 1995.

The banking reforms were essentially focussed on three issues: de-regulation of the banking sector and relaxation of entry barriers to foreign and new private banks to foster greater competition; the introduction of accounting standards and income recognition and asset classification norms to bring greater transparency in bank accounts, along with prudential measures and provisioning norms; and capital adequacy for risks to which the banks were exposed.

The Narasimham Committee Report II (1998): The period 1992–97 saw the implementation of recommendations of the Narasimham Committee Report I. The soundness of the Indian banking system was amply proved during the South-East Asian financial crisis as India emerged unscathed from this major upheaval in the financial sector. The second generation reforms of the Narasimham Committee were related to: (i) strengthening the banking system; (ii) up-grading technology and human resource

development; and (iii) legislative measures to cover banking policy. Keeping in view the purview of the paper, relevant recommendations affecting foreign banks were as follows:

- The risk to asset ratio was to increase from eight per cent to ten per cent in a phased manner.
- Banks should avoid lending to parties in financial difficulties in order to settle interest dues and to reduce the percentage of non-performing assets (NPAs).
- Banks should reduce NPAs in a phased manner.
- Move towards international practices of income recognition with the introduction of 90 days instead of the existing 180 days.
- Emphasis was laid on internal control and internal inspections and audit.
- Foreign banks may be allowed to set up subsidiaries or joint ventures in India. They should be treated on a par with private banks and be subject to same conditions in regard to branches and directed credit as other banks.

The committee's recommendations were directed towards operational flexibility, creating autonomy in the banking sector and improving the quality of portfolios so as encourage healthy competition. The main objective of the financial sector reforms in India in the 1990s was to create an efficient, competitive and stable financial sector that could in turn contribute to stimulating economic growth. These reforms in the financial sector led to the expansion of foreign banks in India, since they were permitted to set up subsidiaries, joint ventures or branches.

Effective supervision: Following the Narasimham Committee Report on Financial Sector Reforms significant changes took place in the Indian banking system as well as in regulatory and supervisory approaches and strategies. The Board for Financial Supervision, which was constituted in 1994, changed RBI's supervisory strategy from a system of periodic

inspections to a system of continuous supervision and periodic inspections. The key elements of supervision were: restructuring of the system of banking inspection i.e. focus, process, reporting and follow up; off-site surveillance as a supplement to on-site inspection; an enhanced role for external auditors; strengthened corporate governance and internal control and audit systems. This supervisory framework was largely in compliance with the principles of the Basel Committee on Core Principles for Effective Banking Supervision.

Changes in disclosure norms: With a view to bringing transparency in the banking system, banks were required to provide additional information in their balance sheets in respect of: (i) maturity pattern of loans and advances; (ii) foreign currency assets and liabilities; and (iii) lending to sensitive sectors as defined by RBI. These norms became effective from 31 March 2000 and were applicable to Indian and foreign banks.

A road map for presence of foreign banks in India (2005): After the process of liberalisation of the financial sector had begun in 1991, by 2005 RBI had become confident that a robust banking system had been established, which was broadly in conformity with international standards. With the objective to further enhance its efficiency and stability to the best of global standards, RBI released the Road Map for Presence of Foreign Banks in India in 2005. The road map contained the following salient points:

- Foreign banks wishing to establish a presence in India for the first time could choose to operate through a branch presence or a 100 per cent wholly owned subsidiary.
- For new and existing foreign banks it proposed to go beyond the existing commitment given to the World Trade Organisation of permitting 12 branches in a year.
- Foreign banks already operating in India would be allowed to convert existing branches into wholly owned subsidiaries while following criteria concerning the mode of presence the respective bank wished to pursue.

- Wholly owned subsidiaries would be treated on par with the existing branches of foreign banks in India for expansion purposes.
- Initially, the entry of foreign banks would be permitted only in private sector banks that were identified by RBI for restructuring. In such banks, foreign banks would be allowed to acquire a controlling stake in a phased manner.
- In considering an application made by a foreign bank for acquisition of a five per cent or larger stake in a private bank, RBI would take into consideration the history and reputation of said foreign bank not only in India but globally as well as the interests of stakeholders. The maximum limit allowed would be 74 per cent.
- In the second phase starting in April 2009, limitation on the operations of wholly owned subsidiaries were to be removed and these would be treated on a par with domestic banks.
- In the second phase, after reviewing the extent of penetration of foreign investment in Indian banks, foreign banks could be permitted, subject to regulatory approval, to enter into mergers and acquisition transactions with any private bank in India. This was subject to a maximum ownership limit of 74 per cent.

In 2004–05 no other issue had led to such public debate or acrimony than the one on foreign equity in Indian banks. The zeal of the advocates of liberalisation and financial sector reforms which would allow the free flow of foreign capital was equally matched by the ideological antipathy of leftist parties to any such freedom. ‘The Banker’ of London reported how the RBI ruling had ‘dismayed bankers and investors.’ A few days after the issue of draft guidelines, Y.V. Reddy, Governor of RBI, in a lecture on ‘India and the Global Economy’ at Lal Bahadur Shastri National Academy of Administration, Mussorie, emphasised the appropriate timing for a significant entry of foreign banks in India. He said, ‘The Reserve Bank of India is currently examining various options for strengthening the financial

sector, in general, and the banking sector, in particular, concurrent with the well calibrated de-regulation process already set in motion.’

On the whole there was disenchantment in foreign financial circles over the new policy. Foreign banks perceived the Indian market as more attractive than China since it was endowed with established legal systems, a stock and securities market and other infrastructure. Many foreign banks had acquired stakes in Indian banks and were unhappy with the setback to their hopes. The rationale behind RBI policy to adopt a gradual and cautious approach in allowing foreign banks to acquire stakes in private banks was whether foreign banks would meet the credit needs of domestic investors. There was a popular belief in India that the foreign banks were engaged in ‘cherry picking’ and leaving out high risk creditors/projects to domestic banks so as to weaken them. Reddy rightly said,

‘A judgemental view needs to be taken whether and when a country has reached the ‘threshold’ and the financial integration should be approached cautiously with a plausible road map by answering questions in country-specific context.’

Operations of Foreign Banks in India

India, an attractive destination: The Indian market had always been an attractive and lucrative destination for foreign banks, more so in the post-liberalisation period. Several factors like growing demand, increased saving, a huge middle class (equal to the combined population of several European nations), high interest rates and consistent economic growth were the main drivers.

Operations of foreign banks in the early phase: In India there were no regulatory restrictions on foreign banks in respect to their operations. Exchange banks enjoyed a good deal of freedom in their operations and were engaged in multifarious activities, some of them were related to banking while others were related to trade and commerce. Under Section 42 of RBI Act 1934 exchange banks were required to send to the central government and RBI a weekly report showing:

- The amount of demand and time liabilities in India.
- The amount held in India in currency notes of the government of India and bank notes.
- The total amount held in India and Burma.
- The amount held in India in rupees and coins and subsidiary coins.
- The amount of advances made and bills discounted in India.
- The balance held in RBI at the close of business each Friday.

The aforesaid information was treated as confidential and a consolidated statement was prepared. J.B. Taylor, Governor of RBI, felt that

‘We consider that a consolidated statement based on the returns collected under clause 42 should be published on the ground that they should be of interest and value to the public. Though the returns of the individual banks must be regarded as confidential, this consideration does not apply to statistical returns compiled from the all.’

After the establishment of RBI, the monopoly of exchange banks in foreign exchange business was breached as Indian banks were allowed to deal in it and slowly and gradually foreign banks were brought under the regulatory and supervision regime. The primary objectives of the establishment of foreign banks in India were to develop economic relations with the country so as to avail themselves of opportunities in the import-export trade. The size of country and its economy, less restrictive regulatory practices and high interest rates helped enable the maximisation of profits with a reduced element of risk.

The regulated entry of foreign banks: The RBI Act 1934 and the Banking Regulation Act 1949 were two key regulatory instruments for governing the Indian banking sector. The RBI Act empowered it to exercise control and regulate the banks, non-banking financial institutions and other financial institutions. For regulating the banking sector, RBI issued master circulars on a yearly basis to incorporate changes in policy, supervision and regulation of the banking sector. All banks, irrespective of being Indian or foreign, were required to obtain a licence for commencing business in India. For the entry of foreign banks in India a capital requirement was fixed at US \$70 million for wholly owned subsidiaries and US \$25 million for branches. The key factors taken into consideration by RBI for the issue of a licence were: the business plan of the foreign bank, the reciprocity offered to Indian banks in the host country, India's economic and political relations with the country in which the bank was incorporated, the history of the foreign bank in India and globally and the international ranking of bank.

Liaison offices of foreign banks: Foreign banks were also allowed to set up a presence in India through opening liaison offices. Generally foreign banks in the first instance set up a liaison office to get to know the economic environment of the country, explore business opportunities and to understand the systems and procedures governing the operations of banks. Liaison offices were not allowed to engage in the banking business or to

FOREIGN FINANCIAL INSTITUTIONS & NATIONAL FINANCIAL SYSTEMS

S.No	Name of Foreign Bank	Country of Incorporation	Centre	Date of opening
1.	Commonwealth Bank	Australia	Bangalore	7 July 2005
2.	Raiffeisen Zentral Bank Osterreich AG	Austria	Mumbai	1 November 1992
3.	Fortis Bank	Belgium	Mumbai	6 October 1987
4.	KBC Bank N.V	Belgium	Mumbai	1 February 2003
5.	Emirates Bank International	UAE	Mumbai	16 June 2000
6.	Credit Industriel et Commercial	France	New Delhi	1 April 1997
7.	Natixis	France	Mumbai	4 January 1999
8.	Bayerische Hypo-und Vereinsbank	Germany	Mumbai	12 July 1995
9.	DZ Bank AG Deutsche Zentral-Genossenschafts Bank	Germany	Mumbai	22 February 1996
10.	Landesbank Baden- Wurttemberg	Germany	Mumbai	1 November 1999
11.	Dresdner Bank	Germany	Mumbai	6 September 2002
12.	Commerzbank	Germany	Mumbai	23 December 2002
13.	Banc Intesa Banca Commerciale	Italy	Mumbai	1 November 1988
14.	Sanpaolo IMI Bank	Italy	Mumbai	20 January 1991
15.	Uni Credito Italiano	Italy	Mumbai	1 August 1998
16.	Banca Popolare Di Verona Enovara	Italy	Mumbai	18th June 2001
17.	Everest Bank Ltd.	Nepal	New Delhi	24 March 2004
18.	Caixa Geral de Depositos	Portugal	Mumbai Goa	8 November 1999
19.	Vnesheconombank	Russia	New Delhi	1 March 1983
20.	VTB India	Russia	New Delhi	May 2005
21.	Banco de Sabadell SA	Spain	New Delhi	2nd August 2004
22.	Hatton National Bank	Sri Lanka	Chennai	1 January 1999
23.	UBS AG	Switzerland	Mumbai	24 November 1994
24.	Bank of New York	USA	Mumbai	27 October 1983
25.	Wachovia Bank N.A	USA	Mumbai	1 November 1996

Source: Statistical table of Reserve Bank of India

trade directly or indirectly. In addition, they were prohibited from earning revenues in India and had to meet their expenses from the head office. The approval of RBI was requested for establishing liaison offices. Liaison offices played a limited role in collecting information about possible opportunities in the sphere of banking and providing information about the parent bank and its products to Indian investors. From 1987 to 2005, 25 foreign banks opened their liaison offices in India and, interestingly, 68 per cent of these offices were located in Mumbai. Germany opened five liaison offices, followed by Italy (four), Russia (three), while Belgium and the USA each had two (see Table 3).

Areas of operation of foreign banks: From the late nineteenth century to the middle of twentieth century, the operations of foreign banks were confined to financing foreign trade, lending and deposits, dealings in foreign exchange, etc. But after the liberalisation of the economy foreign banks extended their area of operations to include foreign exchange trading, non-resident Indian banking accounts, investment banking, project financing, corporate finance, trade finance, derivatives, retail banking, credit cards and ATMs. Key players in these areas of operation were Citibank, Standard Chartered Bank, Hong Kong and Shanghai Banking Corporation, Deutsche Bank, BNP Paribas and ABN AMRO. They had a network of 205 branches out of 258 foreign bank branches in the country.

Risk factors in operation: The strong performance of the banking sector in the pre-liberalisation and post liberalisation period and the future growth potential succeeded in attracting many new entrants to start business in India. Historically, British and American banks always had a strong presence in India. But due to RBI's policy of diversification new players from Europe and Asia also started business in the country. As a result of this, competition in the banking sector became intense.

Evaluation of the Operations of Foreign Banks in India

RBI and the government of India were initially very cautious in allowing foreign banks unrestricted permission to establish foreign banks in India as Indian banks were in the infant stage of growth and the unmatched competition would have destroyed them. India followed a restrictive and cautious policy towards the establishment of foreign banks initially. Liberalisation eventually opened doors for them. India's approach towards liberalisation was appreciated by the International Monetary Fund and the World Bank and emerging market economies were advised to follow it as a prototype. Until September 2006, 29 banks (see Table 4) with 258 branches accounted for 0.36 per cent of the total branch network even as they had a share of 8.53 per cent of banking assets.

Help in raising foreign exchange: Foreign banks helped Indian corporations and industries to raise foreign exchange and capital especially when the country was passing through the foreign exchange crisis in the early 1990s. In addition, these banks not only brought financial resources but also a high degree of technical knowledge in operational activities. Foreign banks also played an important role in the Indian economy by financing the export and import trade. The profits of foreign banks in India jumped from Rs. 7.57 billion in 1995–96 to Rs. 22.50 billion after a decade, showing an impressive increase of 200 per cent. There was no doubt that Indian banks were facing stiff competition from foreign banks and their profits were adversely affected.

The introduction of new technology in banking: High operating costs of the Indian banking system had been a cause of concern for policy makers as it brought stickiness in lending rates through their spreads. Foreign banks in India brought along with them a highly computerised banking technology which placed them a cut above domestic banks in marketing banking products and services based on information communication technology. Initially the customer-oriented approach and innovative products

Table 4 – List of foreign banks operating in India (as at the end of September 2006)			
Serial No.	Name of foreign bank	Country of incorporation	No. of branches
1	ABN AMRO Bank N.V.	Netherlands	24
2.	Abu Dhabi Commercial Bank Ltd.	UAE	2
3.	Arab Bangladesh Bank Ltd.	Bangladesh	1
4.	American Express Bank Ltd.	USA	7
5.	Antwerp Diamond Bank N.V.	Belgium	1
6.	Bank of Indonesia	Indonesia	1
7.	Bank of America	USA	5
8.	Bank of Bahrain and Kuwait BSC	Bahrain	2
9.	Bank of Nova Scotia	Canada	5
10	Bank of Tokyo-Mitsubishi UFJ	Japan	3
11.	BNP Paribas	France	8
12.	Bank of Ceylon	Sri Lanka	1
13.	Barclays Bank Plc	UK	1
14.	Calyon Bank	France	5
15.	Citibank NA	USA	39
16.	Shinhan Bank	South Korea	1
17.	China Trust Commercial Bank	Taiwan	1
18.	Deutsche Bank	Germany	8
19.	DBS Bank Ltd.	Singapore	2
20.	HSBC Ltd.	Hong Kong	45
21.	JP Morgan Chase Bank Ltd.	USA	1
22	Krug Thai Bank Public Company Ltd.	Thailand	1
23.	Mizuho Corporate Bank Ltd.	Japan	2
24.	Mashreq Bank PSC	UAE	2
25.	Oman International Bank	Sultanate of Oman	2
26.	Standard Chartered Bank	UK	81
27.	Sonali Bank	Bangladesh	2
28.	Societe Generale	France	2
29.	State Bank of Mauritius	Mauritius	3
		Total	258

Source: Report on Trend and Progress of Banking in India 2005-06, p. 101.

gave foreign banks a competitive edge over domestic banks. But with the development of information communication technology in India and its adoption by Indian banks, the technology gap was considerably narrowed down and domestic banks also attained higher levels of efficiency. With the passage of time and by adopting technological changes the cost of operations was brought down, while increased competition in the market compelled all banks to align their cost structure close to the best practices in banking.

Financial reforms and liberal policy towards foreign banks: The liberal policy for the entry of foreign banks in India was expected to raise the bar of efficiency, productivity and to introduce innovative practices in management and technology. The entry of foreign banks also led to intense competition in the banking sector in both credit and deposit markets. In the 1990s financial reforms and a liberalised policy towards foreign banks was conducive to their growth and paved the way for their expansion in India. The regulatory regime followed by RBI in respect of foreign banks was non-discriminatory and liberal by global standards. Prudential norms applicable to foreign banks or capital adequacy, income recognition and asset classification were, by and large, the same as for the Indian banks. In fact, some Indian banks contend that a certain amount of positive discrimination existed in favour of foreign banks by way of low priority sector lending compared to Indian banks.

The introduction of new financial products in banking: Foreign banks came to India fully equipped with the latest technology and a new cocktail of financial services. They increased the diversity of customer and financial services. Domestic banks were compelled to shed their old style of working and to introduce quality services to the customer. The best practices followed by foreign banks in supervision, regulation and customer relations were also introduced by domestic banks.

Foreign banks' expectations for more liberalisation: Foreign banks operating in India were not keen on local incorporation unless RBI treated

them on a par with domestic banks in terms of branch expansion. Not a single foreign bank applied for local incorporation until 2005. Foreign banks were also not very keen to become wholly owned subsidiaries of overseas parents because they feared that RBI would want them to list on local bourses. In addition, conversion into a subsidiary was not beneficial as it did not give them the advantage of opening more branches. This restriction had constrained their growth and was the biggest issue in their day-to-day operations.

Domestic banks were critical of foreign banks on the following counts:

- Foreign banks brought financial resources and foreign exchange but this was accompanied by shocks from the international financial system.
- With the injection of huge financial resources the money market witnessed radical changes.
- Domestic banks were at a disadvantage in competition with foreign banks as they possessed limited financial resources, expertise and technological exposure.
- There was some positive bias in favour of foreign banks as the priority sector lending of domestic banks was fixed at 40 per cent, while for foreign banks it was 32 per cent. This included lending for foreign trade. Foreign banks were shy in lending to the agriculture sector, which they regarded as risky.
- Foreign banks were engaged in niche banking with a concentration in major towns with no exposure to rural and semi-urban areas. They took the best credits and left the worst for domestic banks, making them more prone to risk-lending.
- Foreign banks encouraged lending in favourable economic conditions but in difficult times, they provided less.

Conclusion

The initial suspicion, opposition and restrictive approach towards foreign banks has, to a large extent, subsided as over the years domestic banks have gained in experience and become technologically savvy. Domestic banks have also become strong and stable and have introduced innovative practices to remain in competition with foreign banks. This experience, interaction and competition has been mutually beneficial to foreign and domestic banks, resulting in assimilation and diffusion of sound banking practices and making the Indian banking system healthy, transparent, financially viable and integrated in the international financial system.

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Reasons of Cross-Border Activities of
Financial Institutions and their Influence
on National Banking Systems



REASONS FOR FINANCIAL INSTITUTIONS TO CROSS BORDERS: DRAWING ON POLISH EXPERIENCE

WITOLD KOZIŃSKI

Abstract

The paper tries to identify the main reasons underlying foreign banks' entry into Poland during the transition period, comparing them to those presented in the literature. Most determinants most often mentioned in the literature are also present in the Polish case, but in different stages of domestic banking development. The number of foreign financial institutions and their economic role evolved with the evolution of the domestic market, and with expanding economic liberalisation. The major motive behind foreign banks' entry seems to have been the desire to participate in the growing domestic financial market. Foreign banks also played a crucial role in the privatisation of domestic banks and their subsequent modernisation as well as in making the market competitive. They improved the efficiency of the whole banking sector and made good quality banking services available to the general public, thus greatly contributing to the development of financial intermediation in the host country. They also added to economic growth using parent banks' access to funds in international financial markets and channeling them to the host country. The presence of foreign banks was very helpful in preserving financial stability in international financial markets during the turbulent period.

I. Potential (Theoretical) Motives of the Entry of Foreign Banks into the Polish Market

One of the important characteristics of contemporary economic life is the global presence of financial institutions. Many banks are operating internationally; they are present and active in both developed countries and emerging economies. The major question is what are the reasons for cross-border banking activities?

The main determinants of cross-border banking identified in the literature are, as can be expected: countries' creditworthiness, the quality of the institutional environment and growth opportunities. Furthermore, there appears to be a regional or vicinity bias in cross-border flows and banking. But it does not explain the entry of foreign banks into countries, which are not well developed, with poor quality of institutions and infrastructure.

Banks' aspirations in entering a foreign market have traditionally been classified into four main areas: 1) servicing exporters from the home country; 2) servicing foreign subsidiaries of home country clients (including global companies); 3) participating in the host country's capital/financial markets; and 4) participating in the host country's banking system.¹

1. A frequent motive, but not the only and primary one, for establishing banking offices abroad has been to provide banking services to home country clients. The range of banking services typically offered includes the provision of information about the general and economic conditions for doing business in a particular foreign country and the collection of receivables for home country exporters. The logic of this behavior is to preserve existing banking relationships in the home country.

¹ J.G. Blandon, *Cross-Border Banking in Europe: An Empirical Investigation* (Universitat Pompeu Fabra Barcelona 2005).

2. Closely related to the first motive of cross-border banking movements is banks' willingness to follow their clients' multinational expansion. Information asymmetries between local banks and client's financial needs constitute a main advantage for the foreign bank. Empirical research as well everyday observations support a follow-the-client behaviour in the banking sector.
3. Banks establish facilities abroad with the aim of participating in the host country's capital / financial markets. Hence, frequently, through overseas offices banks transfer internationally savings originated in the home country. But when the market has not already been developed, that motive seems less convincing.
4. Banks enter foreign countries to carry out the typical commercial banking activity of lending and accepting deposits, thus expanding their growth opportunities outside the original market. Participating in the host country banking system is therefore a natural motivation for establishing overseas offices, when the domestic market is saturated with banking services and a recipient country offers attractive growth potential.

When we analyse the behaviour of foreign banks in Poland since 1990, we may observe that all the above-mentioned motives and reasons played a role. We also saw that most foreign banks that entered the Polish market were mostly large, internationally active institutions. A few different phases or stages of banks' entry may be defined in that respect.

There are multiple reasons to expect that large banks are more suitable to expand abroad. In the first place, multinational companies, which are also more inclined to expand to other countries, are expected to be customers of larger banks and, therefore, it is more likely that these banks will be attracted to new locations, thus offering some services abroad. Second,

banks with a large home-market share might have stronger incentives than other banks to search for risk diversification and expansion opportunities abroad. Finally, increasing returns to scale in some of the banking services that are characteristic of international banking, such as portfolio management and investment banking, favour large banks. These results are consistent with the hypothesis that foreign banks enter specific areas where they have a comparative advantage, which may put pressure on the domestic (host country) banks already focused on that type of lending.

II. Phases of Domestic Banking Market Development and the Changing Role of Foreign Banks

Unstable Macroeconomic Conditions and Liberal Licensing Policy

Poland in the first stage of transition from command to market economy might be briefly characterised as a country with highly unstable macroeconomic conditions, persistent and high inflation, and a poor legal framework – all of which created an extremely unfriendly environment for new economic activity, including banking.

It is therefore hard to explain the reasons for foreign banks' entry in the first phase of economic transition with so many deficiencies in the host country. These include: a poor legal framework and inadequate law enforcement capacities; an inefficient judicial system; poor creditors' rights which were symptomatic of economic, social and political uncertainties of the early nineties; combined with growing unemployment and companies with deteriorating financial positions.

Maybe there were other reasons, quoted in the academic studies on foreign institution and their cross-border activities, which can better explicate why some foreign banks moved into Poland as early as the period

of 1990–1992. Those few foreign banks – pioneers, which accepted the uncertainties and hazards, were: Raiffeisen Bank, Citibank and ING – then called Nationale Nederlanden. These banks focused on corporate banking and trade finance, and provided modern and competitive services to the most promising corporate customers. In a short time they became highly profitable and much bigger, but their market share remained low.²

In related literature we can find the hypothesis that, when the domestic financial markets are less developed, foreign banks are interested in only serving parts of the demand for financial services, such as export financing, financial leasing, etc. They are merely interested in serving some specific groups of clients, such as foreign-owned multinationals and large export-oriented domestic enterprises. The observation of the behaviour of foreign banks active in the Polish market at that time confirms this supposition. Other financial services and services to other groups of clients were seen as less desirable, perhaps due to higher risks, and high levels of information and transaction costs. Consequently, domestic banks dominated in providing financial services such as consumer and housing credit, credit to small and medium size enterprises, etc. In markets for these services competitive pressure on domestic banks due to the presence of foreign banks presence was low. Subsequently, domestic banks were able to pass on increased investment costs – due to foreign banks' competitive pressure – on to their clients in these markets. A low market share of foreign banks and their concentration in just a few market segments allowed domestic banks to enjoy high profit margins in an oligopolistic market.

2 After four years of operations in Poland the financial performance of foreign banks was very positive: in 1995 Citibank achieved a ROA of 6.2 % and a ROE of 54.6 % and Raiffeisen Bank in Poland – ROA of 1.6 % and ROE of 28.7 % (sector average ROA 2.0 % and ROE 44.9 %). Most striking was the amount of profit per employee in foreign banks – in Citibank PLN 300,000 and in Raiffeisen Bank PLN 50,000 with a banking industry average of PLN 30,000.

The Phase of Banks Restructuring and Limited Access of New Banks on the Market: 1992–1995

The liberal licensing policy of the first years of economic transformation in Poland (1990–1991) resulted in the creation of numerous poorly managed and under-capitalised banks. Also, banks controlled by the state treasury were short of capital and overburdened with nonperforming loans. Many of those loans were inherited from the command economy or were a consequence of the close relations of banks with state companies that were maintained despite the major systemic change. Thus, there was an imperative for banks to restructure, combined with efforts to strengthen supervisory capacities and skills with the corresponding improvement of the legal framework. Eventually, the liberal licensing policy was discontinued and only a few new banks were granted licenses in the subsequent period of 1992–1995. The chief reason was to effectively restructure and consolidate the banking sector before further liberalisation could take place.

The effective restructuring of banks took place in the period of 1993–1995; the banks controlled by the state treasury received a capital injection and were persuaded to restructure their loan portfolios. A lot of banks, mostly private, which were in poor condition, undertook the rehabilitation programmes overseen by the banking supervision authority. Insolvent private banks were either merged with healthy banks or liquidated. The number of active banks was successively reduced – from 81 in 1995 to 73 in 2000 and 68 in 2011.

Phase of Liberalisation³

After the consolidation and restructuring of domestic banks as well as an evident improvement in the legal framework, and creation of more stable macroeconomic conditions, there was a basis for moderating the existing restrictions on the entry of foreign financial institutions. Financial services liberalisation requires some degree of capital account liberalisation as foreign banks need daily and unrestricted access to international financial markets to operate effectively. Domestic deregulation and capital account liberalisation also involve the removal of lending restrictions, which needs to be done in a consistent fashion.⁴ Many countries have encouraged inflows of capital by removing restrictions and controls on capital outflows, deregulating domestic financial markets, liberalising restrictions on foreign direct investment, and improving their economic environment and prospects through the introduction of market-oriented reforms.⁵

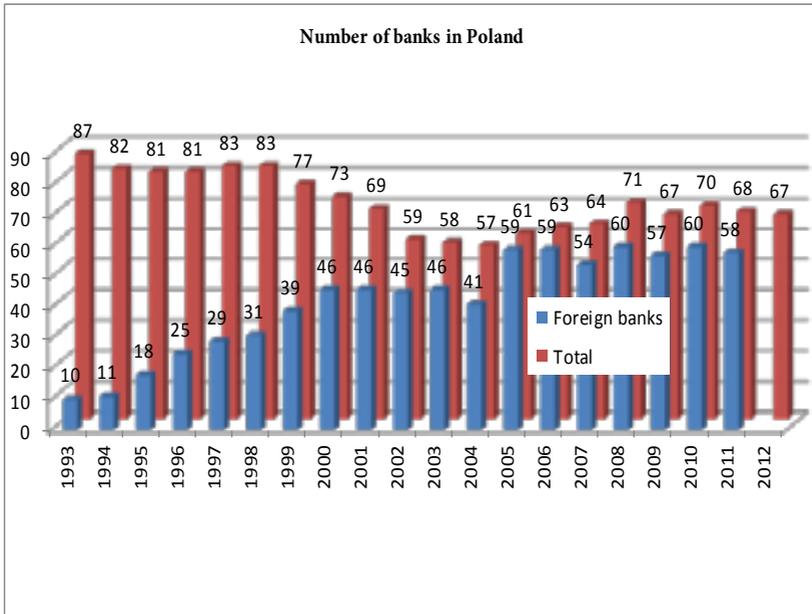
The financial liberalisation that accelerated in Poland in 1995 was driven by several factors. Firstly, one can mention the stable macroeconomic environment with gradually declining inflation, the application for membership in the OECD and the prospective entry into the EU. All these developments were conducive to a high inflow of foreign direct investments. As a result, many multinational firms established their subsidiaries or branches in Poland.

With the liberalisation we can also observe the entry of new banks in Poland, mainly from EU countries. Many foreign banks were granted a license after 1995 and eventually, the assets of foreign banks grew substantially, from 13.7 per cent in 1996 to 69.5 per cent of total assets of the banking sector in 2000. Foreign banks were very active in the privatisation

3 It also involved the received credit rating.

4 S. Claessens, 'Competitive Implications of Cross-Border Banking', *World Bank Research Working Paper* 3854 (Washington 2006).

5 P. Agenor, *Benefits and Costs of International Financial Integration: Theory and Facts* (Oxford 2003).



process. They invested extensively in banks listed on the Warsaw Stock Exchange, gradually taking a dominant stake (in banks such as BRE, Kredyt Bank, BIG as well as Bank Slaski, WBK). The participation in the privatisation process that gained momentum in 1999 was the fastest and the most effective way of entry. Foreign banks, with the acquisition of existing domestic banks, gained direct access to the market (with the client base, the network and a brand name).

III. The Consequences of Foreign Banks' Presence, their Macroeconomic Impact and Role in Protecting the Country's Financial Stability

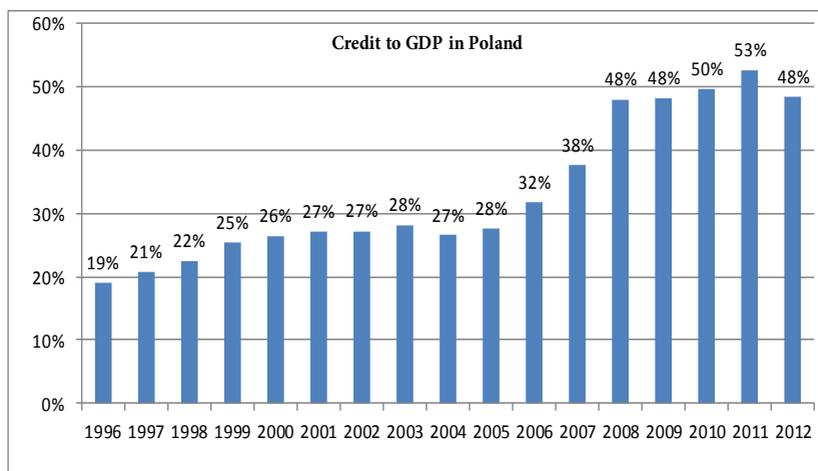
The Development of Banking Services and the Modernisation of Banks

A common argument in favour of financial openness is that it may increase the depth and breadth of domestic financial markets and lead to an increase in the degree of efficiency of the financial intermediation process, by lowering costs and 'excessive' profits associated with monopolistic or cartelised markets. In turn, improved efficiency may lead to lower markup rates in banking, a lower cost of investment and, finally, to higher growth rates.

The observation of developments in the Polish banking market confirms that, in the long term, the presence of foreign banks contributed to the fast growth of financial intermediation as measured by the ratio of private credit to GDP.

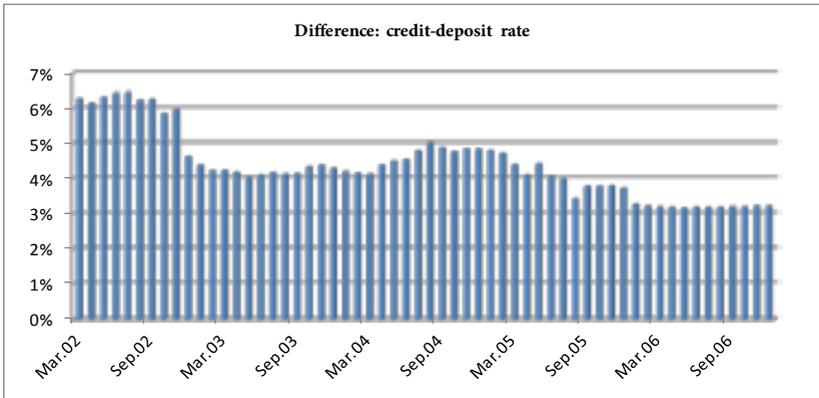
The result of banks' privatisation, in which mostly foreign banks participated, was fast modernisation of the banking sector. It led to the development of new banking products and expansions into new market segments and, eventually, to the dissemination and wide use of banking services by households and firms. This process also induced an improvement in the quality and availability of financial services in the domestic market, by increasing the degree of bank competition and enabling the application of more sophisticated banking techniques and technology (such as more advanced risk management systems), which increased efficiency by reducing the cost of acquiring and processing information on potential borrowers.⁶

⁶ That process was also accelerated by the development of the financial sector infrastructure, for which the creation of the Credit Information Bureau was of critical importance.



A foreign bank presence leads to positive spill-over effects. Usually, foreign banks introduce new financial services. The introduction of these services inspires domestic banks to also develop such services, improving the efficiency of financial intermediation in the domestic financial system. Moreover, foreign banks may also introduce modern and more efficient banking techniques that are new to domestic banks. These modern banking techniques can be easily imitated.

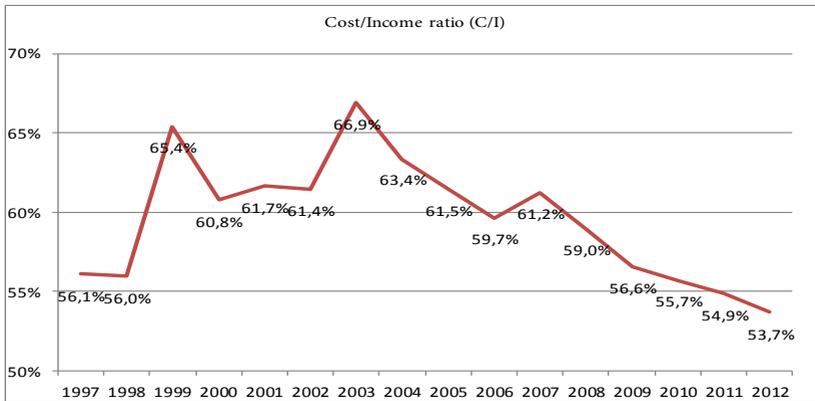
While observing that process in the longer term, one may notice that the presence of foreign banks stimulates domestic banks to reduce costs and increase the efficiency of existing financial services through competition. In the presence of foreign banks domestic banks are pressured to improve the quality of their services in order to retain their market shares. Analysing the financial results of the banking sector in Poland in the nineties and early two thousand, we can see that increased competition led to lower interest rates (by narrowing the interest rate differential as measured by the difference between the lending and term deposit rate) and profit margins.



But on the other hand, a foreign bank presence usually leads to (temporarily) higher costs for domestic banks. The reason is that domestic banks need to incur costs to keep up with the large, highly reputed, international banks. Thus, for instance, they may need to spend money to implement new services, improve the quality of existing services and operations (and integrated IT systems as it was the case in Poland), and implement new bank management techniques. They may need to invest to upgrade their staff, at least in the short run. In the longer run, the costs of investments focused on implementing new services, upgrading the quality of existing activities, improving management, and the education of staff contribute to domestic banks' overall cost reductions. This process was observed since 2000. The efficiency of most banks, as measured by the 'cost to income ratio' improved impressively, dropping from 65 per cent in 1999 to close to 50 per cent on average in 2012.

Additionally, foreign banks influenced the improvement in the management of domestic banks, particularly when foreign banks directly participated in the management of domestic banks in the case of frequent takeovers, which we observed in many cases in Poland.

FOREIGN FINANCIAL INSTITUTIONS & NATIONAL FINANCIAL SYSTEMS



Foreign banks also had an essential impact on the quality of human capital in the domestic banking system in a number of ways. When foreign banks import high-skilled bank managers to work in their foreign branches, local employees/bankers may learn from the practices of these foreign bank managers. Foreign banks also invest in the training of local employees. Increasing the quality of available human capital for the domestic banking system contributed to more efficient domestic banking practices, which may help to reduce costs.⁷ On the other hand, it seemed that a foreign bank presence also contributed to improvements in bank regulation and supervision, since these banks demanded comparable systems of regulation and supervision from regulatory authorities in the recipient country.⁸

The presence of foreign banks greatly contributed to the reduction of governmental influence in the domestic financial sector, which also reduced the importance of financial control policies, such as interest rate restrictions, directed credit policies, etc., that were in use at the beginning

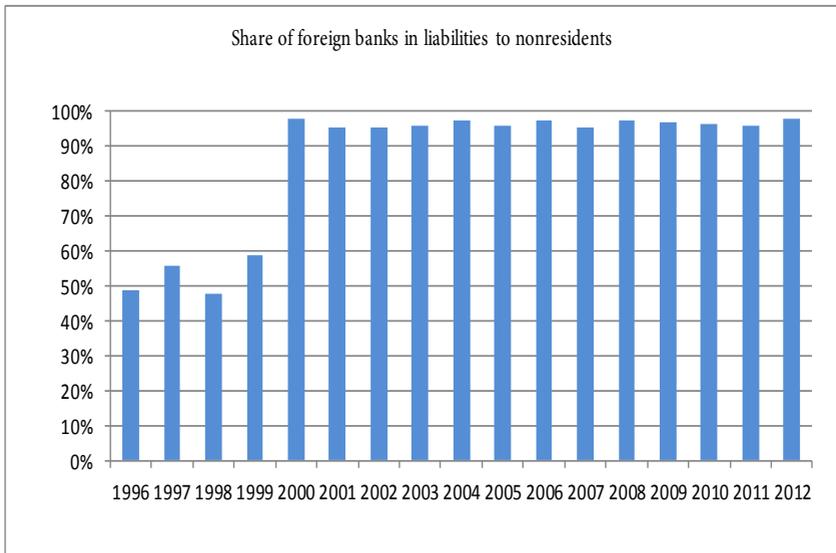
7 N. Hermes, R. Lensink, 'Foreign Bank Presence, Domestic Bank Performance and Financial Development', *The Journal of Development Studies* (2004).

8 Most foreign parent banks were from other EU countries; harmonisation of the legal framework, resulting from Polish accession to the EU greatly improved the environment in which they operated.

of the economic transformation. By the mid-nineties they had been eliminated.

Macroeconomic Consequences

Most importantly, the large presence of foreign banks enhances a country's access to international capital, mainly indirectly through parent banks.⁹ The inflow of funds did not stop after the outbreak of the global financial crisis. In this way the presence of foreign banks contributed to the stability of the domestic financial system and reduced the natural volatility in capital flows. Foreign banks in Poland relied on foreign funding on a much larger scale than domestic banks. Since 2000 almost all imported funds from abroad were used by banks with foreign owners. That fact might have



⁹ They usually enjoyed higher credit ratings than their subsidiaries in Poland and consequently, a lower cost of external funding.

provoked instability, if foreign parents were unable to maintain provision of new funding to their Polish subsidiaries.

Foreign bank penetration, bringing both benefits and concerns, may affect the economic growth of host countries both directly and indirectly. Direct benefits arise when foreign banks bring additional capital into the host countries, seek profitable uses of these funds, and exert effective corporate control for productive use of loanable funds. By doing this, foreign banks may directly boost the efficiency of resource allocation, leading to an accelerated economic growth in the host country. At the same time, foreign bank penetration could indirectly achieve a better resource allocation, by intensifying competition in the banking market and stimulating domestic banks to improve their operational efficiency in financial services.¹⁰

An assessment of the allocation of credit among domestic and foreign banks has shown that foreign institutions were more inclined to extend credit to modern and technologically advanced sectors of the economy, while their domestic competitors had more customers (borrowers) from traditional economic sectors.

Potential Negative Consequences

Although the inflows of capital may increase domestic investment, their impact on long-run growth depends on the direction of credit distribution. It may be limited, if such inflows are used to finance speculative or low-quality domestic investments, such as excessive investments in the real estate sector. This phenomenon actually occurred in Poland, where the banks with foreign participation competed in the mortgage housing market by offering loans denominated mostly in foreign currencies. That

¹⁰ Ji Wu and al., 'Foreign Banks Penetration, Resource Allocation and Economic Growth: Evidence from Emerging Economies' (University of Munich 2009).

policy, after several years, led to a credit boom and a strong increase in real estate prices.¹¹ Fortunately, it did not turn into a major problem, due to supervisory watchfulness and an appropriate response of banks,¹² which modified their approach to mortgage lending in foreign currencies. Also, the supply factors played a positive role in stabilising real estate prices. As a consequence, we did not observe major negative effects relating to the quality of mortgage loans in banks' portfolios.

In general, although it was not the case in Poland, low-productivity investments in the non-tradable sector may reduce the economy's capacity over time to export and eventually lead to growing external imbalances. The large capital inflows induced by financial openness can have undesirable macroeconomic effects, including rapid monetary expansion, inflationary pressures, and real exchange rate appreciation as well as widening current account deficits.

The other unwelcome consequence may be that foreign banks may ration credit to small firms (which tend to operate in the non-tradable sector) to a larger extent than domestic banks, and concentrate instead on larger and stronger ones (which are often involved in the production of tradable goods). In this case, the riskier and less cost effective financing of SMEs is left to domestic banks.

Conclusions

The dominant motive behind foreign banks' entry into Poland seems to be their desire to participate in the growing financial market. That market has expanded significantly since the mid-nineties, after the first years of the

11 That phenomenon was also observed on a much wider scale in some new EU member states, where lending booms, funded mostly by the inflow of capital from abroad vastly contributed to the extension of macroeconomic imbalances, notably widening current account deficits.

12 The Polish Financial Supervision Authority issued the recommendation inducing banks to impose more restrictive lending policies.

transformation and stabilisation of macroeconomic conditions. Foreign banks exploited the emerging opportunities, utilising their experience and expertise from domestic markets. Their growth was primarily based on the host country's collected funds, but supplemented with imported savings from abroad. They used their parent bank's access to international financial markets. The presence of foreign banks might be assessed as beneficial both from the point of view of the recipient country – gaining broader access to international sources of capital and the development of financial intermediation; and from the perspective of parent banks, which gained access to growing markets and diversified their activities, achieving better returns than in overbanked domestic markets.

HISTORY COMPARED: AUSTRIAN BANKS' INTERNATIONALISATION DURING THE MONARCHY AND AFTER THE FALL OF THE IRON CURTAIN

PETER R. HAISS & REINHARD SCHWAIGER

Abstract

We analyse the role of Austrian banks during the Austrian-Hungarian Dual Monarchy and compare it with the current role after the fall of the Iron Curtain. We discuss the historic impact on growth and development of banks in the Central European region and on the Balkan Peninsula and provide insight into Vienna's role as a financial centre. We assess determinants for the internationalisation process during the time of the monarchy and in the post-communist period. We find that, historically, Austrian banks pursued a 'follow the client' strategy, mainly driven by the establishment of industrial firms along the newly created railroad network, while the present strategies are more directed towards the retail market and therefore pro-active.

I. Introduction

Finance, financial and institutional innovation and banks' cross-border activities, at all times, were and are strongly interwoven with political and economic development. Austria was a great power during the times of the monarchy, not only in terms of geographical size, but also in economic

terms, and banks geographical reach expanded strongly at the time. Nowadays, Austrian banks, in particular, play a major role across Central, Eastern and South Eastern (CESEE) Europe once again, and ties to the East, which originated in a former era, are often referred to. The historic and current importance of the region and the massive expansion of banks serve as motivation for this paper.

The Austrian Empire was no perfectly homogeneous economic area. Rather, it was divided into several, at times quite different markets.¹ We thus argue that particularly the Viennese banks' geographic expansion during the monarchy bears many features of full-fledged internationalisation. Kaltenbeck and Schubert analyse the role played by Austrian banks in Central and Eastern Europe (CEE) in two very different periods of the twentieth century, namely after the dissolution of the Austro-Hungarian empire in 1918 and after the fall of the Iron Curtain 80 years later.² We take a different angle and provide an insight into the role of Austrian banks in the Dual Monarchy in the form of a historical review and gain an overall picture within the time frame of the monarchy and after the collapse of communism until now. We purposely leave out the time period in-between, which was characterised by a rather strong regional contraction. This important period is covered by, among others, Schubert (2008) and Stiefel (2008).³ The main idea is to assess the determinants and factors of internationalisation in the time of the monarchy and after the fall of the Iron Curtain. We particularly emphasise the transnational features

1 D. Stiefel, 'The Bankers View: Austria's Economic and Political Development and the Role of the Banks', in: G. Feldman and P. Hertner (eds.), *Finance and Modernization* (Farnham 2008), pp. 3–28.

2 G. Kaltenbeck and A. Schubert, 'Size Matters – Does it? – Two very Different Episodes of Eastward Expansion of Austrian Banks', Paper presented at the European Association for Banking and Financial History e.V. (EABH) Conference 2009 (Nikosia 2009).

3 A. Schubert, 'Torn between Monetary and Financial Stability: An Analysis of Selected Episodes of Austrian Central Banking History', in: G. Feldman and P. Hertner (eds.), *Finance and Modernization* (Farnham 2008), 51–74; Stiefel, 'The Bankers View', pp. 3–28.

of financial development as advocated by Flandreau.⁴ The theoretical framework is set by Williams' (1997) internationalisation theory with a focus on the 'Follow Your Customer' (FYC) strategy.⁵ In addition, 'push and pull' factors related to the mechanism of Austrian banks' internationalisation are taken into account.⁶

Furthermore, the model of internationalisation developed by Johanson and Vahlne (1993 & 2009) in the 1970s should provide insight into the process of firms' international expansion.⁷ Here, the focus is put on the psychic distance chain which stresses more subjective characteristics of internationalisation as is the case with path dependency. The psychic distance is also covered by Wurm's (2006) explanations of Austria's advantages in the Central Eastern and South Eastern Europe (CESEE) region over banks from other countries. Economic geography plays an important role when analysing the branch networks within the two periods.⁸

The remainder of the paper is structured as follows. The first part will explain the most important theoretical foundations. The second part focuses on the emerging industrialisation and the profound changes in the economic and social structure of the Austrian empire. Emphasis is put on the ascent of railroading as a leading sector and industrial policy. The third part will focus on the post Cold War situation in Central European,

4 M. Flandreau, 'Banking Networks and European Financial Architecture on the Eve of the Industrial Revolution', Paper presented at the European Association for Banking and Financial History (EABH) e.V. Conference 2008 (Frankfurt a.M. 2008).

5 B. Williams, 'Positive Theories of Multinational Banking: Eclectic Theory versus Internalisation Theory', *Journal of Economic Surveys*, vol. 11, issue 1 (1997), pp. 71–100.

6 D. Focarelli and A. F. Pozzolo, 'Where Do Banks Expand Abroad? An Empirical Analysis', *The Journal of Business*, vol. 78, issue 6 (2005), pp. 2435–64; R. Haselmann, 'Strategies of Foreign Banks in Transition Economies', *Emerging Markets Review*, vol. 7, issue 4 (1997), pp. 283–99.

7 J. Johanson and J.-E. Vahlne, 'The Mechanism of Internationalisation', *International Marketing Review*, vol. 7, issue 4, (1993), pp. 11–24; J. Johanson and J.-E. Vahlne, 'The Uppsala Internationalization Process Model Revisited: From Liability of Foreignness to Liability of Outsidership', *Journal of International Business Studies*, vol. 40 (2009), pp. 1411–31.

8 S. Wurm, 'The Development of Austrian Financial Institutions in Central, Eastern and South-Eastern Europe – Comparative European Economic History Studies', Working Paper no. 31 (University of Applied Sciences bfi Vienna (2006).

Southeast European and Eastern European countries, and the unique opportunities provided for Austrian banks.

While we find similarities in areas covered geographically, we argue that internationalisation patterns differ: during the monarchy internationalisation was rather a commercial/investment banking-driven ‘follow the customer’ approach, and to a certain extent implemented state industrialisation policy. Initially, right after the fall of the Iron Curtain, Austrian banks similarly followed their corporate customers after the opening up of the CESEE region. However, there was no state policy behind the move at this time; going abroad was rather a way of escaping the low margins of the saturated home market.⁹ In addition, Austrian banks quickly changed gears and since then have emphasised market entry via retail branch networks. Different from Swedish banks, for example, who reduced lending in the Baltics, Austrian banks maintained lending during the crisis in their commitment to the region.¹⁰ Knowledge of these patterns and the historic setting are important for market participants, regulators and supervisors in host and home countries of banks in the region.

Strategies of Banks

In the context of banking operations, internationalisation means the process of participation in an existing undertaking or the foundation of a new organisational unit outside the boundaries of the home market. This multinational enterprise is defined by Buckley & Casson (2009) as a firm that owns and controls activities in two or more different countries

9 P. Haiss, ‘Central European Strategies of Austrian Banks’, *Österreichisches Bankarchiv, Zeitschrift für das gesamte Bank- und Börsenwesen*, vol. 39, issue 5 (1991), pp. 327–35; Stiefel, ‘The Bankers View’.

10 R. De Haas, Y. Korniyenko, E. Loukoianova and A. Pivovarsky, ‘Foreign Banks and the Vienna Initiative: Turning Sinners into Saints?’, *IMF Working Paper* No. 12/117 (2012).

or regions.¹¹ During the monarchy and in more recent history, Austrian-Viennese banks have expanded outside the regional boundaries of the home market into host territories characterised by historic ties, different languages, different levels of financial development, larger geographic distances from the headquarters, higher information costs, and higher growth prospects. Further, by crossing state borders characterised by the changing degrees of integration of home and host states over time as well as different levels of economic and institutional development, it seems feasible to compare internationalisation patterns then (during the monarchy) and more recently (after the fall of the Iron Curtain). As a joint measure for internationalisation during both time periods under investigation, we look at the development of branch networks. Besides the volume of foreign assets or loans, this is a typical measure, which we regard as specifically appropriate for our purpose, because establishing foreign networks (branches and subsidiaries) are cost-intensive means of entering markets and thus a certain proof of long-term intentions.¹²

Internationalisation Theory

Trying to explain foreign banks' strategies in transition economies leads to a general question: Why should ownership, i.e. foreign or domestic ownership within the same country or region, of a bank be a determinant of banking strategy? Firstly, an exterior view would suggest other factors like a bank's interior health, lending objections or funding patterns to be the most important determinants and therefore the more important roles for defining strategies.¹³ However, regulatory barriers have to be taken into

11 P.J. Buckley and M.C. Casson, 'The Internalisation Theory of the Multinational Enterprise: A review of the progress of a research agenda after 30 years', *Journal of International Business Studies*, vol. 40 (2009), p. 1564.

12 See e.g. Haiss, 'Central European Strategies', pp. 327–35.

13 Haselmann, 'Strategies of Foreign Banks'.

account, which may differ from domestic to foreign banks. As a result, both types of institutions have different strategies.¹⁴

Empirical findings on strategies of foreign banks in mature market economies like Germany or the United States allow a clear distinction between foreign and domestic banks: Foreign banks show a strong tendency to specialise in financing enterprises which have the same country of origin, i.e. they follow their customer. Thus, this kind of strategy is referred to by us as 'Follow Your Customer Strategy' (FYC). On the other side, domestic banks tend to focus on relationship lending.¹⁵

Besides the FYC strategy mentioned above other factors have been identified by Haselmann (1997) which act as determinants for banking strategies in foreign countries, namely 'push and pull factors'. A 'push' condition refers to weak economic conditions in the home market and therefore leads to increased activity in a host market. Diminished profit margins or an overall bad economic outlook may serve as a trigger. The counterpart to the 'push' condition, a so-called 'pull' factor, describes an economic environment in a foreign country that is likely to attract foreign banks due to a favourable economic outlook.¹⁶

The form of foreign banking participation in the CEE region differs quite a lot in comparison to foreign banks' behaviour elsewhere. Foreign Banks are strongly integrated and focus mainly on retail banking and wholesale markets. As a result, banks compete with domestic banks and the initial 'follow your customer strategy' is no longer evident. It seems that long term growth is the main motivation and strategy for foreign banks.¹⁷

14 P. Haiss, M. Eller and K. Steiner, 'How Do Foreign Owned Banks Contribute to Economic Development in Transition Economies?', *Osteuropa Wirtschaft*, vol. 50, issue 3-4 (2005), pp. 232-47; Haselmann, 'Strategies of Foreign Banks'.

15 Haselmann, 'Strategies of Foreign Banks'.

16 Haiss, 'Central European Strategies'; Haselmann, 'Strategies of Foreign Banks'.

17 Haiss et al, 'How Do Foreign Owned Banks'; Haselmann, 'Strategies of Foreign Banks'.

Focarelli and Pozzolo (2005) identify three different factors that have a strong impact on banks' internationalisation, namely the degree of integration, institutional characteristics and profit opportunities. The degree of integration between the home country and the host country has a positive effect on the overall probability that a bank will expand in a given country. According to Focarelli and Pozzolo (2005), profit opportunities are likely to be a key factor affecting the pattern of banks' internationalisation process. The importance of a relatively low level of per capita GDP and inflation rate, as well as a larger credit market are important factors in considering the expected growth of the destination country.¹⁸

Williams (1997) elaborates the defensive expansion strategy, a similar approach to the 'follow your customer' approach.¹⁹ Banks respond to their clients' movement abroad. Thus, bank behaviour is due to real sector foreign direct investments (FDI) abroad, because they want to defend their client-bank relationship. It seems logical that a client, whose bank is not present abroad, will have to establish a new bank-client-relationship and therefore it is possible that the original domestic relationship will fall apart. In addition, since a banking relationship consists of information flows, a bank is allowed to assess any new loan proposal at low cost. Lower costs represent a competitive advantage in comparison to possible new competitors.²⁰

According to Johanson and Vahlne (2009) internationalisation frequently starts in foreign markets that are close to the domestic market in terms of psychic distance.²¹ Psychic distance is defined in terms of factors such as closeness in language, culture, and political systems, which disturb the flow of information between the firm and the market. Thus, firms start internationalisation by going to those markets they can most easily

18 Focarelli and Pozzolo, 'Where Do Banks Expand', pp. 2460–1.

19 Williams, 'Positive Theories', pp. 71–100.

20 Williams, 'Positive Theories', p. 76.

21 Johanson and Vahlne, 'The Uppsala Internationalization', p. 1412.

understand.²² According to Ninan & Puck (2010), market entry is strongly determined by market information; a lack of market information is heavily influenced by psychic distance, which prevents firms from entering certain markets.²³

Wurm (2006) and Haiss (1992) state that the cultural closeness between Austria and CESEE countries is one of the reasons for the success of Austrian banks, implying a certain path dependency of foreign investment.²⁴ Moreover, Magri, Mori & Rossi (2004) find evidence that significant cultural distance as well as geographical distance have a negative impact on operations in a foreign country.²⁵ Some Austrian firms already had business relations with neighbouring CEE countries before 1989. Thus market knowledge, contacts and closeness were indeed an advantage for Austrian firms at an early stage.²⁶

II. Historical Review: Austria's Industrial Development During the Franz-Josephian Era

At the end of the eighteenth century, the industrial revolution, which had its origins in Western Europe, had begun to show its effects in various parts

22 Johanson and Vahlne, 'The Uppsala Internationalization', p. 1412; Johanson and Vahlne, 'The Mechanism of Internationalisation', p. 13.

23 S. Ninan and J. Puck, 'The Internationalization of Austrian Firms in Central and Eastern Europe', *Journal for East European Management Studies*, vol. 15, no. 3 (2010), pp. 237–59.

24 P. Haiss, 'The Twin Challenges to Austrian Banking: the Environment and the East', *Long Range Planning*, vol. 25, no. 4 (1992), pp. 47–53; Wurm, 'The Development of Austrian Financial Institutions'.

25 S. Magri, A. Mori and P. Rossi, 'The Entry and the Activity Level of Foreign Banks in Italy: An Analysis of the Determinants', *Journal of Banking & Finance*, vol. 29, issue 5 (2004).

26 A. Schuh and H. Holzmüller, 'Marketing Strategies of Western Consumer Goods Firms in Central and Eastern Europe?' in: H.-J. Stütting, W. Dorow, F. Classen & Blazejewski (eds.), *Change Management in Transition Economies* (New York 2003), pp. 176–88; Stiefel, 'The Bankers View', pp. 3–28.

of the Habsburg monarchy.²⁷ During the reign of Kaiser Franz Joseph I., Austrian emperor from 1848 until his death during the First World War in 1916, the Habsburg monarchy was eventually affected by the industrial revolution. The century of the industrial revolution was a period of growing international capital flows.²⁸ The industrial fraction of national income increased as well as overall welfare in terms of social product per capita. In addition, both the number of employees in industrial domains and the incorporated capital stock were soaring. Modern technologies during these times like the steam engine, spinning machines or the processing of steel and iron led to bigger companies with larger operational facilities as opposed to predominantly ordinary, small-scale trade at this time.²⁹ Based on the growing textile industry as a leading industry other sectors were booming as well. Austria's industrial revolution illustrates a classic case in which the textile industry is soon substituted by the coal, iron and steel industry as a leading industry and economic motor for other connected economic sectors.³⁰ Many important industrial areas in the Danube monarchy were not situated within the borders of the later Austrian Republic but further north in the territories of Bohemia.³¹ For example, the districts in the north of Bohemia and some regions of Silesia and Moravia underwent an early transition to mechanised production and formed the monarchy's industrial core.³² The industrial belt in Bohemia and Silesia accounted for between 20–40 per cent of the total production within one region. Another area with a high concentration of production

27 J. Schiffer, 'The Late Habsburg Monarchy – Economic Spurt or Delayed Modernization?' in: W. Hafner and H. Zimmerman, *Vinzenz Bronzin's Option Pricing Models: Exposition and Appraisal* (Berlin 2009), pp. 307–22; Stiefel, 'The Bankers View', pp. 3–28.

28 N. Sussman and B. Eichgreen, 'The International Monetary System in the (Very) Long Run', *IMF Working Papers* 00/43 (2000).

29 K. Bachinger and H. Matis, 'Österreichs Industrielle Entwicklung', in: A. Brusatti, *Die Habsburgermonarchie 1848–1918*, vol. 1, *Die wirtschaftliche Entwicklung* (Vienna 1973), p. 105.

30 Bachinger and Matis, 'Österreichs industrielle Entwicklung', p. 106.

31 Stiefel, 'The Bankers View'.

32 A. Steidl and E. Stockhammer, 'Coming and Leaving – Internal Mobility in Late Imperial Austria', *Working Paper* No. 107, Vienna University of Economics (Vienna 2007), p. 2.

was the Vienna basin, but it comprised a lower density of 16–25 per cent.³³ The same tendency is shown in the dense concentration of the railway network around these industrial regions and the close dependence of industrial development and railroading. On the eve of the First World War the *Cisleithanian*³⁴ industrial structure illustrated the importance of the *Sudetenland*³⁵ with its 85 per cent of overall coal production, 70 per cent of the chemical industry, 94 per cent of the sugar industry and 75 per cent of the textile industry.³⁶ As far as banking is concerned, the Sudetenland and the Trieste region were the most profitable areas of operation, both being separated after the treaty of Versailles.³⁷

Railroading During the Franz-Josephian Era

Trains and cargo steamships carried wood, coal and agrarian products in large quantities to the manufacturing centres, thus forming the basis of a future common market.³⁸ As the most modern method of transportation at this time the railway had powerful ties to the ongoing industrialisation process. Even more significant is the close connection between banking houses and railroading. First and foremost, railroading presents a capital-intensive field of business and therefore institutions had to raise funds.

33 Bachinger and Matis, 'Österreichs Industrielle Entwicklung', p. 229.

34 *Cisleithania* is the name of the Austrian part of the Austrian-Hungarian Dual Monarchy; derives from the river Leitha which was a border river between Hungary and Austria (Hungarian: *Ciszlajtánia*, Czech: *Předlitavsko*, Polish: *Przedlitawia*, Slovene: *Cislajtanija*, Ukrainian: *Tsysleitàniia*).

35 Sudetenland: German denomination for the northern, southwest and western regions of the Czech Republic which at the time had a large German speaking population (Czech and Slovak: *Sudety*, Polish: *Kraj Sudetów*).

36 P. Eigner, 'Die Habsburgermonarchie im 19. Jahrhundert: Ein Modellfall verzögerter Industrialisierung?', *Beiträge zur historischen Sozialkunde*, vol. 27, no. 3/97 (1997), pp. 112–22.

37 D.F. Good, 'Financial Integration in Late Nineteenth-Century Austria', *The Journal of Economic History*, vol. 37, no. 4 (1977), p. 892.

38 Schiffer, 'The Late Habsburg Monarchy', p. 312.

Secondly, the early days of railroading were characterised by a speculative framework, which attracted different investors.³⁹

The first conventional railroad track for steam trains in the Danube monarchy was built before the revolution of 1848. The years 1867 to 1873 went down in history. The *Gründerzeit*, a period of time in Europe characterised by an economic spurt which lasted until the stock exchange crash in 1873, saw a rapid industrial upswing with an expansion of the rail network by two and a half fold.⁴⁰ The contribution of the railway to overall economic development was bilateral. On the one hand, transportation costs decreased and, on the other hand, close economic ties to other industry sectors (coal, iron, steel, wood, etc.) created additional demand. Around 1850 the Austrian railway sector played a leading role, because almost one fifth of the overall investments in Austria were accounted for by the railway sector.⁴¹ It seems logical that industrial enterprises settled along the new axes of transportation. At peak periods more than 1.000km of newly built track was laid annually.⁴² A comparison of the railway network and the concentration of industrial settlement and branches of banks clearly indicates their mutual dependence. The concentration clearly arises in the Viennese basin and Bohemia, especially the Sudetenland.

Banking During the Franz-Josephian Era

According to Eduard März (1968), Austrian economic history was in large part bank history – a fact that emphasises the importance of banks as a

39 K. Bachinger, 'Das Verkehrswesen', in: A. Brusatti, *Die Habsburgermonarchie 1848–1918*, vol. 1, *Die wirtschaftliche Entwicklung* (Vienna 1973), p. 279.

40 D.F. Good, *Der wirtschaftliche Aufstieg des Habsburgerreiches 1750–1914* (Vienna/Cologne/Graz 1986), p. 146.

41 Good, *Der wirtschaftliche Aufstieg des Habsburgerreiches*, pp. 80, 146.

42 E. März, *Österreichische Industrie und Bankpolitik in der Zeit Franz Josephs I. Am Beispiel d. k.k. priv. Österr. Credit-Anst. f. Handel u. Gewerbe* (Vienna/Frankfurt/Zurich 1968), p. 90.

motor and supporter of economic growth.⁴³ Government, for its part, had a significant influence on banking activities, which aimed at advancing the industrialisation process.⁴⁴ The first steps towards a banking market – in a modern sense – were taken in 1853 with the foundation of the ‘Niederösterreichische Escompte-Gesellschaft’. This bank was set up as a joint stock corporation like many other banks in Europe around 1855 in accordance with the countries level of industrialisation.⁴⁵

In 1855 Anselm von Rothschild, in alliance with Johann Adolf Fürst zu Schwarzenberg, Max Fürstenberg and some other additional members of the ‘high’ aristocracy, were granted the licence for the foundation of the ‘k.k.priv. Österreichischen Credit-Anstalt für Handel und Gewerbe’ following the model of the French *Crédit Mobilier* institute founded by Emile and Isaac Péreire.⁴⁶ The focus was laid on the accumulation of both small and big funds and the subsequent investment in undertakings like the extension of the Austrian railroad track system, where the Credit-Anstalt played a major role.⁴⁷ Sometimes the opening of a bank branch and the entering into service of a newly built railway happened at the same time.⁴⁸ The enormous capital base of 100 million Gulden enabled Creditanstalt to extend its activities beyond the regular business of a merchant bank, such as the granting of long-term loans and the acquisition of industrial companies on a large scale.⁴⁹ Since the establishment of the Austrian-Hungarian Dual Monarchy in 1867, Austrian banks’ operating range stretched across the whole territory with subsidiaries in Hungary,

43 März, *Österreichische Industrie und Bankpolitik*.

44 Stiefel, ‘The Bankers View’.

45 J. Mentschl, ‘Das Österreichische Unternehmertum’, in: A. Brusatti, *Die Habsburgermonarchie 1848–1918*, vol. 1, *Die wirtschaftliche Entwicklung* (Vienna 1973), p. 258.

46 E. März and K. Socher, ‘Währung und Banken in Cisleithanien’, in: A. Brusatti, *Die Habsburgermonarchie 1848–1918*, vol. 1, *Die wirtschaftliche Entwicklung* (Vienna 1973), p. 332.

47 Creditanstalt, *Ein Jahrhundert Creditanstalt-Bankverein* (Vienna 1957), p. 30; März, *Österreichische Industrie und Bankpolitik*, p. 40.

48 März, *Österreichische Industrie und Bankpolitik*, p. 90.

49 Schiffer, ‘The Late Habsburg Monarchy’, p. 312.

Czechoslovakia and Upper Italy.⁵⁰ Between 1866 and 1873 46 stock banks were founded. In total 72 joint stock banks existed in 1873 in Vienna. However, sooner or later the bubble had to burst: Only 28 banks survived the stock market crash in 1874.⁵¹ In 1879 only 14 were still in business.⁵²

By European standards, the banks of Austria-Hungary were rather unique, creating what Hilferding (1910) referred to as ‘*Finanzkapitalismus*’.⁵³ They participated actively in the transformation of large firms into joint stock companies and provided a large number of the loans demanded by the big groups. The Viennese industrial banks had in a certain sense a focus on the East from the very beginning. The most important branches were situated in regions which became Italian, Czech or Hungarian territory after the fall of the monarchy. In the same way, the most important industries were located outside of Austria after 1918.⁵⁴

The economic leap forward was the result of a mixture of various factors: the financial sector was mushrooming; the expanding rail network was making demands on the iron industry; technical innovations; and the will to invest.⁵⁵ The absence of an adequate capital market created a close relationship between banks and industry.⁵⁶ First and foremost, the large Viennese banks participated in almost every industrial undertaking at that time. First of all, banks’ role as lenders of capital and as issuing houses has to be mentioned. Secondly, banks participated as shareholders and major

50 März and Socher, ‘Währung und Banken in Cisleithanien’, p. 335.

51 Schubert, ‘Torn between Monetary’, p. 63 provides a list of 40 Austrian banks liquidated in 1873.

52 F. Baltzarek, ‘Finanzrevolution, Industrialisierung und Crédit-Mobilier-Banken in der Habsburgermonarchie’, in: O. Rathkolb, T. Venus, and U. Zimmerl (eds.), *Bank Austria Creditanstalt, 150 Jahre österreichische Bankengeschichte im Zentrum Europas* (Vienna 2005), p. 27.

53 R. Hilferding, ‘Das Finanzkapital. Eine Studie über die jüngste Entwicklung des Kapitalismus’ (Vienna 1910).

54 H. Kernbauer and F. Weber, ‘Multinationales Banking im Donauraum? Die Geschäftspolitik der Wiener Großbanken 1918–1929’, *Österreichische Zeitschrift für Geschichtswissenschaften ÖZG*, 4/1993/4 (1993).

55 Wurm, ‘The Development of Austrian Financial Institutions’, p. 17.

56 Eigner, ‘Die Habsburgermonarchie im 19. Jahrhundert’.

shareholders. Over the years a policy shift of moving away from the foundation business towards the development of existing industries became visible.⁵⁷ These close links are often considered to have a symbiotic nature. Kernbauer and Weber (1986) even consider it to be an intimate relationship with banks the dominant partner due to their retention of majority shareholdings.⁵⁸ Banks' ownership of blocks of shares in industrialised firms and their directors' presence on the supervisory boards of industrial and commercial stock companies was considered to be an essential potential of great power.⁵⁹

Vienna was the 'headquarters' of the Austrian-Hungarian banking industry during the monarchy, but it has to be noted that its sphere of influence was not limited to domestic territories.⁶⁰ All great joint stock banks and major industries had their headquarters in Vienna, although production sites were normally situated in the western half of the empire with a high concentration around Prague. The Viennese stock exchange was the most important capital market, not only for the lands of the monarchy, but for the whole South Eastern and Central European region.⁶¹

A major factor for Vienna's uniqueness was the stringent division of labour within the monarchy: different regions of the monarchy specialised in different branches of the economy. While Vienna attracted the major

57 H. Kahr, 'Die Österreichischen Banken zwischen 1913 und 1926', unpublished Master thesis (Vienna University of Economics and Business 1977), p. 5.

58 H. Kernbauer, and F. Weber, 'Multinational banking in the Danube basin – The business strategy of the Viennese banks after the collapse of the Habsburg monarchy', in: A. Teichova, M. Levy-Leboyer, and H. Nussbaum (eds.), *Multinational enterprise in historical perspective* (Cambridge 1986), p. 186.

59 H. Wixforth, 'Die Böhmisches Escompte-Bank nach dem Zerfall der Habsburger Monarchie – eine Bank zwischen Eigentümer und nationalen Wirtschaftsinteressen', *Zeitschrift für Unternehmensgeschichte*, vol. 40, issue 2 (2004), pp. 222–38.

60 W.P. Kattinger, 'Die Österreichischen Banken in den Nachfolgestaaten der Habsburger Monarchie 1919–1928', unpublished Master thesis (Vienna University of Economics and Business 1980), pp. 1–3.

61 A. Nentwich, 'Die Bedeutung Wiens als Finanzzentrum in den Jahren 1918 bis 1929', unpublished Master thesis (Vienna University of Economics and Business 1986), p. 13; Wixforth, 'Böhmisches Escompte-Bank', p. 224.

share of the empire's administration and service firms, in particular banks and insurance companies, Trianon Hungary was mainly agricultural.⁶²

The scope of bank operations was generally limited to the territory of the Danube monarchy, only Länderbank had two branches abroad (Paris and London) and Anglo-Österreichische Bank had one in London. The number of foreign branches i.e. branches situated in the later successor states, exceeded in any single case the number of branches in Vienna or the later Austrian Republic.⁶³

Kernbauer and Weber (1993) and Eigner (2008) see Vienna before 1914 as the sole financial centre in central Europe besides Berlin. Additionally, Vienna had an autonomous relationship with Paris and London, the major financial centres in Europe.⁶⁴ Bankers, Industrialists or members of the aristocracy, sometimes backed with foreign capital, founded the Viennese-based banks, which later expanded to the East. According to Rudolph (1976), Weber (2007) and Stiefel (2008), the most important cities as regards branch locations show, not surprisingly, a significant focus on the later Czech Republic and the areas with a high density of industrial production.⁶⁵ The impression arises that banks during the monarchy, as well as after the fall of communism, first entered relatively close or neighbouring markets (Czech Republic, Hungary); later, more distant countries (e.g. Southern Balkans) were dealt with.

62 P. Haiss and B. Heissenberger, 'Economic Geography in Historic Perspective: Danube-Area Strategies of Austrian Banks during the Monarchy, the Interwar-Period and Now', Paper presented at the 25th Symposium on Money, Banking and Finance, Luxembourg, 2008.

63 Kernbauer and Weber, 'Multinationales Banking im Donauraum', p. 585.

64 P. Eigner, 'In the Centre of Europe: Vienna as a Financial Hub, 1873–1913', in: D. Feldman and P. Hertner (eds.), *Finance and Modernization – A Transnational and Transcontinental Perspective for the 19th and 20th Centuries* (Farnham 2008), pp. 29–50; Kernbauer and Weber, 'Multinationales Banking im Donauraum'.

65 R.L. Rudolph, *Banking and Industrialization in Austria-Hungary: The Role of Banks in the Industrialization of the Czech Crownlands*, (Cambridge 1976), pp. 1873–1914; F. Weber, 'Interview/private conversation on 11 Feb. 2007', cited from Haiss and Heissenberger, 'Economic Geography in Historic Perspective'; Stiefel, 'The Bankers' View'.

Figure 1 – Most important branch locations of Austrian banks



Source: F. Weber, Interview/private conversation on Feb. 11, 2007 and J. Nautz, 'Zerfall und Integration: die Referate der Wissenschaftlichen Doppelkonferenz Politische Desintegration und Wirtschaftliche (Re-) Integration', (Wien 1994) cited from Haiss and Heissenberger, 'Economic Geography in Historic Perspective' (2008), p. 4.

III. Austrian Banks' Internationalization after 1945

The loss of traditional markets in Central, Eastern and South-Eastern Europe due to the Iron Curtain had changed Austrian banks' orientation

drastically after the Second World War.⁶⁶ Between 1970 and 1980 growth was focused on major financial centres mainly through interbank and external trade. In the next step the branch and representative offices network grew considerably between 1980 and 1985 but until 1989 banks' orientation was unambiguously directed towards the west (particularly London, New York, Tokyo). In 1990 joint-venture activities were considered to be a very active bridging position for Austrian banks. With the fall of the Iron Curtain the focus shifted from the west to the east with an emphasis on neighbouring countries. Austrian large banks acquired foreign banks in the course of the privatisation process.⁶⁷ As Austrian banks held about 15 per cent market share of financial activity in the Eastern Bloc, the special historic relationship between Austria and the successor states of the Habsburg Empire was one of the foundations Austrian banks built on.⁶⁸ Experience in this region and closeness to it was a unique selling proposition when dealing with international clients.⁶⁹

In the CEE region Austrian banks can be called pioneers. From 1990 on, Austrian banks tried to increase the number of representative offices and, whenever possible, to establish banks or joint ventures.⁷⁰ However, the client base consisted mainly of non-resident corporate customers or joint ventures, and retail banking was still in its infancy. Thus the lion's share of Austrian banks' investments in the early 1990s concerned greenfield investments. Soon the privatisation process changed the scene for banks in the east.⁷¹ Already at this time the share of Austrian banks' exposure to the east was relatively large.⁷² What is striking is that Austrian banks took

66 Wurm, 'The Development of Austrian Financial Institutions'; Stiefel, 'The Bankers' View'.

67 Haiss, 'The Twin Challenges'; Haiss, 'Central European Strategies'.

68 Stiefel, 'The Bankers' View', p. 27.

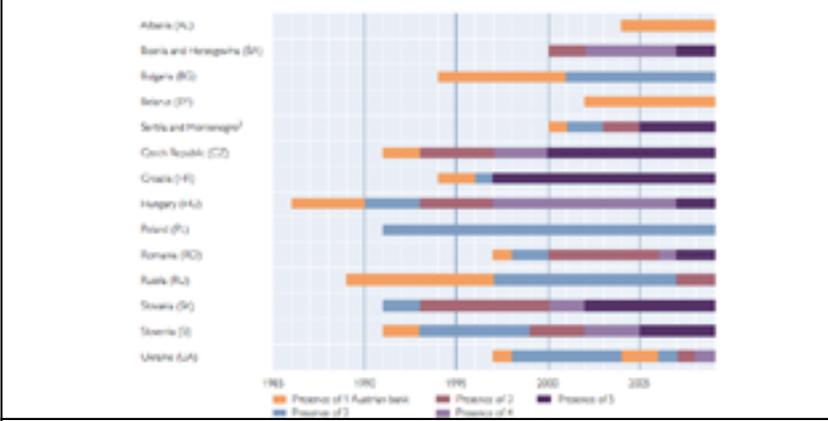
69 Wurm, 'The Development of Austrian Financial Institutions', p. 46.

70 Haiss, 'The Twin Challenges'.

71 OeNB, 'Focus On European Economic Integration 1989–2009 – Twenty Years of East-West Integration Hopes and Achievements', *Austrian National Bank*, (Vienna 2009), p. 51.

72 Wurm, 'The Development of Austrian Financial Institutions', pp. 46–7.

Figure 2 – Timeline of Austrian Banks’ subsidiaries in CEE countries 1985-2006



Source: OeNB, ‘Focus On European Economic Integration 1989–2009’, Austrian National Bank (2009), p. 101.

the leading role in what is referred to as ‘bank pull’. This means instead of following their clients, as other banks did, Austrian banks took the initiative and acted proactively.⁷³

The era of communism was characterised by a monobank system with hardly any separation between banks of issue and commercial banks. After the collapse of communism conditions and economic structures underwent major changes. The banking sector was hit most radically by the dissolution of the monobank system. As soon as the basic conditions were in place foreign investors flooded the market.⁷⁴

The relatively small financial markets suffered from asymmetric information, inadequate capitalisation and insufficient supervision. Thus privatisation of the large former state owned banks required strong equity involvement of foreign banks and international institutions like the European Bank for Reconstruction and Development (EBRD), which

73 Wurm, ‘The Development of Austrian Financial Institutions’, p. 47.

74 E. Bradacs and P. Haiss, ‘Das eklektische Paradigma im Bankensektor: Ergänzungen notwendig’, in: H. Zschiedrich and U. Christians (eds.), *Banken in Mitteleuropa im Spannungsfeld von Transformation und Innovation* (Munich 2007), pp. 175–96.

reduced the risk for foreign investors by providing guarantees and ensuring a more reliable framework for banks.⁷⁵

According to Barisitz (2009) most of the Central and Eastern European countries experienced a process of two different waves of banking reform.⁷⁶ In the first wave countries went through an extensive liberalisation process and a limited restructuring process. In the second wave countries installed hard budget constraints and capitalism in order to achieve a market-oriented development.⁷⁷ For most countries it took time to implement new structures and change institutional characteristics and therefore properly functioning financial markets were not in place before the late 1990s.⁷⁸

The high share of privatisation of the once completely state-owned banking sector and low entry barriers for foreign investors resulted in an extremely high share of foreign banking participation and fast credit growth.⁷⁹ Most successor states to the Soviet Bloc countries which have already become new members of the European Union or who are candidates have one thing in common: Banking is dominated by FDI originating in Western European countries including Austria.⁸⁰ Stöllinger (2010) concludes that since 2001 until 2009 more than 50 per cent of Austrian FDIs were made in the CEE area, about half of that went to the financial

75 G. Fink, P. Haiss, L. Orlowski and D. Salvatore, 'Central European Banks and Stock Exchanges: Capacity-building and Institutional Development', *European Management Journal*, vol. 16, no. 4 (1998), p. 431.

76 S. Barisitz, 'Banking transformation 1980–2006 in Central and Eastern Europe – from Communism to Capitalism', *South-Eastern Europe Journal of Economics*, 2/2009 (2009), pp. 161–80.

77 Barisitz, 'Banking transformation 1980–2006'; Breuss et al, 'How well prepared are the New Member States?'

78 Barisitz, 'Banking transformation 1980–2006', p. 177.

79 P. Haiss and A. Ziegler, 'Transition Results and Perspectives of (Un)Healthy Credit Growth in Central, Eastern and South-Eastern Europe', in: P. Chadraba and R. Springer (eds.), *Proceedings of the 19th Annual Conference on Marketing and Business Strategies for CEE*, December (2011); Haselmann, 'Strategies of Foreign Banks'.

80 M. Eller, P. Haiss and K. Steiner, 'Foreign Direct Investment in the financial sector and economic growth in Central and Eastern Europe: The crucial role of the efficiency channel', *Emerging Markets Review*, vol. 7, issue 4 (2006), pp. 300–19; Barisitz, 'Banking transformation 1980–2006'.

sector.⁸¹ Their proximity together with cultural similarities and a shared history gave Austrian banks some advantages in these new markets.⁸² On the one hand, Austrian banks followed their clients who wanted to start businesses in the CEE region in order to provide services. On the other hand, investors were attracted to the region concerned by the promising business opportunities. Initially, Austrian banks took the opportunity of the ongoing liberalisation process via greenfield investments but in a second wave they changed their strategy to brownfield investments during privatisations.⁸³

Austrian banks' investment activities were driven by forecasts of market growth, expectations of return and strategic considerations.⁸⁴ Besides the expected economic growth, interest margins were considerably higher in comparison to Austria, but this advantage vanished with increasing competition. Secondly, the level of bank intermediation was clearly lower than in Austria.⁸⁵ The strategy shifted more and more from large corporate customers to retail customers.⁸⁶ The end of the war in the Balkans brought some further bankable countries, and around year 2000, banks' focus shifted to South-Eastern Europe (SEE), with foreign investors zeroing in on the most densely populated country excluding Poland:

81 R. Stöllinger, 'Fokus Finanzsektor – Österreichs Direktinvestitionen in Mittel- u. Osteuropa', *FIW Policy Brief* no. 6 (Vienna 2010).

82 E. Nowotny, 'Austria's role in the international financial system', *BIS Review*, vol. 79, issue 1 (2009), p. 3.

83 P. Haiss and A. M. Winkler, 'Post-Crisis Business Models of Austrian Banks in Central and Eastern Europe', Paper presented at the European Economics and Finance Society (EEFS) Conference (Athens 2010), p. 3.

84 W. Altzinger, 'Austria's Foreign Direct Investment in Central and Eastern Europe: 'Supply Based' or 'Market Driven'?', *Working Paper* no. 57 (1998), p. 15; OeNB, 'Focus On European Economic Integration', p. 52.

85 Measured balance sheet total/GDP; F. Breuss, G. Fink and P. Haiss, 'How well prepared are the New Member States for the European Monetary Union?', *Journal of Policy Modeling*, vol. 26, issue 7, (2004), pp. 769–791; Fink et al, 'Central European Banks and Stock Exchanges'.

86 OeNB, 'Focus On European Economic Integration', p. 51.

Romania.⁸⁷ In mid-2000, Austrian banks expanded their focus further to the Commonwealth of Independent States (CIS) countries as well, seeking additional investment opportunities further abroad, as has been the case during the monarchy.⁸⁸

The fact that Austria has a common border with four countries in CEE fostered a very early and broad-based market entry and helped set up the client base during the early years, due to the investment by many Austrian companies. Intercultural understanding was a helping hand.⁸⁹ Haiss (1991) adds to the close geographic location the historic ties which present a unique competitive advantage for Austrian banks.⁹⁰

According to Wurm (2006) Austrians are seen to be more understanding, culturally and emotionally closer to the people in South-Eastern Europe than other Western Europeans; the mentality seems to fit. 'They stress the understanding of the Austrians for the nations of the Balkans and Danube region, which derives from a common past'. The proximity of Austrian culture to the cultures of Central, Eastern and South-Eastern Europe and the similar ways of conducting business, the so-called (low) psychic distance, which clearly relates to a common history, had a strong impact on their success in these areas.⁹¹

Data on Austrian Banks in CESEE

Today Austrian banks have become key players in CESEE markets. They basically 'own' some markets in CEE with aggregate market shares

87 G. Fink, P. Haiss and M. von Varendorff, 'Serbia's Reform of the Banking Sector – Implications for Economic Growth and Financial Development', *Southeast European and Black Sea Studies*, vol. 7, issue 4 (2007), pp. 609–39; Wurm, 'The Development of Austrian Financial Institutions'

88 OeNB, 'Focus On European Economic Integration', p. 51.

89 OeNB, 'Focus On European Economic Integration', p. 52.

90 Haiss, 'Central European Strategies', p. 327.

91 Wurm, 'The Development of Austrian Financial Institutions', pp. 64–6.

accounting for around 44 per cent in Bosnia and Herzegovina and more than 67 per cent in Croatia.⁹² Business in the CESEE region accounts for more than 56 per cent of total Austrian banking assets.⁹³ As of the end of 2011 the major Austrian banks maintain a network of more than 8,000 branches.⁹⁴ In comparison to that 1914 figures indicate a 150 strong branch network of the top 10 Austrian banks.⁹⁵ According to de Haas et al (2012), Austrian banks even kept their CESEE lending book open throughout the global financial crisis with the exception of country-specific issues in Hungary and the Ukraine; in any case more so, on average, than e.g. Swedish banks in the Baltics.⁹⁶

We tried to verify whether there is a trend towards rising household lending in the more recent period covered. According to data compiled from various RZB CEE reports, the share of loans to households exceeds the share of loans to private enterprises over the 2007–2011 period in Croatia, where Austrian banks hold a comparatively high market share of 67 per cent.⁹⁷ For the Czech Republic, Slovakia and Hungary the share of loans to households rises over the 2007–2011 period, , exceeding the share of loans to corporations in all three years. According to OeNB data on the debt claims of Austrian banks' subsidiaries in CEE and CIS (including Russia where lending by foreign banks is very strongly skewed towards the corporate sector), the share of lending to households rises slightly over the 2008 to 2012 period for which this data is available. Since Austrian banks hold a high fraction of the high foreign share in lending in these countries,

92 Swedish banks similarly have a stronghold in the Baltic countries, and Greek banks are among the major players in bordering South-Eastern European countries, though not across the CESE region. See RZB (2012) for details. A comparison of Austrian banks CESEE exposure also indicates a higher level in countries which tend to have a certain geographical closeness.

93 OeNB, 'Facts on Austria and its Banks', *Austrian National Bank* (2012), p. 19; Haiss and Winkler, 'Post-Crisis Business Models', p. 1.

94 RZB, 'CEE Banking Sector Report 2012', *Raiffeisen Research* (2012), p. 72.

95 *Compass Finanzielles Jahrbuch für Österreich*, vol. 1 (Vienna 1915).

96 De Haas et al, 'Foreign Banks and the Vienna Initiative'.

97 RZB, 'CEE Banking Sector Reports', various issues (10/2007) and (10/2010) and (06/2012).

Table 1 – Austrian banks’ market share by countries (per cent)

	End 1999	End 2000	Mid 2001	End 2002	End 2003	End 2004	End 2005	End 2006	End 2007 **	End 2008 **	End 2009 **	Mid 2010	End 2011 **
AL								35.4	~30	~30	~30	27	
BG							19.4	29.0	24.6	24.8	24.4	22.0	22.1
BH				27.0	41.0	45.0	52.6	52.6	~50	~50	~50	47.0	44.5
CZ	5.0	21.0	25.0	27.0	31.0	32.0	34.9	37.0	37.1	34.8	34.1	34.0	32.8
HR	9.0	9.0	18.0	36.0			45.2	63.0	64.3	65.8	66.6	66.0	67.0
HU	14.0	18.0	15.0	16.0	15.7	20.5	20.7	20.4	22.2	23.0	22.3	23.0	22.6
ME							8.0	8.3	14.4	15.3	16.9	15.0	
PL	5.0	7.0	7.0	10.1	10,5	11.2	11.0	11.0	2.2	2.3	2.0	2.0	2.1
RO				9.5	10.5	14.5	17.5	41.6	40.3	37.3	36.2	35.0	36.0
RS							37.1	30.0	29.2	27.9	28.1	25.0	26.3
SI	3.0	5.0	5.0	8.5	10.0	11.0	14.2	16.0	17.0	18.9	17.9	17.0	16.8
SK	11.0	16.0	40.0	46.0	43.0	44.0	44.1	52.0	50.0	50.0	50.2	36.0	45.7
UA							12.9	8.2	8.5	13.6	12.4	11.0	10.2

Calculations include all banks domiciled in Austria (e.g. UniCredit Bank Austria)
Source: OeNB, ‘Financial Stability Report’, Austrian National Bank, various issues (Nr. 2/2001; Nr. 5/2003; Nr. 9/2005; Nr. 11/2006; Nr. 13/2007; Nr. 21/2011);
*** figures provided by OeNB, private conversation, Austrian National Bank, Jul. 25 (2012).*

taken together, we interpret these data together as evidence that the share of household lending of Austrian banks in the neighbouring countries grew in the more recent period covered (please see Table 2).

The speed of Austrians’ entry into business is noteworthy; they were ‘there’ even before the fall of the Iron Curtain. Austrian companies had comparatively strong foreign trade relations with the East Bloc countries, and that went hand in hand with banking services.⁹⁸ There could also be a case for inherent historic ties. In addition, there were family relationships

98 Stiefel, ‘The Bankers’ View’, p. 27.

and friendships. Thus historic ties still play a part nowadays but more on a cultural than on a historic level.⁹⁹

IV. Summary and Conclusion

In this paper we investigate bank internationalisation across time. We compare expansion strategies of Austrian (particularly Vienna-based) banks into neighbouring Central, Eastern and South Eastern European (CESEE) countries during the monarchy and after the fall of the Iron Curtain. We find that during the Habsburg dual monarchy Austrian banks often pursued a 'Follow Your Customer (FYC) Strategy' in the crown lands (i.e. what is nowadays referred to as transition economies from CESEE). This assumption can be confirmed by means of the railroading system and other businesses. So banking was driven by industrial policy. In the beginning the highly speculative railway business with its implications on related industries was a major driver for almost every business activity. In some cases the opening of a bank's branch happened in line with the official opening of a new railway connection and banks were responsible for the floating of shares.

The banking sector, as far as industrial banks are concerned, emerged as a matter of fact due to the high demand for loans in the course of the industrialisation process e.g. in Silesia and Bohemia. Furthermore, evidence indicates a strong integration of banks and industrial companies. Important bank branches settled around essential industrial centres particularly in Moravia, Silesia and Bohemia. Rudolph (1976), Weber (2007) and Stiefel (2008) emphasise that the enlargement of the branch network took place largely in the Czech crown lands, the industrial heart of the monarchy.

⁹⁹ Wurm, 'The Development of Austrian Financial Institutions', pp. 67–8.

Table 2 – Comparison loans to households and to private enterprises in selected countries (per cent of GDP)

CZ	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Loans private enterprises % GDP	33,5	29,8	19,5	17,6	16,6	16,3	17,6	19,7	20,3	22,1	20,9	20,7	21,3
Loans households % GDP	4,0	4,7	5,3	6,4	8,2	10,1	12,7	15,4	18,3	21,0	24,0	25,4	26,0
HR													
Loans private enterprises % GDP	-	14,9	18,0	25,9	24,9	24,8	26,8	31,2	24,6	25,6	27,0	29,9	32,0
Loans households % GDP	-	15,3	18,5	23,8	27,7	30,4	34,0	38,2	35,4	36,5	36,5	37,8	37,4
SK													
Loans private enterprises % GDP	36,1	32,0	21,2	18,8	17,8	14,7	23,6	25,1	17,3	25,0	24,8	23,8	24,1
Loans households % GDP	4,3	4,7	5,1	5,5	7,0	8,6	11,3	13,5	11,8	18,3	20,9	22,4	23,7
HU													
Loans private enterprises % GDP	20,5	23,8	24,5	21,5	23,3	24,1	26,0	27,3	28,4	28,6	30,1	27,8	27,4
Loans households % GDP	4,1	4,5	6,1	8,5	12,4	14,5	17,2	19,9	23,1	27,5	30,8	31,4	30,2

Source: RZB, CEE Banking Sector Reports, various issues 10/2004, 10/2007, 06/2012.

The stringent division of labour within the Habsburg monarchy, with Hungary as the granary of the empire, the industrial core in the now Czech

Republic and Vienna as the administrative centre led to the emergence of a strong banking machinery in Vienna. Less prosperous countries like the Balkan states did not have the know-how of Austria with its financial metropolis Vienna. This pattern was predominant again after the fall of the Iron Curtain. The difference between now and then is the political side: Austria has shrunk in size and is no longer seen as an imperialistic empire and thus greatly appreciated. The banks' expansion after the fall was not driven by state or industrialisation policy or a single industry, but rather by private, commercial business motives.

Nowadays the situation in the CESEE region does not seem to be similar to that during the monarchy. An obvious FYC strategy as in former times cannot be confirmed. Only directly after the fall of the Iron Curtain some 'first mover' banks followed their corporate clients into the neighbouring CESEE countries, but then changed their strategy to setting up (or acquiring) retail networks across CESEE, and going further East as well. Banks were attracted by the favourable economic conditions which can be referred to as a pull condition. Operations were aimed at long-term growth and banks took the initiative.

After the fall of the Iron Curtain organic growth would foster expansion, which was eventually substituted by acquisitions and mergers, all dependent on privatisation strategies and thus market access. Due to different strategies and frameworks banks' branch networks did not enlarge as fast during the Habsburg monarchy as after the fall of the Iron Curtain. Moreover, today's branch network is around 50 times larger in terms of the number of branches.

We also find that the historic ties, which are often mentioned to a certain extent, serve as base for the subjective closeness and the (rather low) psychic distance. In daily business the same attitude or mentality is striking; characteristically, Austrians are considered by Wurm (2006) as quite close to the East. In the same way Austrian expertise regarding market operations in the East is undisputed. Furthermore, the importance

of the geographical distance between Austria and the successor states to the East Bloc and the Balkan Peninsula should not be underestimated. As in former times, though for different reasons, Austria is seen today as an important hub and gateway to the East with Vienna as its influential centre of regional financial expertise. This special relationship is being tested in the ongoing financial crisis.

Further work in this area could include econometric tests of our hypotheses, e.g. via gravity equation analysis that is common in the international trade literature. Similar to Mauro, Sussman and Yafeh (2002) by comparing bond spreads ‘then and now’ one could run panel regressions on a selection of European countries, with the number of bank branches (or a measure of their activity from the balance sheet) of Austrian banks in CESEE countries as a function of the usual set of variables in trade studies (e.g. geographical distance, GDP per capita, legal similarity etc).¹⁰⁰ In the spirit of economic geography, path dependence theory could be applied as an alternative to investigate the regional clustering of Austrian banks’ foreign activities in both periods.¹⁰¹ Data availability of bank assets and branch data across time and countries precluded us from doing so far.

100 P. Mauro, N. Sussman and Y. Yafeh, ‘Emerging Market Spreads: Then Versus Now’, *The Quarterly Journal of Economics*, vol. 117, issue 2 (2002), pp. 695–733.

101 R. Boschma and K. Frenken, ‘The Emerging Empirics of Evolutionary Economic Geography’, *Journal of Economic Geography*, vol. 11, issue 2 (2011), pp. 295–307.

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BORDER EFFECTS ON LOCAL BANKING SYSTEMS. THE SWISS- ITALIAN FRONTIER BETWEEN THE TWO WORLD WARS (1914–1945)

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Abstract

Drawing on a large body of literature about the border effects on economic integration, this paper focuses on the consequences a frontier could exert on the local banking systems of two areas located on the Swiss-Italian boundary, over the years between the First and Second World War. It then compares the Italian province of Como and the Swiss canton of Tessin, highlighting the specific characteristics of their banking systems and trying to clarify how their evolution has been influenced by the proximity of a political border and by the transformations in the economic and legislative framework of those years, with special regard to the restrictions on trade and foreign exchanges introduced in Italy in the 1930s. Specific attention is devoted to international trade and capital flows across the border. In conclusion, this research tries to speculate how the two banking systems would be structured if they were not separated by any frontier.

Introduction

The notion of border does not have a clear meaning. Applied to the history of the American settlement of the West, Turner sees in the frontier a mobile

line that is constantly being overcome and moved.¹ In this perspective, the American frontier is clearly different from the European, the latter being rather a line of separation between one nation and another, a limit that tends to block rather than stimulate its overcoming.

Traditionally, then, literature has considered the administrative border as a barrier to the development of frontier regions, defined as 'subnational areas whose social and economic life is directly and significantly affected by proximity to an international frontier.'² Location theorists such as Christaller and Lösch, despite not having developed a systematic theory on that, point out that the border areas are disadvantaged by the existence of barriers to international trade and the threat of military invasion. In short, national boundaries would tend to artificially separate spatially complementary regions.³ Similarly, those who rely on the growth pole theory, argue that the main effect of a political border is to block the diffusion process of a development pole, giving rise to situations in which underdeveloped areas on one side of border areas coexist with over-development on the other.⁴

Although these interpretations did not exclude a positive impact on border regions in the case of stable boundary lines (for example through the development of commerce on the border; the gains associated with the collection of duties or cross-border investments to circumvent customs duties, as in the case of 'tariff-factories'), the dominant view was still that of a barrier that tends to hinder their development. The empirical analysis,

1 E.J. Turner, *The Frontier in American History* (New York 1953).

2 N.M. Hansen, 'Border Regions: A Critique of Spatial Theory and a European Case Study', in: N.M. Hansen (ed.), *Human Settlement Systems. International Perspectives on Structure, Change and Public Policy* (Cambridge 1978), p. 247.

3 W. Christaller, *Die zentralen Orte in Süddeutschland* (Jena 1933); A. Lösch, *Die räumliche Ordnung der Wirtschaft* (Jena 1940).

4 R. Gendarme, 'Les problèmes économiques des régions frontalières européennes', *Revue économique*, 21 (1970), pp. 889-917.

however, seems to resize this position, as Hansen noted with reference to the tri-national region of Alsace-Baden-Basel.⁵

In fact, depending on the region and historical period, the border may be seen not only as a 'glass wall' that separates two or more different socio-economic and institutional systems, but also as a filter which makes these areas interconnected, allowing a selective flow of information and factors of production.⁶ Such a concept looks particularly noteworthy now, due to the double dimension of European integration, international and regional at once, as it is made clear by the telling definition, 'Europe of regions'. In this regard, a third theoretical approach considers border areas to be functioning as a connecting tissue between different institutional contexts. In this case, the contact function dominates over that of separation:

'In the Europe of the twentieth century, the most important difference with the "old" Europe of Countries will consist not only of the abolition of barriers and frontiers, but also and more generally speaking in the transformation of the border from a barrier into a contact line.'⁷

A large body of literature documents the impact of borders on trade. For a long time the political and administrative boundaries have been, in fact, considered one of the main sources of costs related to trade. Recent studies have attempted to measure the economic integration across borders and the border effects on trade, for instance as large deviations from the law of one price or within the framework of a gravity model.⁸ They have reached

5 Hansen, 'Border regions', pp. 252–8.

6 R. Ratti, *Regioni di frontiera. Teorie dello sviluppo e saggi politico-economici* (Lugano 1991); A. Bramanti and R. Ratti (eds.), *Verso un'Europa delle Regioni. La cooperazione economica transfrontaliera come opportunità e sfida* (Milan 1993); R. Ratti and S. Reichman (eds.), *Theory and Practice of Transborder Cooperation* (Basel/Frankfurt am Main 1993).

7 R. Ratti, 'Strategies to Overcome Barriers: from Theory to Practice', in: R. Ratti and S. Reichman (eds.), *Theory and Practice of Transborder Cooperation*, p. 241; L. Senn, 'Introduzione: verso un'Europa delle Regioni', in: A. Bramanti and R. Ratti (eds.), *Verso un'Europa delle Regioni*, pp. 13–4.

8 See, for instance, C. Engel and J. Rogers, 'How Wide is the Border?', *American Economic Review*, 86 (1996), pp. 1112–25; J. McCallum, 'National Borders Matter: Canada-US Regional Trade Patterns', *American Economic Review*, 85 (1995), pp. 615–23.

meaningful results as the identification of ‘endogenous borders’ – i.e. actual boundary lines from an economic point of view although not necessarily from a political one – determined by geographical and infrastructural features of the territory, as well as by situations of ethno-linguistic heterogeneity capable of producing network effects of long duration. This would explain the persistence of border effects even in times of economic integration, as well as their pre-existence to the formation of new political boundaries, as has happened in the Habsburg Empire after WWI.⁹

Instead, the study of banking systems in border regions has received less attention so far, maybe due to the fragmented nature of available data that makes it difficult to make similar efforts aimed at assessing the border effect on the credit framework of these geographic areas. In this perspective, Switzerland looks like a real laboratory, due to the importance of several border regions scattered around the country. Following the approach of Ratti, these areas show different characteristics, depending on the nature of the relations across the border (complete or limited to some factors), the direction of trade flows (symmetric or asymmetric) and, finally, the intensity of trade. Therefore, there are border areas, particularly those marked by the presence of a natural boundary (as in the case of the Valais or Grisons), which appear to be characterised by extremely limited exchanges. On the contrary, other regions show almost complete exchange relationships, although their intensity is hampered by the boundary line, as is the case of two advanced border areas such as Basel and Geneva. Finally, a third type is defined by situations in which such relations appear largely incomplete and distorted, as in the case of Tessin. These examples

9 H.C. Heinemeyer, M.S. Schulze and N. Wolf, ‘Endogenous Borders? Exploring a Natural Experiment on Border Effects’, *Cepr Discussion Paper*, No. 6909 (2008); N. Wolf, ‘Path Dependent Border Effects: the Case of Poland’s Reunification (1918–1939)’, *Explorations in Economic History*, 42 (2005), 414–38; M.S. Schulze and N. Wolf, ‘On the Origins of Border Effects: Insights from the Habsburg Empire’, *Journal of Economic Geography*, 9 (2009), pp. 117–36.

Map 1 – The border region between Como and Tessin



Source: Author's own creation

are particularly significant in that they conflict with the traditional thesis, which argues that frontier regions are sites of penalisation.¹⁰

This paper focuses on the Swiss-Italian border line separating the Swiss canton of Tessin from the neighbouring province of Como (in particular, it concentrates on the main town of Como), a strategic area placed on one of the main arteries linking the Mediterranean sea with central and northern Europe (Map 1). Notwithstanding their geographic proximity,

10 R. Ratti, 'I problemi delle regioni di frontiera: il caso del Ticino', in: M. Baranzini and A. Cencini (eds.), *Contributi di analisi economica* (Bellinzona 1987), pp. 135–7; R. Ratti, 'Éléments de théorie économique des effets frontières et de politique de développement régional. Exemplification d'après le cas des agglomérations de frontière suisses', *Revue suisse d'Economie politique et de Statistique*, 128 (1992), p. 325.

these areas look demographically and economically very different from each other: at first glance it seems that the border has created a 'difference', an imbalance between the two respective stages of development. At the time of national unification, the province of Como (then also including the centres of Varese and Lecco) was considered the fifth most densely populated province in Italy; in 1881, its population was around 515,000 inhabitants, while in Tessin in 1890, there were only 126,000 inhabitants (an increase of just 35,000 people in the following 50 years).¹¹

The main characters of the industrial system also showed marked differences between the two sides of the border. The industrial census of 1911 documented the intensity of the process of industrialisation that characterised the province of Como, showing a fairly even distribution of manufacturing output among the three major towns of Como, Varese and Lecco. This province was always characterised by a dense network of small and very small factories, but the survey data also gave a picture of relative concentration. The textile sector, especially the silk industry, continued to be the leading sector, although we observed a strong expansion of metallurgy and mechanical industry. The secondary sector now employed nearly 48 per cent of active people. Across the border, Tessin could count on a production system that was much more fragile, with an industrial manpower that in 1911 just touched 7,700 people. Even the silk production, which in the second half of the nineteenth century had a certain development, now showed signs of irreversible collapse, despite the fact that the silk industry in Como still represented the dominant sector of the local economy.¹²

11 R. Canetta, 'Il perdurante divario tra risorse e popolazione', in: S. Zaninelli (ed.), *Da un sistema agricolo a un sistema industriale: il Comasco dal Settecento al Novecento. La lunga trasformazione tra due crisi (1814–1880)*, 2 (Como 1988), pp. 609–11; A. Rossi, *Dal paradiso al purgatorio. Lo sviluppo secolare dell'economia ticinese* (Locarno 2005), p. 22.

12 A. Cova, 'Dal dominante setificio all'industria multisettoriale', in: G. Rumi, V. Vercelloni and A. Cova (eds.), *Como e il suo territorio* (Milan 1995), pp. 355–64; S. Guzzi-Heeb, 'Per una storia economica del Canton Ticino', in: J.-F. Bergier (ed.), *Storia economica della Svizzera* (Lugano 1999), pp. 328–32; R. Ceschi, 'L'età delle migrazioni transoceaniche e delle ferrovie', in: R. Ceschi (ed.), *Storia del Cantone Ticino. L'Ottocento*, 1 (Bellinzona 1998), pp. 307–8.

Within this context, the different evolution of the local banking systems may have affected the specific development paths of the two border areas. But to what extent have the banking places of Como and Tessin been affected by the presence of a political border? In other words, to what extent has the frontier hampered or favoured the banking business? This and further investigation will clarify how these regions were different from each other and from surrounding areas not on the border, according to a 'difference-in-differences' approach. Giving an answer to this question would therefore allow us to speculate, following a counterfactual logic, what would have happened to the Tessin and Como banking systems in the absence of a political frontier.

The chronological period of reference covers the years between the two world wars, because they offer the opportunity to evaluate the effect exerted on the border region by the sudden alternation of phases of expansion and crisis, as well as the occurrence of two exceptional war periods. It is also particularly interesting as the period witnessed an extremely invasive government intervention in the regulation of international economic relations, especially in controlling trade and foreign exchange transactions, subordinating the economies of the border regions to national interests. The remainder of the paper deals with the border effect on local credit systems according to three thematic strands. Section I focuses on trade flows, Section II on capital movements, Section III on institutional factors and on the role of Lugano as strategic banking place for Italian interests. Section IV concludes.

I.

The first aspect to consider is the special position of this border in the trade between Italy and Switzerland and, through this country, with central-northern Europe, particularly Germany. In fact, the town of Como

and especially the small Swiss town of Chiasso – the latter being located close to the border making a single conurbation with Como – play the role of major gateway to the goods shipped along the north-south axis, representing the counterpart in southern Switzerland of the northern gateway of Basel, on the border with the Franco-German areas of Alsace and Baden-Württemberg.

The importance of the Gotthard railway tunnel, opened in 1882, for the development of such trades is widely recognised in the literature. It is therefore necessary to dwell on the effect that this infrastructure had on the border region considered here. First, the Italian-Swiss Convention of 1869 in favour of the Gotthard railway made it possible for Como to be placed on the route of the international railway line.¹³ On the other hand, the administration of international customs was fixed in Swiss territory, in the town of Chiasso. The latter has thus become a major hub for rail traffic across the frontier, developing an extensive system of administrative and commercial services on the basis of huge flows of goods transiting through that centre, as evidenced by the growing importance of a large group of shipping companies.

The strong growth in global transit traffic through Switzerland was a clear sign of the centrality of this country as a logistical platform for sorting trade flows on a European scale. The highest growth rates occurred throughout the 1920s, particularly in the first five years when an exceptionally high growth rate at 18.2 per cent was registered, a value never equalled either before or in the following years until at least the 1960s. Obviously, the international economic framework strongly affected the variation of these values, so that during WWI and the early 1930s there was a contraction in the volume of transit, while the second half of the

13 On the core position of Switzerland for European communications, see P. Cafaro, 'Le centre et la périphérie. Le passage stratégique du Simplon: deux tableaux', *Annali di storia moderna e contemporanea*, 1 (2013), forthcoming. On the Gotthard railway, see B. Caizzi, *Suez e San Gottardo* (Milan 1985); M. Kuder, *Italia e Svizzera nella seconda guerra mondiale. Rapporti economici e antecedenti storici* (Rome 2002), pp. 25–6; A. Carera, 'Percorsi ordinari e vie del vapore', in: Zaninelli (ed.), *Da un sistema agricolo a un sistema industriale*, p. 443.

1930s marked a strong recovery. Overall, in the period between the two world wars, the proportion of transit traffic in total traffic in Switzerland ranged between the high values of 30 and 43 per cent.

In these trades, the attractiveness of the Gotthard railway line was by far dominant. If one considers, for example, the other important pass for north-south commercial flows, i.e. the Simplon, it is quite apparent that the latter absorbed, throughout the period between the two world wars (but also later), a portion of traffic of between 20 and about 30 per cent of

Map 2 – Railway lines through Chiasso and Luino



Source: Author's own creation

Gotthard, thus clearly occupying a less prominent position. The centrality of Gotthard, especially for the exchanges between Italy and Germany, was further confirmed in 1938 by the fact that Switzerland held the largest share of traffic through all the Italian rail crossing places (42.5 per cent) while 30.9 per cent passed through Gotthard.

The function of Chiasso on this line was not originally recognised. In fact, according to the Convention of 1878, the connection of the Italian railway network with that of the Gotthard was due further to the west, i.e. in Luino along the line that was supposed to connect Bellinzona – capital of Tessin Canton – with the port of Genoa. It did not, however, refer to the line Bellinzona-Lugano-Chiasso-Milan, which in the long run would have turned out to absorb increasing trade flows as a result of the weakness of the Ligurian port and the economic growth of Lombardy (Map 2). In 1938, the share of transit flows from Gotthard directed towards Luino (320,000 t.) was equal to only 26 per cent of that via Chiasso (1,227,000 t.), a share which declined even further in the following decades.¹⁴ On the other hand, the predominant function performed by Gotthard reveals the presence of a strong trade flow headed to another border-region, i.e. Basel, a commercial centre with which Chiasso – as a gateway to the Italian market – was closely related along the north-south international axis.¹⁵

The activity of the international station of Chiasso, with large trade and related business operations and customs clearance, has undoubtedly required the support of banking systems operating on both sides of the border. The initiative of a big national bank such as the Schweizerischer Bankverein of Basel, which in 1908 opened a branch office in a small town like Chiasso cannot be explained otherwise. It dealt immediately with the financing of forwarding agents, just when the growth of trade foreshadowed further strong developments in the shipping business. In

14 R. Ratti, *I traffici internazionali di transito e la regione di Chiasso* (Fribourg 1971), pp. 106–17; J. Manzoni, D. Meroni and R. Ratti, *Il pulsare dell'economia dei traffici. Vita e storia delle case di spedizione a Chiasso* (Chiasso 1983), pp. 148–9.

15 Ratti, *I traffici internazionali di transito*, p. 89.

Chiasso, in 1905, a branch of the Banca della Svizzera Italiana (BSI) was also present. A leading local bank with headquarters in Lugano, the BSI maintained a close relationship with the largest Italian universal bank Banca Commerciale Italiana (Comit) of Milan, who took over the BSI in 1909. In 1913, then, even the Schweizerische Kreditanstalt of Zurich was introduced in Tessin, opening a branch not in Chiasso, but in the biggest centre of Lugano, which could also support international trade.¹⁶

The frontier had significant effects on the Italian side of the border as well, stimulating joint action by the local business environments and large groups belonging to major financial centres of the peninsula. In those years the local banking structure became stronger and more articulated, with a large presence of national banks which gradually settled on the place of Como, attracted not only by the industrial consistency of that province but also by the growing opportunities related to international business with neighbouring Switzerland.¹⁷ A first move for a reorganisation of this place had actually been made in 1906, when a branch of the Società Bancaria Italiana (SBI) was eventually established after merging with the local limited partnership banks Catelli Corti & Co. and Clerici Giorgetti & Co.¹⁸ In 1908 a subsidiary of Comit was also present in this place. However, a major turning point was represented by the creation of Banco Lariano in 1908, which became a reference credit institution for the whole province in the following decades. It was established thanks to a joint initiative of Como's businessmen and some Milanese banks (Credito Italiano, Prandoni and Zaccaria Pisa).¹⁹ Thereafter, other big Italian banks – including Credito Italiano (Credit) and Banco di Roma – set up their

16 V. Mazzolini, *Le banche nel Ticino* (Roveredo 1946), pp. 126–8; *Historical Archives of Bank of Italy* (ASBI), Rome, Raccolte diverse, Relazioni e bilanci, Pratiche, no. 4, doc. 23; *Historical Archives of Intesa Sanpaolo* (ASI), Milan, Banca Commerciale Italiana, Sg, cart. 33, fasc. 22, sf 1.

17 G. Rumi, V. Vercelloni and A. Cova (eds.), *Como e il suo territorio* (Milan 1995).

18 F. Bonelli, *La crisi del 1907. Una tappa dello sviluppo industriale in Italia* (Turin 1971), pp. 30–6.

19 *Historical Archives of UniCredit* (ASU), Milan, Verbali del Comitato centrale, vol. 5, 11.04.1908.

Table 1 – Freight traffic at the station of Chiasso

Year	Min tons per year (average)
1913-1914	0.99
1914-1915	0.92
1915-1916	0.34
1916-1917	0.37
1917-1918	0.18
1918-1919	0.24
1919-1923	1.18
1924-1930	3.19
1931-1938	2.43
1939-1945	4.77

Source: J. Manzoni, D. Meroni and R. Ratti, *Il pulsare dell'economia dei traffici*, pp. 73 and 87.

own branches at this location so that, in the mid 1920s, Como's banking system became far more diversified than two decades before.²⁰

Unfortunately, it is not possible to trace out in the balance sheets of those banks explicit information that allow the quantification of the involvement of the banking system in trade financing which, as mentioned, was affected by the international station and customs near to Chiasso, in Swiss territory. However, there are several clues that clearly testify to the many economic interests in this field, in addition to the previously mentioned concentration of major credit institutions in these border areas; a presence that is not justified (at least for the case of Tessin) by the existence of a strong local economy. A direct reference is provided, for example, by the desire of Banco Lariano to set up a branch in Chiasso, i.e. across the border, to try and grab some business opportunities in that important commercial centre. This attempt, just before WWI, was later given up for uncertain reasons (maybe due to regulatory difficulties that may have hampered the establishment of foreign banks there), but this still did not prevent Lariano

²⁰ Associazione bancaria italiana, *Annuario delle banche e banchieri d'Italia* (Milan 1925).

from getting a market share in Chiasso by making direct contacts with local shipping companies, which were granted operating loans.²¹

On the other hand, the outbreak of the conflict and especially Italy's entry into the war in 1915 had a tangible impact on the volume of goods in transit through Chiasso, which fell to less than one fifth of the pre-war values (Table 1). The precarious situation had thus blocked the expansion of the international station of Chiasso, which was started at the end of 1918 and completed in 1923, when new goods and customs yards were eventually opened. The improvement of infrastructure to support transit traffic turned out, however, insufficient to the needs of those years, demonstrating how the volume of goods processed in Chiasso had grown throughout the 1920s far beyond the most optimistic forecasts.²² In addition, in 1925, to further facilitate the shipping activities a free port was created on that place, which represents a strategic response in areas where the border principally acts as a barrier. The free port typically introduces a distortion in relations between two border areas, as there is not a connection between the political and the customs border. You could then deposit goods of foreign origin in a territory which belongs to Switzerland, from a political point of view, but which is abroad, from a fiscal one. In fact, as to the fiscal legislation, the consequences are obvious: 'the goods will pay duties only if they are finally introduced in Switzerland, but they can also continue in transit without being subject to Swiss customs formalities.'²³

It was therefore in the 1920s that the position of Chiasso appeared to gain more strength, exploiting its position on the international axis that bound it to the railway junction of Basel. In this case, the border effect encouraged some large Italian banks to follow the example of Comit and establish a Tessin affiliate, creating a bridgehead just across the border. The

21 ASI, Milan, Banco Lariano, Verbali del Cda, scat. 1099, vol. 2, 19.02.1914.

22 Manzoni, Meroni and Ratti, *Il pulsare dell'economia dei traffici*, pp. 82–5.

23 Ratti, 'Éléments de théorie économique des effets frontières', pp. 328–30; Manzoni, Meroni and Ratti, *Il pulsare dell'economia dei traffici*, pp. 91–3; C. Kuster, *Il Ticino zona franca italiana?* (Lugano 1937).

Banco di Roma, then, which at that moment was engaging in a significant expansion of its international network, opened a branch office in Lugano in 1919 and one in Chiasso in 1920, with the aim of acting as an intermediary in the commercial and financial relations between Switzerland and Italy. The Credit behaved in a similar way, although in this case the Italian bank acted indirectly, founding in 1919 an institute with headquarters in Lugano, the Banca Unione di Credito (BUC). In 1920 it was also established in Chiasso.²⁴

The banking systems on the Swiss and Italian side of the border had been gathering pace with the entry of large national institutions, which allowed this region to address the positive phase of the 1920s with a stronger and more diversified credit structure. The crisis in the next decade instead caused a decline in commercial traffic transiting to this place (Table 1). But above all it induced a more invasive intervention by state authorities, especially the Italian one, which called for action to cope with the worsening of the balance of payments. This is a very clear example of the consequences that regulatory intervention by the national government can have locally on the border regions. The main actions relating to foreign exchange and trade were taken by the Italian Government in mid-decade, with the introduction in 1934 of the state monopoly of foreign exchange. It had been only a few years earlier, in 1930, when complete freedom in currency transactions had been re-established. In 1935, imports were restricted by quotas, except for those goods that were traded through bilateral agreements (clearings), a mechanism which came to affect more than half of total trade.²⁵

24 R. Di Quirico, *Le banche italiane all'estero. Espansione bancaria all'estero e integrazione finanziaria internazionale nell'Italia degli anni tra le due guerre* (Fucecchio 2000), p. 103; Mazzolini, *Le banche nel Ticino*, p. 95.

25 G. Tattara, 'La persistenza dello squilibrio dei conti con l'estero dell'Italia negli anni Trenta', in: P.F. Asso et al., *Ricerche per la storia della Banca d'Italia. Finanza internazionale, vincolo esterno e cambi 1919-1939*, 3 (Rome/Bari 1993), pp. 380-2.

With regard to their impact on Como, which was strongly oriented toward silk exports, these interventions should not have had a negligible effect on the smooth running of operations. The enterprises, in order to obtain bank approval for export, were required to prove that they had obtained a credit from a foreign bank in the importing country or to have obtained advance payment from the importer, which already was to have been transferred to Italy.²⁶ The consequences of the administrative constraints on banks most active in international operations were likely to be particularly heavy, as was apparent for the Banco Lariano. The prohibition of foreign exchange transactions, for example, now centralised by the state institution Istituto nazionale per i cambi con l'estero (INCE), resulted in Lariano's loss of important customers of shipping agents, crippling the activities of Lariano's branch in Ponte Chiasso, located on the Italian side of the border. Hence it was closely linked to commercial operations that took place in Chiasso.²⁷ This decreased even more the already scarce investment opportunities in the province due to high banking competition in Como and the difficulties of the main industry of the area, based on silk. Thus it drove the bank to look for new operations outside the province, especially in Milan and Varese. The devaluation of the lira in 1936 allowed a loosening and part correction of some trade and currency limitations, even if it did not imply a return to greater freedom in this field.²⁸

It is significant that the measures taken by the Italian authorities had consequences also beyond the border, particularly in Chiasso, so that the branch of the Banco di Roma located there was closed in 1935, following the decreasing importance of this commercial centre caused by administrative constraints which had distorted normal business relations with Italy. On the one hand, limitations were imposed in 1934 on the import

26 A.M. Galli, 'Il sistema produttivo e finanziario', in: S. Zaninelli (ed.), *Da un sistema agricolo a un sistema industriale: il Comasco dal Settecento al Novecento*, 4-1 (Como 1998), pp. 397-8.

27 ASI, Milan, Banco Lariano, Verbali del Cda, scat. 1094, vol. 2, 22.07.1935.

28 ASBI, Rome, Banca d'Italia, Vigilanza, pratt., no. 1344, fasc. 1.

and export of Italian currency. On the other hand, the business of shipping agents was reduced, partly due to the fact that customs-related operations had been moved to Milan rather than being worked out at the frontier. Not to mention that even the economic sanctions on Italy imposed by the League of Nations between 1935 and 1936, following the Italian invasion of Ethiopia, had an impact on the economy of Chiasso. This was the case particularly among shippers, even if the negative consequences probably should not be overestimated since Switzerland did not block the transit of goods to Germany via Gotthard, except for arms and ammunition.²⁹

Further investigations are necessary to understand to what extent the strong growth of traffic in transit via Chiasso affected local banking systems in later years, especially during WWII (Table 1). Particularly when the Gotthard had a large increase of trade volumes between Italy and Germany, which came to represent 88 per cent of total transit through the Gotthard in the first four years of the conflict (compared to 38 per cent between 1919 and 1934).³⁰ However, we have to consider that the administered exchange rate regime and the restrictions on trade had greatly reduced the banks' autonomy in these border areas. This seemed to be the case of Banco Lariano which, after September 1943, no longer had the ability to keep current accounts with shippers, since such accounts were centralised by the Como branch of the Bank of Italy to ensure stricter control of foreign exchange transactions related to international trade.³¹

29 Mazzolini, *Le banche nel Ticino*, pp. 128–9; Manzoni, Meroni and Ratti, *Il pulsare dell'economia dei traffici*, pp. 99–115.

30 Manzoni, Meroni and Ratti, *Il pulsare dell'economia dei traffici*, pp. 148–9.

31 ASBI, Rome, Banca d'Italia, *Vigilanza*, pratt., no. 1345, fasc. 1.

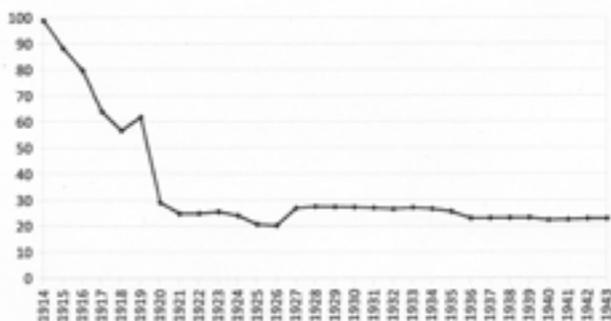
II.

The evolution of local banking systems was affected not only by the inclusion of this border region in the transit trade between northern and southern Europe, but also by the particular importance of currency transactions in periods of financial turbulence, together with the great power of attraction that Switzerland has exerted on foreign capital. This attraction would reach its maximum intensity after WWII but was clearly felt even earlier. This feature came along with the traditional strength of this country as an exporter of capital, so that it can be defined, especially with reference to the second half of the twentieth century, as a real capital 'turntable' on an international scale.³² WWI had greatly strengthened the Swiss financial centre and, especially in times of crisis, Switzerland became a place of refuge for foreign capital.³³ As to the currency system, this country still belonged to the Latin Monetary Union (LMU), formally dissolved in 1927, which Italy also took part in. Within this institutional framework, in the previous century there had been large flows of coins from one member country to another, taking advantage of arbitrage opportunities that the system left open. It is understandable, therefore, that the places of Como and Tessin were enlivened by the considerable work offered by the trading of foreign currencies and by the proximity of the Swiss-Italian border, which gave rise to a daily movement of metal currencies. These flows were particularly intense as a result of asymmetric shocks that increased exports of coined metals to financially more stable countries. This was also due to WWI, when abnormal issuances of banknotes in the warring countries made coins disappear from circulation, being hoarded, melted

32 P. Bairoch, 'L'économie Suisse dans le contexte européen: 1913–1939', *Revue suisse d'histoire*, 34 (1984), p. 480; P. Bairoch, 'La Suisse dans le contexte internationale aux XIXe et XXe siècles', in: P. Bairoch and M. Körner (eds.), *La Suisse dans l'économie mondiale* (Geneva 1990), p. 114; Y. Cassis, 'Swiss International Banking, 1890–1950', in: G. Jones (ed.), *Banks as Multinationals* (London/New York 1990), p. 160.

33 Kuder, *Italia e Svizzera nella seconda guerra mondiale*, p. 45.

Figure 1 – Swiss francs per 100 Italian lira (1914–1943)



Source: H. Siegenthaler, *Historische Statistik der Schweiz* (Zurich 1996), p. 837.

or exported. Switzerland, therefore, became the centre of attraction of the silver coming from other LMU States, mainly from France but also from Italy.³⁴

But in addition to the metal flows, even the possibility of arbitrage between Italian and Swiss notes represented a significant source of profits, especially in some periods, both for the formal banking sector and for a network, not always institutionalised, of small exchange offices. This seems to be a typical example of the border-effect, since the two local banking systems could benefit from the effective passage of notes from Italy to Switzerland by virtue of geographic proximity to the political border. It is not surprising then that Banco Lariano's cross-border arbitrage operations

³⁴ F. Marconcini, *Vicende dell'oro e dell'argento. Dalle premesse storiche alla liquidazione della Unione Monetaria Latina (1803–1925)* (Milan 1929), pp. 284–8. On the effects for the banking places of Como and Tessin in the late nineteenth century, see E. Berbenni, 'Banking systems on the border. Italy and Switzerland under the Latin Monetary Union (late 19th-early 20th centuries)', *Annali di Storia moderna e contemporanea*, 1 (2013), forthcoming.

in foreign exchange came out to be especially profitable during WWI, while growing difficulties slowed down ordinary discount activity.³⁵

On the Swiss side of the frontier, foreign exchange transactions had stimulated the birth of money changers in Chiasso: their origins are traced back to the second half of WWI, when the Italian lira depreciated heavily against the Swiss franc, changing the pre-war situation in which the two currencies were almost equal. The result was that the lira was accepted in Switzerland as a means of payment instead of the franc and the franc, in turn, was sometimes used in payments in Italy (Figure 1).³⁶ The crisis of the international monetary system created the conditions for profitable transactions in foreign currencies. Particularly evident in this border region, it put in direct contact two countries that, following the war, showed different degrees of exchange rate stability: a country with a strong currency, i.e. Switzerland, and another with a weak one, i.e. Italy.³⁷

Foreign exchange transactions became particularly interesting, however, since 1934, when strict monetary restrictions were eventually introduced, bringing about the reintroduction of the state monopoly of foreign exchange. The application of these restrictions provided strong incentives for Italian and Swiss smugglers, who took advantage of the different quotations of the Italian lira on the open market compared to the official price. In fact, the fear of an imminent devaluation of the Italian currency – actually carried out in October 1936 – induced Tessin banks (even those controlled by Italian capital such as the branch of the Banco di Roma) to apply an exchange rate much lower than the official one: in September 1935, banks in Lugano only accepted Italian currency at the exchange rate of about 20 francs per 100 lira, while the official exchange rate was 25 francs.³⁸ Moreover, the restrictions introduced in Italy on the

35 ASI, Milan, Banco lariano, Verbali del Cda, scat. 1099, vol. 2, 30.11.1915.

36 Mazzolini, *Le banche nel Ticino*, pp. 115–22.

37 On the Gold Standard, see B. Eichengreen, *Golden Fetters: the Gold Standard and the Great Depression, 1919–1939* (New York/Oxford 1992).

38 *State Archives of Como*, Como, Fondo Prefettura, Gabinetto, II versamento, c. 52.

amount of lira freely exportable abroad (350 lire per passenger, according to a ministerial decree of 25 May 1936) increased the demand for small notes, whose price increased compared to the notes of 500 and 1000 lira. Smugglers could then take advantage of this unequal exchange, buying notes of 100 lira in Italy and then change them in Chiasso with Italian notes of a bigger denomination.

These and other possibilities of profiting from the exchange of lira made use of loopholes that were open in the currency monopoly regime. It opened up the possibility to money changers in Chiasso to take a stance in such transactions as intermediaries between smugglers and the Swiss banks, to whom they sold the majority of lira they had bought. The exchange offices then had a liaison function, which was particularly important during WWII to make it possible for a large amount of Italian currency to cross the border.³⁹

It is certain, however, that financial relations between the two sides of the border were not confined to a search for profits in foreign exchange transactions. The local situation was affected to a large extent by the particular international framework and, above all, the difficulties of the Italian balance of payments in the 1930s. In fact, immediately after the devaluation of the pound in 1931, the widespread fear that the Italian lira should also depreciate, led to a drain of capital of vast proportions. In 1934, the scepticism of financial markets about the stability of the lira caused a new wave of capital outflows from the country, which led to the introduction of the above-mentioned measures restricting trade in currencies. The purchase in the market of foreign securities or Italian securities issued abroad was prohibited, and residents were forced to notify the ownership of such assets, forbidding also the export of cheques and banknotes.⁴⁰

The capital export from Italy, although not comparable to the massive flow in the second half of the century, even then should have had a

39 Mazzolini, *Le banche nel Ticino*, pp. 119–22.

40 Tattara, 'La persistenza dello squilibrio dei conti con l'estero', pp. 380, 402–11.

non-negligible weight, although difficult to quantify. The monetary difficulties of those years and the deterioration of the international political condition with the troubles brought about by the aggressive foreign policy of Mussolini – mainly following the Ethiopian campaign – had a great part in explaining the export of Italian capital to Switzerland. It seems that it was essentially the result of tax fraud that led to the reinforcement of Swiss banking secrecy in 1934. The story about one of the most influential Italian businessmen of the time, Carlo Feltrinelli, involved in a wide scandal after the emergence of considerable capital held by him at some Swiss banks (however, such operations were entirely legal until 1934), provides clear evidence of the diversified presence of Italian assets in Switzerland, not only in Tessin but also in banks based in Zurich and Basel.⁴¹

A survey in October 1935 conducted by the Swiss National Bank, tried to measure Italian assets in Switzerland, composed largely of deposits in Swiss banks. It was estimated to total about 220 million Swiss francs, including current accounts and securities deposited, a figure certainly underestimated, since only the largest banks were taken into account. Moreover, it did not include valuables stored in safe-deposit boxes. Of this amount it was believed that only 50 million was declared to Italian tax authorities. In fact, after 1934 it was largely a matter of capital flight, due to the obligation then introduced in Italy to give the INCE any Italian assets held abroad. According to a report compiled in 1937 by the Swiss Bankers Association, Italy was in third place after Germany and France for foreign capital held in the Swiss Confederation. In 1944, the size was estimated at between 500 and 600 million francs (i.e. between 309 and 371 million francs in 1935, taking into account the consumer price index), excluding

41 L. Segreto, *I Feltrinelli. Storia di una dinastia imprenditoriale (1854–1942)* (Milan 2011), pp. 362–83.

precious metals and jewels deposited, a figure that points to a significant presence of lira, illegally exported before and during the war.⁴²

Exports of lira could have different origins. There was, for example, Swiss capital invested in Italy that was repatriated, as well as Swiss industrialists and merchants active in Italy and looking for a safe investment in Swiss banks. However, as monetary conditions and political-military events got worse, more and more Italian capitalists put their money in safety across the border.⁴³ The passage of notes was physically carried out, both for the purpose of foreign exchange arbitrage and the export of capital to Switzerland in the frontier region between Como and Tessin. Since May 1934, a few days before the introduction of the first restrictive measure on foreign exchange, the director of the Como branch of the Bank of Italy wrote to Rome, with some concern, that there was an intensification of speculative foreign exchange operations by Swiss and Italian citizen-residents near the border. The major banks of Como benefited in some way from these transactions, although the awareness of being under special observation by the central bank induced them to move with particular care. Several of those operators – who imported francs in Italy and exported lira to Switzerland – were forced ‘to go to Milan to carry out those operations that until a few days ago they were doing in Como.’⁴⁴

There are other clues that highlight the attempt to circumvent sometimes the Como area (perhaps because of its proximity to the border, which made it more likely to be subject to controls by the Italian authorities), and to fulfil these operations directly in the major financial centre of Milan. In 1938, for example, there were currency movements that did not take place physically across the border, but through intermediaries

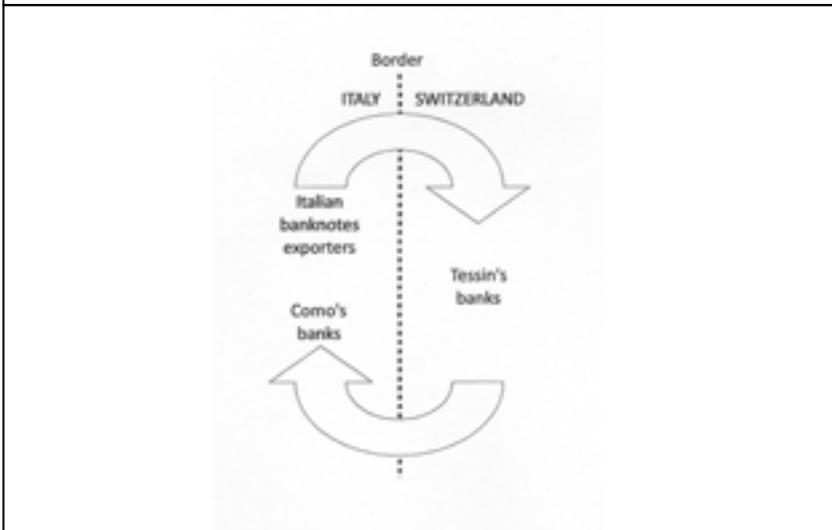
42 M. Kuder, *Italia e Svizzera dal 1945 al 1970. Commercio, emigrazione, finanza e trasporti* (Milan 2012), pp. 179–80. Swiss consumer price index is available at the website of the Office fédéral de la statistique, http://www.bfs.admin.ch/bfs/portal/it/index/themen/05/02/blank/key/basis_aktuell.html (Last accessed: 9 April 2013).

43 Mazzolini, *Le banche nel Ticino*, p. 119.

44 ASBI, Rome, Banca d'Italia, *Rapporti con l'estero*, Pratt., no. 272, fasc. 17.

who paid sums of money in lira in Milan on behalf of another person who received the equivalent in foreign currency in Lugano. In addition, under certain circumstances, large amounts of Italian lira also flooded Tessin from foreign markets, as happened during the crisis of Munich in September 1938, when there was a widespread sense of distrust in international markets as to the solvency of the Italian banks in case of war. All British, French and Dutch banks suddenly suspended the acceptance credits granted to various Italian banks, while three major Italian banks (Comit, Credit and Banco di Roma) underwent significant deposit withdrawals at their foreign subsidiaries. In the days before the conference in Munich, the Italian currency flooded Chiasso and Lugano, a small part coming directly from Italy, in part by the Swiss – ‘who were pushed by panic (panic which incidentally also hit the other cantons in Switzerland, France and England) to put off the Italian currency they had into their

Figure 2 – Circular flow of Italian banknotes across the Swiss border



Source: Author's own creation

coffers' – and for about three-quarters from Djibouti (via Paris) where the French had been hoarding it.⁴⁵ The political and military events, increasing the tension in international markets, had evidently pushed to get rid of the Italian currency.

Whatever the origin and the way in which Italian banknotes came to Tessin, it is not possible to argue that the banks of Como were not touched by this movement, although there is very little evidence in this regard. The involvement of the Banco Lariano in currency transactions (sometimes even not totally legal) with Switzerland is evident from the very first years after WWII, while little is known of the previous period.⁴⁶ However, it seems that the local banking system was touched at least indirectly by currency movements across the border, since Tessin banks could ship the Italian banknotes received back to Italy, sending them to correspondent banks of Como. It was a circular flow well documented in the period beginning in the 1950s and throughout the 1960s, and one characterised by massive Italian capital exports to Switzerland. But it can be believed that it was also in place in the inter-war period, as demonstrated by the difficulties caused to the circulation of Italian notes when, in 1935, the Bank of Italy attempted to identify illegal exporters of capital by placing obstacles to those re-importers of lira in Italy, who would not declare the origin of such currencies. It happened thus that some retailers and banks in Chiasso and Lugano refused 'to accept our [Italian] notes rather than asking the personal details of payers or depositors, with which then they would have the notes themselves easily received by the banks of Como which they wanted to send them to' (Figure 2).⁴⁷

45 *State Archives of Como*, Como, Fondo Prefettura, Gabinetto, Il versamento, c. 59; Di Quirico, *Le banche italiane all'estero*, p. 261.

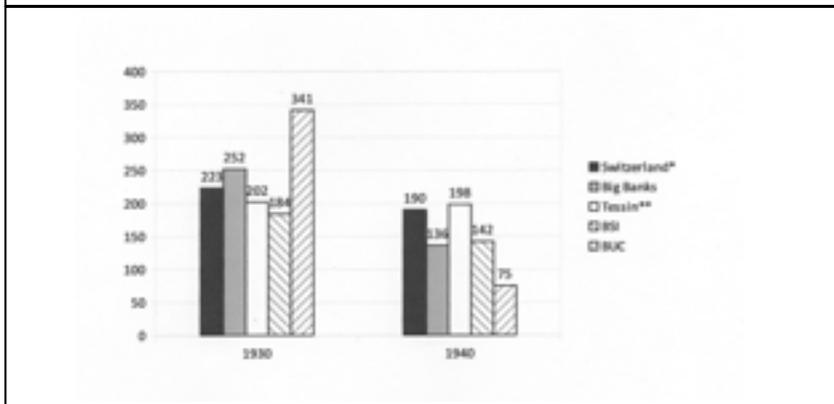
46 ASBI, Rome, Banca d'Italia, Vigilanza, pratt., no. 1346, fasc. 1.

47 *State Archives of Como*, Como, Fondo Prefettura, Gabinetto, Il versamento, c. 52; Q. Leoni, *Banche, assicurazioni private e credito ipotecario: conseguenze economiche per il Ticino, 1957–1971* (Locarno 1975), pp. 156–9; Kuder, *Italia e Svizzera dal 1945 al 1970*, pp. 210–1; ASBI, Como, *Relazione sull'andamento economico provinciale*, 1962.

It is difficult to say to what extent the links with the Italian market allowed the Tessin banking centre, as a whole, to deal quite well with the global crisis of the 1930s, which had instead resulted in a reduction of the total assets of the Swiss banking system. Especially the big banks active on the international market underwent heavy losses because of the gloomy economic situation and the spread in central and eastern Europe, mainly in Germany, of restrictive measures on foreign exchange. This hindered repatriation of capital previously invested and the transfer of interests, so that in 1940 the assets of Swiss banks were halved compared to ten years previously. The influx of foreign capital, which had fled to Switzerland to escape devaluations and foreign exchange restrictions, could not make up for such negative effects.⁴⁸

Of course, the balance sheet figures should be viewed with caution. On the one hand, the coexistence of accounts in different currencies can, for

Figure 3 – Total assets (1920 = 100)



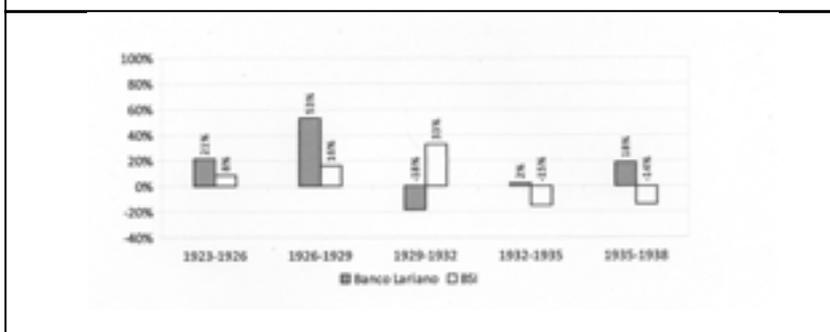
* Cantonal banks, land banks, other local banks, savings banks and big banks.

** Only banks based in Tessin, except branches of banks from outside the Canton.

Sources: H. Siegenthaler, *Historische Statistik der Schweiz*, pp. 810–1; V. Mazzolini, *Le banche nel Ticino*; ASI, Milan, *Banca Commerciale Italiana*, Us, b, 8.

48 H. Siegenthaler, *Historische Statistik der Schweiz* (Zurich 1996), pp. 810–1; Kuder, *Italia e Svizzera nella seconda guerra mondiale*, p. 71.

Figure 4 – BSI and Banco Lariano: percentage change, on a four-year basis, of deposits and correspondent accounts



Source: ASI, Milan, *Banca Commerciale Italiana, Us, b, 8*. Data on Banco Lariano are available at <http://imitadb.unisi.it/home.asp> (Last accessed: 9 April 2013).

example, make a change in the total balance sheet partly reflect the fluctuations in exchange rates. On the other hand, it is likely that the items that appear in the financial statements only give a partial view of the global banking business: consider, for example, 'off balance sheet' operations such as the custody of funds and securities transactions on behalf of third parties.⁴⁹ In view of this, looking at the total assets of the Tessin banks we could argue that the development of two banks strictly linked to Italy – the BSI and the BUC, both controlled by two Italian banks, the first by Comit and the second by Credit – was basically similar to that of the big Swiss banks, which were characterised by strong growth in the 1920s and a marked contraction in the following decade. However, this contraction emerged for BSI at around 1934, apparently due to its greater sensitivity to regulatory changes introduced in the neighbouring state, which must have impeded the normal relations entertained until then, by requiring the return to Italy of investments and deposits abroad (Figure 3). A comparison of deposits collected by the BSI and Banco Lariano, operating on the opposite sides of the border, seems to highlight the difficulties

⁴⁹ Mazzolini, *Le banche nel Ticino*, pp. 74–5 and 99.

encountered in the second half of the 1930s in Tessin, albeit with due caution, since nothing is known of any capital and securities in custody, which do not appear on the balance sheet (Figure 4). This trend, however, was much more pronounced for the BUC (closely related to the history of the Feltrinelli mentioned above) than for the BSI, which was able to always keep high levels of liquidity. According to some sources, at the end of WWII this bank held, along with Schweizerische Kreditanstalt, most of the Italian deposits in Switzerland.⁵⁰

The capital movements across the border are therefore a key variable for understanding the evolution of that part of the Tessin banking place, which is more strictly interwoven to the Italian market and, possibly, to the Como credit system. The interplay between the two sides of the border is structurally unstable, clearly prone to factors that are exogenous to the two local entities such as the above-mentioned restrictive measures taken by one of the political authorities in defence of national interests. The frontier, in this case, was supposed to act mostly as a 'barrier' between two different institutional systems. But there could also be some exceptional events that strengthen the effect of a border. Such was the case during WWII on the place of Como, when Banco Lariano reached very high levels of liquidity due to the outstanding rise in deposits and because of massive inflows of refugees to Como's province as well as firms from Milan in search of a safe place near the frontier with neutral Switzerland. It was essentially 'hot money', which had flowed to Como for exceptional political reasons and was potentially unstable, but it turned out to be essential during the post-war period in giving the local banking place the opportunity to get hold of new clients from outside the provincial area.⁵¹ This allowed the Banco Lariano to downsize the negative impact of war inflation on the real value of its deposits, while the inflationary trend had rather devastating

50 D. Gerardi, *La Suisse et l'Italie 1923–1950. Commerce, finance et réseaux* (Neuchâtel 2007), 476; ASI, Milan, Banca Commerciale Italiana, Us, b, 8.

51 ASI, Milan, Banco Lariano, Verbali del Cda, scat. 1094, vol. 8, 18.3.1944, 24.2.1945, 2.8.1945; ASBI, Rome, Banca d'Italia, Vigilanza, pratt., no. 1345, fasc. 1, sfasc. 1–2.

effects for the Italian banking sector as a whole: between 1942 and 1945, i.e. the period of maximum inflation, this value decreased by 78 per cent at the national level, while in 1946 Banco Lariano could still rely on deposits equal, in real terms, to 74 per cent of their value in 1939.⁵²

III.

Finally, thanks to the presence of a frontier, the Tessin banking place has become a strategic centre for Italian interests, both for banks and for public institutions, who were able to make international operations through Swiss companies. This is probably the feature that stands out more clearly as a distinguishing feature of the two neighbouring banking systems. In this respect a direct link is apparent between the big political and financial Italian centres of Rome and Milan (the latter hosting the operational headquarters of some major Italian banks) with the important banking place of Lugano. The geographical proximity of Lugano to Milan, about 80 km from each other, helped to reinforce the idea of Tessin as an appendage of Lombardy in Swiss territory, easily controlled from Italy without the need for overly complex structures and with institutional advantages for being part of Switzerland. It would ensure greater political, economic and financial stability than Italy. Conversely, Como was clearly bypassed in these relationships, not being a financial centre capable of expressing any form of genuine autonomy from Milan.

In this regard, it is necessary to dwell on the banks of Lugano that were under direct Italian control, i.e. the Banco di Roma, the BUC and especially the BSI. While little is known about the activity of the Swiss branches of the Banco di Roma, with regards to the last two banks it is certain that

52 A. Caracciolo and C.O. Gelsomino, 'La Banca d'Italia tra l'autarchia e la guerra 1936-1945', in: F. Cotula, M. De Cecco e G. Toniolo (eds.), *La Banca d'Italia. Sintesi della ricerca storica 1893-1960* (Rome/Bari 2003), p. 386. Data on Banco Lariano are also available at <http://imitadb.unisi.it/home.asp> (Last accessed: 9 April 2013).

they were widely used by the respective controlling shareholders (Credit and Comit) to carry out international affairs – and on the Italian market as well – along with a series of financial companies specifically set up in Lugano to control especially foreign investments. These were maintained outside of any control of the Italian authorities in order to circumvent Italian currency legislation and the many obstacles placed in the way of capital export from Italy.⁵³

In particular, according to its international vision, Comit attached great importance to its subsidiary BSI as this latter allowed it to raise foreign currencies that were made available to the banking group which Comit itself had built abroad since the first decade of the twentieth century. In those years the Italian banking system was able to trigger a process of internationalisation (including primarily Near East, Eastern Europe, Latin America and the major financial centres of London, New York and Paris), which made Italy achieve a deeper integration within the international circuits of capital, mainly in support of trade flows. In the late 1920s the Italian banking network abroad was primarily made up of organisations that operated by adapting to the needs of local business and taking advantage of the investment opportunities provided by the hosting countries, while relying on the parent company and other subsidiaries to get financial support or international banking services. In turn, the Italian headquarters could obtain funds, especially in foreign currencies, from the single subsidiaries in order to manage their treasury, thanks to the availability of an international group. Among the Italian banks involved, the Comit was the most effective in building a widespread overseas banking group.⁵⁴

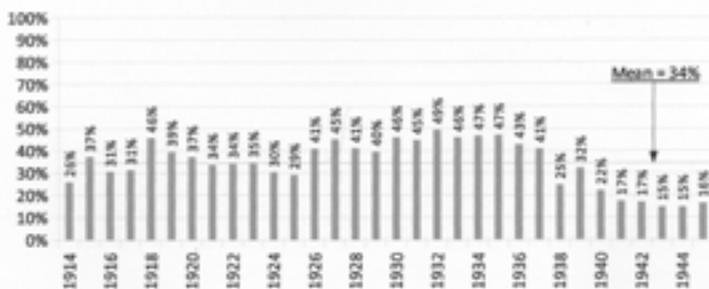
53 Di Quirico, *Le banche italiane all'estero*, p. 117. On the case of BUC see for instance A. Confalonieri, *Banca e industria in Italia 1914–1933. Introduzione. L'esperienza della Banca Commerciale Italiana e del Credito Italiano*, 1 (Milan 1994), pp. 185 and 723.

54 On the banking multinationalization see G. Jones (ed.), *Banks as Multinationals*, (London/ New York 1990). On the international expansion of Italian banks see A. Confalonieri, *Banche miste e grande industria in Italia 1914–1933*, pp. 507–36; G. Toniolo, *Cent'anni, 1894–1994* (Milano 1994), pp. 63–5; R. Di Quirico, *Le banche italiane all'estero*.

A presence on the Swiss place was also to be of primary importance due to its close ties with Italy and other international markets. As a matter of fact, this goal was mainly attained by gaining control of subsidiaries, as was the case of BSI, whose share capital had been mostly acquired by Comit in 1909. The banking group headed by the latter institution was comprised of three main types of banks: the first ones provided the parent company and other group banks with financial resources and foreign currencies; the second ones held their own business while having to resort to the exchange and acceptance services supplied by the first category banks on the international markets; the third ones, finally, depended for their survival on the support and funds provided by the rest of the group.⁵⁵

The BSI belonged to the first category. Together with Comit's branches in London and New York, the North American and French subsidiaries, and the Banca Commerciale Italiana e per l'Egitto, this Swiss bank played, in fact, a role of net creditor to the group, directing capital to Milan and to other Comit subsidiaries. Comit's headquarters could then make use of an external reservoir of funds in foreign currency, which in the early 1930s

Figure 5 – BSI: Ratio of correspondent accounts on total assets (1914–1945)



Source: ASI, Milan, Banca Commerciale Italiana, Us, b, 8.

55 A. Confalonieri, *Banche miste e grande industria in Italia 1914–1933*, pp. 532–3.

was estimated at 40 million Swiss francs. That was to say that, in 1932, 57 per cent of capital raised by the BSI was actually channelled directly to Comit or used in business on its behalf. Furthermore, in the second part of the decade – when exchange controls put in place on an international scale made it increasingly strategic, the function of hard currency collectors carried out by Italian banking affiliations abroad – BSI continued to provide one of the most important contributions, totalling a share of 12 per cent of the overall amount of foreign currencies collected by the whole Comit group in 1937 (23 per cent of those gathered just by its foreign affiliates).

Moreover, this occurred at a time of great difficulty for the Italian banking system abroad, which had to face deposit withdrawals and temporary restrictions of credit by foreign banks, leaving it overall significantly damaged by the financial isolation in which Italy had fallen after the war in Ethiopia. But this role of ‘financial reservoir’ was evidently to

Table 2 – Swiss banks in Basel, Geneva, Zurich and Tessin in 1930 (except savings banks and Raiffeisen banks)

Category	Basel (Stadt and Land)		Geneva		Zurich		Tessin*	
	Nr.	Share capital**	Nr.	Share capital**	Nr.	Share capital**	Nr.	Share capital**
Cantonal banks	1	25.0	0	0.0	1	70.0	1	5.0
Big banks	2	260.0	1	60.0	3	300.0		
Local banks	5	20.8	3	39.3	8	13.5	4	15.1
Mortgage banks	2	7.0	1	12.0	1	15.0		
Financial companies of banking nature	12	465.5	16	261.4	15	387.6		
Total	22	778.3	21	372.7	28	786.1	5	20.1

* Lugano and Bellinzona
 ** Mln Swiss Francs

Source: *Swiss National Bank Das Schweizerische Bankwesen im Jahre 1930 (Zurich 1931), pp. 83–92.*

subordinate, at least partly, the operations of the BSI to the more general needs of the group, as it seems that by looking at the investments of this bank which, for most of the inter-war period, tended to focus on the correspondent accounts (presumably with Comit and the other banks in the group) with a peak of almost half of its total assets in 1932 (Figure 5).⁵⁶ It is highly probable that the high values reached by the accounts with correspondents in the first half of the 1930s reflected the strong support provided by BSI to Comit during the global crisis, while the dramatic decrease that took place during WWII had to be a consequence of the unfavorable course of the war for Italy that led to the almost total liquidation of the Italian banking system abroad, thus putting an end to that circuit of capital within the Comit group.

In the inter-war years, the creation of several financial companies in Lugano by the initiative of some Italian banks was a distinct sign of the interest that this place was able to attract, foreshadowing its future success as a financial centre. Lugano certainly did not have the same financial

Table 3 – Number of bank counters in 1944 (except Raiffeisen banks)

Category	Basel (Stadt and Land)	Geneva	Zurich	Tessin
	Nr.	Nr.	Nr.	Nr.
Cantonal banks	33	1	123	13
Big banks	13	11	46	14
Local banks	24	9	70	32
Savings banks	10	1	90	0
Private bankers	18	12	17	1
Foreign banks	3	5	2	2
Total	101	39	348	62

Source: Swiss National Bank *Das Schweizerische Bankwesen im Jahre 1944 (Zurich 1945)*, pp. 146–7.

⁵⁶ ASI, Milan, Banca Commerciale Italiana, Carte Mattioli, cart. 3, fasc. II, parte II: L'Estero; Di Quirico, *Le banche italiane all'estero*, pp. 244–5.

strength as other Swiss regions, near a border or not. It could not compare, for instance, to geographic areas such as Basel, Zurich or Geneva, which had a banking system much more consistent in both number of institutions and invested capital (Table 2). This difference was less pronounced, however, when the number of bank counters is taken into account, showing a marked dependence of Tessin on decision-making centres from outside the canton (Table 3). Anyway, Tessin was able to gather up international activities that were part of some large Italian banks, which were not interested in the local economy, but were attracted by the opportunity to manage foreign investments in banking, commercial and industrial shareholdings by means of the legal protection provided by a Swiss company, allowing them to circumvent the more restrictive Italian law, especially in regard to foreign exchange.⁵⁷

Credit set up a holding company in Switzerland in 1929, the SA Gestione Valori (AGEVA), which was entrusted with part of its holdings that, in this case, were mainly in Italian companies. However, Comit was the most active bank in this direction. In 1921, together with its considerable foreign development, the Società Internazionale di Credito Mobiliare e Immobiliare (SICMI) was created in Lugano, which later on became the holding company of the majority of Comit's foreign investments. In the following years other financial companies were created, building up a vertical structure controlled by the Milan office of Comit that, through SICMI, managed other holding companies as well, such as Justa – created in Zurich in 1924 and moved to Lugano in 1927 – and the Società Anonima di Partecipazioni ed Affari Finanziari (SAPAF), always based in Lugano.⁵⁸ The crisis of the universal banks in Italy and the subsequent state intervention by the Istituto per la Ricostruzione Industriale (IRI) in the first half of the 1930s did not change this situation significantly, except for some

57 R. Romano, *Il Canton Ticino tra '800 e '900. La mancata industrializzazione di una regione di frontiera* (Milan 2002), p. 102.

58 Di Quirico, *Le banche italiane all'estero*, p. 117; ASI, Milan, Banca Commerciale Italiana, UF, cart. 10, fasc. 3–4.

rationalisation, since the same IRI was aware of the usefulness of holding financial companies in neutral countries to manage their interests abroad; particularly in politically unstable years such as the second part of the decade. In fact, after the Ethiopian war, the Swiss financial centre became increasingly important for Italian state bodies. As a result, some existing financial institutions were maintained and others were newly created. In 1935 the Justa of Lugano became the holding company to which the IRI moved part of its foreign holdings, with the purpose of evading the sanctions imposed by the League of Nations after the Italian invasion of Abyssinia. This structure lasted until the end of WWII, when the process of liquidation of Italian financial companies in Switzerland eventually began, as they had become unnecessary, since they held properties and loans in Central and Eastern Europe that had been lost because of the war.⁵⁹

It is therefore noticeable that the financial relations between Italy and Switzerland had become deeper and deeper since the international isolation of Italy after the war in Ethiopia, when the Swiss banks took the place of those of the US, France and the UK in granting short and medium term credits to Italian banks and the INCE. In fact, in August 1939, when conflict was imminent and the Italian state feared the freezing of Italian funds deposited in banks based in warring countries, the Italian minister for trade and currencies, Felice Guarneri, ordered the banks, administrations and government agencies to transfer available funds placed in London and Paris to Switzerland, preferably to Lugano.⁶⁰

In these events, the place of Lugano became a kind of connecting point between Milan and the primary financial centre of Zurich, which hosted an important stock exchange and was also an international market for foreign exchange trading. From this point of view, the decision of BSI to take over, in 1936, the Zurich subsidiary of the Italian bank Istituto

59 Kuder, *Italia e Svizzera dal 1945 al 1970*, pp. 178–9; Di Quirico, *Le banche italiane all'estero*, pp. 268–70; ASI, Milan, Banca Commerciale Italiana, Carte Mattioli, cart. 153, fasc. Lory Antonio.

60 F. Guarneri, *Battaglie economiche tra le due grandi guerre. 1936–1940*, 2 (Milan 1953), p. 419.

Italiano di Credito Marittimo (Credimare), after the liquidation of the latter, appeared remarkable. Among the banks under Italian control then present in Switzerland (Credimare, BSI, BUC and Banco di Roma), the Credimare was, in fact, the only one based in the greater financial and commercial Swiss centre: therefore, it had to be advantageous to keep a banking institution with predominantly Italian capital there, especially to operate on the foreign exchange market in view of Italian needs in this field during and after the economic sanctions. On the one hand, in fact, it was then possible to have direct access to the Swiss stock market and intensify financial relations with the rest of Switzerland, also on behalf of other Italian banks for export credit operations; on the other – as one considers that the INCE held sizeable resources at the Credimare of Zurich (688,000 Swiss francs on 30 June 1935) and that the latter carried out stock exchange operations even for the Bank of Italy – the BSI occupied a privileged position on that place for the Italian authorities, alongside the major Swiss banks.⁶¹ This was a position that would come in handy during the war when, as a result of the blockade decreed in 1941 by the United States of all European capital deposited in American markets, the Zurich branch of the BSI was commissioned to perform foreign exchange transactions on behalf of the Bank of Italy in order to increase the market of lira in that place.⁶²

IV.

Between the two world wars, the border between Tessin and Italy separated two areas of different levels of economic development. The Italian-speaking Swiss canton showed a backward economy compared to the rest

61 ASI, Milan, Banca Commerciale Italiana, Ad 2, cart. 17, fasc. 23; Ad 2, cart. 8, fasc. 5, f. 11; Gerardi, *La Suisse et l'Italie 1923–1950*, p. 486.

62 ASBI, Rome, Banca d'Italia, Segreteria particolare, pratt., no. 172, fasc. 1.

of the Confederation, as well as towards the neighbouring Italian region of Lombardy, which Tessin also belongs to from a geographical point of view. It is also divided by the Alps from central and northern Switzerland. The ethno-linguistic homogeneity is another element that relates Tessin to Italy, not to mention the high percentage of Italians living in this canton, which in 1930 reached around 19 per cent of Tessin's total population.⁶³ The border region considered here, which includes the Swiss canton of Tessin and the Italian province of Como, is thus characterised by differential factors of an economic and institutional nature but also by similarities that, on the whole, have strongly influenced the development of banking systems at the local level.

In typical border regions such as Tessin, Basel or Geneva, the frontier has never been able to completely separate geographical, economic and cultural areas related to each other, even in the historical periods in which protectionist policies largely prevailed. Yet, at the same time, the existence of a political boundary managed to distort many relations that are complementary by their nature. The inter-war years, for example, which were characterised by increasingly invasive government intervention in commercial and currency transactions, accentuated the effect exerted by the border. This also seems true for banking systems operating at the local level of the frontier region, as the events relating to the town of Como and Tessin canton clearly prove.

The banks in Como were placed in a well developed local economy, capable of producing a mass of bank deposits among the highest in Italy, so that this province was second only to Milan in the Lombardy region which, together with Piedmont, held the greatest amount of deposits at the national level: in 1933, the province of Como (taking into account also that of Varese, whose northern part belonged to the province of Como until 1927) was fourth in Italy for bank deposits.⁶⁴ Como's banking system

63 Kuster, *Il Ticino zona franca italiana?*, p. 25.

64 Bollettino mensile di statistica dell'Istituto centrale di statistica (Rome 1935), p. 61.

actively participated in currency transactions and trade financing. That was directly connected to the fact that the province's industrial output was for a significant part addressed toward export, and its proximity to the political border and international station of Chiasso, which was strategically placed along the railway of S. Gotthard. In some cases, it also seems that there was a kind of interaction between the banks in Tessin and those in Como, as if the latter were in some way functional to the former, for example, as collectors of Italian banknotes previously exported to Chiasso and Lugano and then remitted to Italy to the place of Como.

It should however be pointed out that despite the economic strength of this province, the number of bank counters in Como was not overabundant (in 1936, 108 counters compared to 189 in Bergamo, 183 in Brescia and 368 in Milan), partly because of a low number of rural banks. In this regard, it was observed that Como had not assumed a 'regional' function, being unable to conduct an autonomous action, at least in part, in front of Milan, as was the case of the financial centres of Brescia and Bergamo. The Lombard metropolis continued to affect the credit circuit of the Como place.⁶⁵ On the other hand, the consistency of the local industrial system, especially the textile and mechanical industry, the importance of tourism and the liveliness of international trade made this place particularly attractive for big national banks, also because its location on the borderline was a strategic position in the currency movements between Italy and Switzerland.

Tessin, for its part, has largely benefited from the presence of a boundary between two very different states as to density of population, economy, fiscal policy and income. Especially considering the banking centre of Lugano and the commercial centre of Chiasso, the Swiss economic and institutional framework has granted this canton some advantages that allowed

65 A.M. Biscaini (ed.), *Struttura funzionale e territoriale del sistema bancario italiano 1936-1974* (Rome 1977), pp. 258-9; A.M. Galli, 'Banca e credito: formazione, struttura e vicende del sistema locale', in: G. Rumi (ed.), *Storia di Como. Dall'Età di Volta all'epoca contemporanea (1750-1950)*, 5-3 (Como 2008), p. 334.

it to grow in the long run far beyond the possibilities of its real economy. The stability of the border, the traditional neutrality of Switzerland and its monetary stability are some of the main factors that come into play in explaining the competitive advantage not only of the Swiss Confederation in the international economy, but also, specifically, of the Tessin border region: as all border areas, the latter is therefore the result of local characteristics and national factors, whose interplay can give rise to different outcomes in time and space. Especially in times of national protectionism, the border acts as a sort of dam that regulates the institutional and economic difference between different state realities: the higher the unbalance, the greater the opportunities for the area which is institutionally and economically 'strong' to take advantage of its position. At the same time, however, the economy of the border region looks fragile, as it is likely to depend in an unstable way - in the absence of a structurally strong local economy - on the persistence of those same advantageous conditions that, most of the time, are outside of their control possibilities. The currency regulations introduced in Italy in the mid-1930s provide a clear example of how decisions taken at the national level sometimes considerably modify the general framework, thus also reflecting on the border areas.

In the absence of a border, it is very likely that Tessin would not have had the same importance as a banking centre, due to the limited size of the local economy, but it would have gravitated around the banking place of Como, an industrial pole with higher potential, and made up of both local credit institutions and branches of national banks. In particular, the large Italian banks such as Comit, Credit and Banco di Roma would hardly have been attracted by the peripheral centres (compared to Lombardy) of Lugano and Chiasso, which, without the presence of a political boundary, would have been marginalised. The Como banking system, for its part, could have had a wider range of influence than it actually achieved due to the high degree of attraction exerted by Milan to the south, and to the emergence of the Tessin place to the north. Como was then pressed

between two banking poles by which it was sometimes circumvented or, alternatively, acted as an intermediary between them. The dramatic developments after WWII then took place within an institutional context that was already deeply shaped by the border between the two wars. It is left to ascertain how the process of gradual legislative liberalisation in the second half of the twentieth century has altered the banking structures between the two sides of the border.

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THE REGULATION OF FOREIGN BANKS IN SWITZERLAND (1956–1972)¹

THIBAUD GIDDEY²

Abstract

The Swiss financial centre witnessed an important shift during the 1960s: the number of foreign banks and their importance in relation to the domestic banking sector significantly increased. Faced with this rapid development, Swiss bank representatives and political and monetary authorities reacted strongly. This paper investigates the evolution of the regulatory response by Swiss banking policy actors to the proliferation of foreign financial institutions. In 1969, those reactions led to the adoption of a discriminatory regime, setting higher entry barriers for foreign banks than for domestic institutions. After examining possible reasons for the attractiveness of Switzerland to foreign banks, this paper will analyse the concerns and fears of the domestic banking sector and its regulators. In this regard, it appears that issues such as mere competition, preservation of the international reputation of the Swiss banks and anti-inflationary monetary policy were central to the chosen regulatory regime. Moreover, this paper shows that foreign banks were used as scapegoats in the evolution of the Swiss system of banking supervision. They were more tightly regulated, yet the general framework remained very lax.

1 This article is based on research carried out as part of my ongoing doctoral thesis at the University of Lausanne under the supervision of Dr. Malik Mazbouri, dealing with banking supervision in Switzerland and Belgium (1935–1975).

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Introduction

‘An uncontrolled expansion of foreign influence on our banks represents a real threat to the country.’³ Those are the words used in November 1968 by the Swiss federal government to sum up the dangers related to the increasing foreign hold over the Swiss banking industry. The use of expressions such as *Überfremdung* or *surpopulation étrangère*, which can be partially translated to the English term: ‘excessive foreign control’, refers to a political leitmotif in the Swiss politics of the 1960s. It is noteworthy to mention from the outset that in the context of banking regulation, the federal government adopted the same vocabulary as used in various other political fields such as immigrant labour and corporate governance.⁴

This paper examines the setting up of special regulations for foreign banks in Switzerland in the 1960s. The process began at the end of the 1950s and led to the promulgation of the federal decree establishing the licensing system for foreign-controlled banks of 21 March 1969. A central thesis of this article is that the passing of discriminatory regulation constitutes an important victory for Swiss banking circles, which successfully managed to impose stronger requirements on threatening foreign competitors.

Most historians have neglected this episode in the history of the Swiss financial centre. Although a number of publications address the growing internationalisation of Swiss banks in the second half of the twentieth

3 ‘Message du Conseil fédéral à l’Assemblée fédérale à l’appui d’un projet d’arrêté fédéral urgent instituant le régime du permis pour les banques en mains étrangères (du 13 novembre 1968)’, *Feuille fédérale*, 1968, vol. 2, no 48, p. 787.

4 On the question of immigrants: M. Cerutti, ‘La politique migratoire de la Suisse 1945–1970’, in: H. Mahnig (ed.), *Histoire de la politique de migration, d’asile et d’intégration depuis 1948* (Zurich 2005), pp. 89–134. On the question of corporate governance: M. Lüpold, ‘Der Ausbau der “Festung Schweiz”: Aktienrecht und Corporate Governance in der Schweiz, 1881–1961’, unpublished PhD thesis (Zurich 2010).

century,⁵ the available literature on the development of foreign banks in Switzerland and the limitations imposed on them by the authorities, is remarkably scarce, consisting mainly of legal studies.⁶ Willi Loepfe's recent monograph provides the only historical analysis of the topic.⁷ The paucity of the historiography stands in strong contrast to the richness of the Swiss public archives, which contain an insightful collection of documents. The central core of this article is based on primary archival sources, mainly the archives of the Swiss Federal Banking Commission, the archives of the Swiss National Bank and the archives of the Swiss Bankers Association.

This paper will proceed as follows. The first section puts the regulatory intervention into the context of the extraordinary growth of the Swiss financial sector (1945–1975), and lays out the international criticism levelled against the Swiss banking haven. This is followed by a section

5 See for example: B.V. Christensen, 'Switzerland's Role as an International Financial Center', IMF Occasional Paper, no 45 (1986), pp. 1–40; P. Braillard, *La place financière suisse. Politique gouvernementale et compétitivité internationale* (Geneva 1987); J. Tanner, 'Der diskrete Charme der Gnomen: Entwicklungen und Perspektiven des Finanzplatzes Schweiz', in: C.M. Merki (ed.), *Europas Finanzzentren. Geschichte und Bedeutung im 20. Jahrhundert*, (Frankfurt/New York 2005), pp. 127–47; T. Straumann, 'Finanzplatz und Pfadabhängigkeit: Die Bundesrepublik, die Schweiz und die Vertreibung der Euromärkte (1955–1980)', in: C.M. Merki (ed.), *Europas Finanzzentren. Geschichte und Bedeutung im 20. Jahrhundert*, (Frankfurt/New York 2005), pp. 245–68; C. Baumann and W.E. Rutsch, *Swiss Banking – Wie weiter? Aufstieg und Wandel der Schweizer Finanzbranche* (Zurich 2008).

6 E.F. Burkhalter, *Die Bedeutung, das Wesen und die Struktur der von der Schweizerischen Nationalbank als 'Übrige Banken' bezeichneten Institute*, (Thun 1969); (thereafter: Burkhalter, *Übrige Banken*); M. Meyer, *Die Ausländischen Banken in der Schweiz. Studie im Auftrag des Verbandes der Auslandsbanken in der Schweiz* (St. Gallen 1975); (thereafter: Meyer, *Ausländischen Banken*); H. Schönle, 'Zur rechtlichen Stellung ausländischer und ausländisch-beherrschter Banken in Deutschland, den USA und der Schweiz', in: M. Lutter, H. Kollhoser and W. Trusen (ed.), *Recht und Wirtschaft in Geschichte und Gegenwart. Festschrift für Johannes Bärmann zum 70. Geburtstag*, (Munich, 1975), pp. 893–920; J.-P. Chapuis, 'Le statut des banques étrangères en Suisse', *Droit et pratique du commerce international*, vol. 1, no 1 (1976), pp. 119–38; A. Hirsch, 'Entry for Foreign Banks: The Principle of Reciprocity – The Example of Switzerland', *Issues in Bank Regulation*, vol. 8, no 1, (1984), pp. 63–6; H. P. Dietzi, 'Das Gegenrechtserfordernis als Bewilligungsvoraussetzung zum Geschäftsbetrieb einer ausländischen bzw. ausländisch beherrschten Bank', in: R. v. Graffenried (ed.), *Beiträge zum schweizerischen Bankenrecht* (Bern 1987), pp. 71–90; D. Poncet and C. Lombardini, 'La surveillance des banques étrangères et des groupes bancaires internationaux. La perspective suisse', in: C. Dominicé, R. Patry and C. Reymond (ed.), *Etudes de droit international en l'honneur de Pierre Lalive* (Basel/Frankfurt 1993), pp. 322–33.

7 W. Loepfe, *Der Aufstieg des schweizerischen Finanzplatzes in der Nachkriegszeit. 1945 bis 1975*, (Weinfelden 2011), pp. 197–206; (thereafter: Loepfe, *Aufstieg des schweizerischen Finanzplatzes*).

describing the evolution, origins and motivations of the foreign banks that set up in Switzerland. The third section – the heart of this article – presents the reactions of the Swiss authorities and banking circles to the growing establishment of foreign financial institutions, and emphasises the motivating and restrictive forces in the decision-making process. The final section discusses the key findings and assesses the impact of the legislation.

I.

Post-World War II economic expansion was a period of remarkable growth for the Swiss financial centre. During this ‘Golden Age’ (1945–1972), the total assets of Swiss banks increased sixfold in real terms, while the Swiss real GDP increased by a multiple of 4.5.⁸ Although the trend of more dynamic growth in the financial services sector applied to most OECD countries,⁹ the expansion of Swiss finance was outstanding, since it led, at the end of the 1960s, to the establishment of Switzerland as the world’s third most important financial centre behind London and New York.¹⁰ The success of the Swiss financial centre relied on a combination of political and economic factors in the aftermath of World War II: a strong Swiss franc; free capital and currency circulation; political neutrality; infrastructure spared from the destruction of war; low public debt and comparatively low inflation; a lenient taxation system; and banking secrecy protected under criminal law.¹¹ Those competitive advantages were

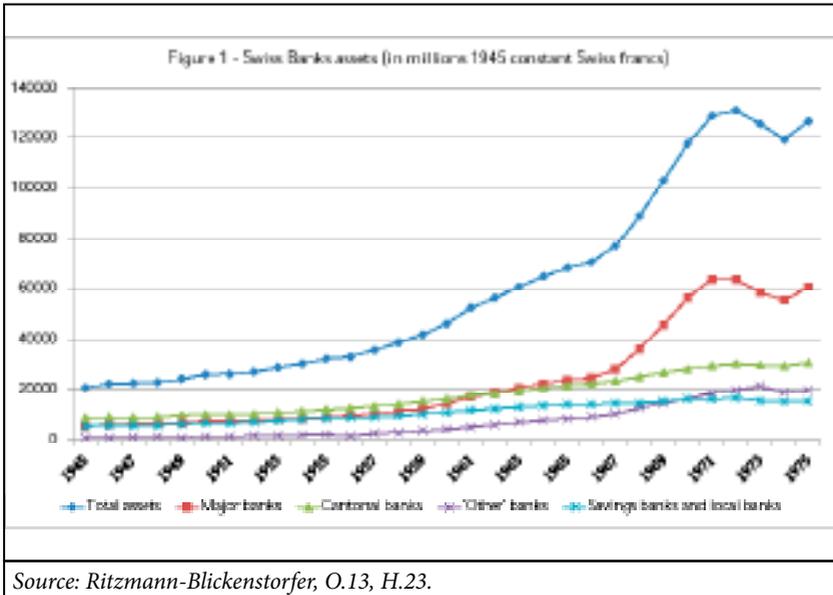
8 H. Ritzmann-Blickenstorfer (ed.), *Historical Statistics of Switzerland* (Zurich 1996), O.13, H.23.

9 C. R. Schenk, ‘Crisis and Opportunity: The Policy Environment of International Banking in the City of London, 1958–1980’, in: Y. Cassis and E. Bussière (ed.), *London and Paris as International Financial Centres in the Twentieth Century* (Oxford 2005), pp. 207–28, 207.

10 M. Iklé, *Switzerland: an International Banking and Finance Center* (Stroudsburg 1972), p. 155; Y. Cassis, *Capitals of Capital: the Rise and Fall of International Financial Centres, 1780–2009* (Cambridge 2010), p. 218; (thereafter: Cassis, *Capitals of capital*).

11 M. Mazbouri, S. Guex and R. Lopez, ‘Finanzplatz Schweiz’, in: P. Halbeisen, M. Müller and B. Veyrassat (ed.), *Wirtschaftsgeschichte der Schweiz im 20. Jahrhundert* (Basel 2012), pp. 467–518, 494; (thereafter: Mazbouri, Guex and Lopez, ‘Finanzplatz Schweiz’).

combined with a long tradition and reputation as a refuge for international funds. When coupled with the extraordinary growth of the world economy, they resulted in a significant inflow of foreign capital. Still, the immediate post-World War II period was a turning point for the Swiss economy, which attempted to return to the new world order. The Swiss diplomatic corps successfully managed to break the isolation and the depreciation inherited from the awkward position towards Germany during the war. The Washington Agreements (25 May 1946) were important steps in the integrative process of Switzerland, and can retrospectively be considered as a victory for Swiss authorities.¹² Following this normalisation of trade relations with the Allies, the Swiss financial centre strongly resumed its international activities. In 1958, the return of many European currencies to convertibility strengthened the surge of capital towards the Swiss financial centre.



12 M. Perrenoud, *Banquiers et diplomates suisses (1938–1946)* (Lausanne 2011), pp. 427–41.

As for the internal competition amongst Swiss banks, the major banks and the 'other banks' – a category that mostly consisted of foreign banks – were the main beneficiaries of the post-war evolution. Both categories showed higher growth rates, in terms of assets, than the cantonal banks as well as the savings and local banks. The major banks thus represented the spearheads of this 'golden age'. The growing internationalisation of banking transactions was the underlying strength of the development of Swiss finance during this period. The share of foreign assets and liabilities in Swiss banks' balance sheets more than doubled between 1962 and 1972.¹³ It is worthwhile to keep in mind that international activity had a long tradition in Swiss banking. As early as the 1920s, Switzerland had occupied a specific position amongst international financial centres: Swiss banks attracted flows of international assets from abroad, which were in turn lent abroad again. This role as a 'turntable' for international capital grew extensively during the 1960s. However, it is only partially reflected in the statistical records of the Swiss National Bank. Indeed, a large part of the transactions took place in off-balance-sheet custody accounts. Cross-border wealth management – as a result of the considerable inflows of foreign capital – became a prime niche-market for Swiss banks. While the amount of capital under management already represented 86 per cent of Swiss GDP in 1948, this share amounted to 237 per cent in 1970.¹⁴

During those booming years, the inflows of foreign capital were so excessive that they incited the Swiss central bankers to take preventive measures. Indeed, the monetary authorities dreaded the inflationary effects related to the inflows of capital and tried to prevent the international use of the Swiss franc as a reserve currency. At first, the Swiss National Bank attempted to settle the problem by signing several gentlemen's agreements with commercial banks. Those agreements included measures such

13 K. Speck, *Strukturwandlungen und Entwicklungstendenzen im Auslandgeschäft der schweizer Banken* (Zurich 1974), p. 35.

14 Mazbouri, Guex and Lopez, 'Finanzplatz Schweiz', p. 477.

as negative interest rates on foreign deposits and the setting of minimal balances and lending limits. Yet these actions proved ineffective, thus the central bankers decided to take another step and prepared a draft of an amendment to the Swiss National Bank law. The bankers opposed this plan and in 1969 the parliament rejected the entire proposal.¹⁵

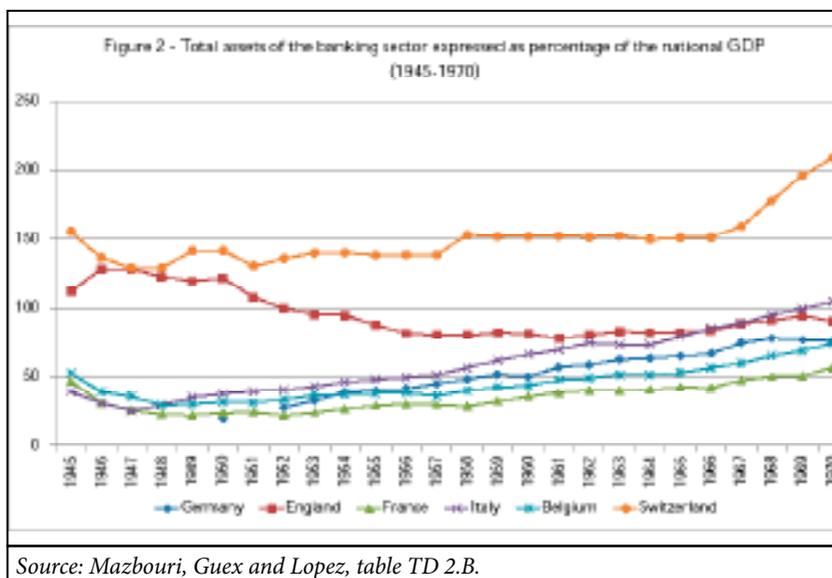
When compared internationally, the growth of the Swiss financial sector is also outstanding. Not only was the power and size of the financial sector disproportionate to the country's surface and real economy, but the development of an oversized banking industry also increased during the post-war period. According to Mazbouri, Guex and Lopez, who compare the size of the major Swiss banks with their European counterparts, the major Swiss banks had much higher growth rates than the German *Grossbanken*, the largest French deposit banks or the British 'Big Five'. In 1970, the assets of Swiss banks reached 60 per cent of British banks, 64 per cent of French banks and 92 per cent of German banks.¹⁶ This trend is evident when the assets of the banking sector are expressed as a share of national GDP. The following figure (Figure 2) clearly shows the specific position of Switzerland compared to other European economies.

In parallel with this formidable growth, the Swiss banking industry coped with increasing international criticism directed against it during the post-war period. Some of the features and practices of the Swiss banks, such as banking secrecy, numbered accounts and related tax evasion, were at the heart of international denunciation. Admittedly, international tensions related to Swiss banking secrecy already existed during the interwar period,¹⁷ but grew extensively in the 1960s. In 1956, the English labour MP and later Prime Minister, Harold Wilson, accused the 'Gnomes

15 P. Bernholz, 'From 1945 to 1982: the transition from inward exchange controls to money supply management under floating exchange rates', in: W. Abegg (ed.), *The Swiss National Bank 1907–2007* (Zurich 2007), pp. 109–99, 194–5; R. Äppli, et al. (ed.), *75e anniversaire. Banque nationale suisse: les années 1957 à 1982* (Zurich 1982), p. 131.

16 Mazbouri, Guex and Lopez, 'Finanzplatz Schweiz', pp. 474–6.

17 C. Farquet, 'The Swiss Tax Haven in the Interwar Period: An International Comparison', paper for the conference 'The Sub-prime Crisis and how it Changed the Past' (Geneva 2011).



of Zurich' of speculating against the pound sterling. At the time of the creation of the Zurich gold pool by the major Swiss banks in 1968, tensions with the City revived. The Zurich gold market soon exceeded the London market in the sale of South African gold.¹⁸ Preceding this event, the American journalist T.R. Fehrenbach published a successful book highlighting some of the affairs related to Swiss banking.¹⁹ Many world-famous newspapers such as the *New York Times* and the *Financial Times* became interested in Swiss banks and the reasons for their success, thus making a broader audience pay attention to those questions. The frequent presence of Swiss landscapes as backgrounds in James Bond movies – which were systematically linked to financial transactions – was a cultural reflection of this evolution and played a part in the popularisation of a stereotypical

18 S. Bott, 'La Suisse et l'Afrique du Sud. 1945–1990. Commerce, finance et achats d'or durant l'apartheid', unpublished PhD thesis (Lausanne 2008); Loepfe, *Aufstieg des schweizerischen Finanzplatzes*, pp. 206–28.

19 T.R. Fehrenbach, *The Swiss Banks* (New York/London/Toronto 1966).

image of the Swiss banker.²⁰ The Swiss Bankers Association soon realised the potential damage of the international critical campaign to the Swiss banking reputation: in 1967, it was decided to counter-attack and set up a special committee in charge of improving the advertising activity of banks abroad.²¹ This public relations operation was carried out in collaboration with the *Département politique fédéral* – i.e. the Foreign Affairs Ministry – which sent a circular to Swiss diplomatic representations in order to contribute to ‘a better understanding of our banking practice.’²² This international context, marked by a cyclical resurgence of strong criticism of Swiss banks, should be taken into account when analysing the reactions of the Swiss banking industry to the growing establishment of foreign banks in Switzerland.

II.

The competitive advantages of the Swiss financial centre already mentioned, as well as very liberal regulation of banking operations, enticed many foreign financial institutions into opening a branch or a subsidiary bank in Switzerland. Before proceeding, four different kinds of foreign establishments should be distinguished. Firstly, a foreign bank could simply open a representative office, which did not involve the incorporation of a company. A representative office was not subject to the banking law and thus was not allowed to perform banking operations. Secondly, a foreign bank could open a branch, that is, a foreign affiliate that was legally part of the company. This kind of foreign establishment had already been under

20 S. Guex and G. Haver, ‘James Bond contre – ou pour ? – les gnomes de Zurich: L’image de la place financière suisse dans la série 007’, in: F. Hache-Bissette, F. Bouilly and V. Chenille (ed.), *James Bond (2)007: Anatomie d’un mythe populaire* (Paris 2007), pp. 330–8.

21 *Archives of the Swiss Bankers Association* (hereafter: ASBA), Minutes of the Board of Directors, preliminary report, 21 Jun. 1967.

22 Circular from Pierre André Nussbaumer (DPF) to the diplomatic representations, 16 May 1967, Documents Diplomatiques Suisses, vol. 24 (1967–1969) (Zurich 2012), doc. 23, dodis.ch/33015.

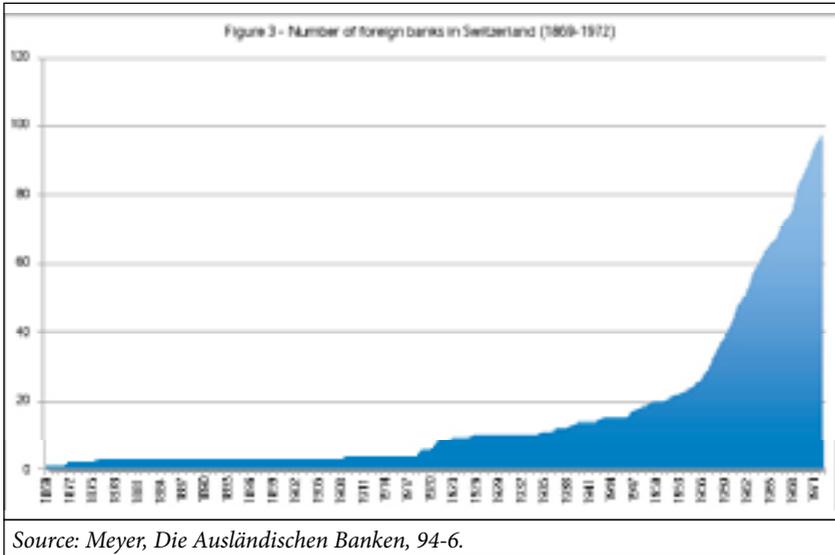
special regulation since 1936: the reciprocity requirement was the main condition to be met in order to establish a foreign branch.²³ The third type of establishment was the incorporation of a subsidiary company. These were banks with their own legal personality, but whose share capital was owned by a single parent company. Lastly, there were also so-called foreign-controlled banks, which were legally the same as subsidiaries. The difference lay in their corporate name, which did not clearly express their foreign nature, and the fact that they were not linked to a single specific parent company but could be owned by one or several financial groups. Until 1969, both subsidiaries and foreign-controlled banks were legally considered Swiss banks, with free entry to the banking sector. Based on this, a foreign investor seeking to open a financial company in Switzerland had a wide range of choice when it came to these different types of establishments. There was a form of ‘regulatory arbitrage’, in which foreign investors could choose the form of incorporation best suited to their needs. As an example: the French Banque de Paris et des Pays-Bas, active in Geneva since 1872 in the form of a branch, decided in 1968 to change to a subsidiary.²⁴

As shown in figure 3, the first foreign banks in Switzerland date back to the end of the nineteenth century. French banks, such as Banque de Paris et des Pays-Bas or Crédit Lyonnais, were part of that movement. Their presence in Geneva mainly allowed them to play an active role in the export of capital to Switzerland.²⁵ During the inter-war period, a dozen foreign banks opened their doors, such as the Geneva branch of Lloyds Europe. But the real take-off of foreign banks in Switzerland took place after the Second World War: 82 out of 96 foreign banks active in

23 Decree from the Swiss Federal Banking Commission concerning foreign banks that are active in Switzerland, 15 Feb. 1936.

24 E. Bussière (ed.), *Paribas 1872–1992: l’Europe et le monde* (Antwerp 1992), p. 163.

25 F. Walter, ‘Finance et politique à la belle époque: la France et les emprunts de la Confédération helvétique (1890–1914)’, *Revue suisse d’histoire*, vol. 32, no 3, (1982), pp. 421–50, 432; Y. Cassis, ‘Le Crédit Lyonnais à Genève, 1876–2001’, in : B. Desjardins, et al. (ed.), *Le Crédit Lyonnais (1863–1986): études historiques* (Geneva 2003), pp. 617–29.



Switzerland in 1972 were set up after 1945; 68 of them were founded after 1958. Indeed, there was a sharp increase after 1958. One of the key factors in this evolution was the restoration of currency convertibility in 1958. In terms of numbers: the share of foreign banks relative to the total number of institutions rose from four per cent in 1945 to eight per cent in 1958 and finally to 20 per cent in 1972.²⁶ In terms of balance sheets: the share of foreign institutions in the total assets of Swiss banks grew from approximately three per cent in 1958 to ten per cent in 1968, and ultimately to 11 per cent in 1972.²⁷ The official records confirm this trend: the assets of the category in which the foreign banks were listed (*übrige Banken*) increased tenfold in real terms, between 1956 and 1971.²⁸

²⁶ Meyer, *Ausländischen Banken*, pp. 94–6.

²⁷ 1958 and 1972: author's calculations based on: *Federal Archives* (thereafter: FA), E6520(A), 1983/50, vol. 1, file 'Ausl. Banken 1959–1974'; 1968: 'Message du Conseil fédéral à l'Assemblée fédérale à l'appui d'un projet d'arrêté fédéral urgent instituant le régime du permis pour les banques en mains étrangères, du 13 novembre 1968', in: *Feuille fédérale*, 1968, vol. 2, no 48, 784.

²⁸ According to Burkhalter, 60 per cent of the assets of this heterogeneous category came from foreign-controlled institutions. See Burkhalter, *Übrige Banken*, p. 59.

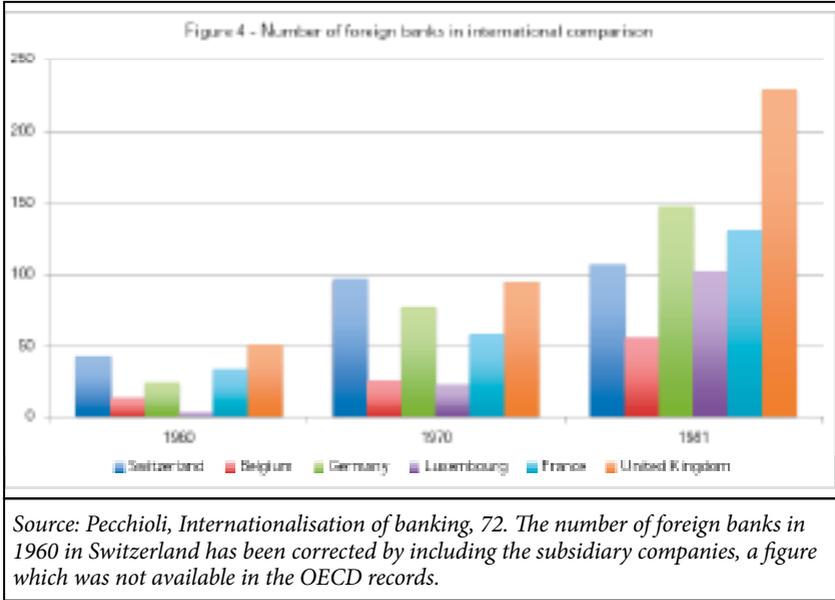
In other words, the Swiss banking sector experienced a massive wave of foreign bank establishments from the 1960s onwards. On a global level, this growth was part of the 'second wave of multinational corporate banking', as opposed to the first wave that took place in the nineteenth century with the expansion of British overseas banks.²⁹ American commercial banks were the main driving force of the second wave, which was related to the birth of the Eurodollar market and the rise of offshore centres.³⁰ The expansion of foreign banks in Switzerland during the 1960s remained outstanding when compared internationally. According to an OECD study, the internationalisation of the Swiss financial centre rapidly increased during the 1960s. In 1970, Switzerland was a safe haven for 97 foreign banks, a number equivalent to the British total (95), but much higher than in Germany (77), France (58) and Belgium (26).³¹

Throughout the twentieth century, there also was a clear evolution with regard to the national origin of the banks established in Switzerland. Until the Second World War, foreign financial institutions for the most part came from neighbouring countries. French banks in Geneva and Italian banks in the Italian-speaking region of Ticino accounted for the bulk of foreign banks. During the 1950s, Switzerland faced a strong increase in Middle Eastern banks (Israeli, Lebanese and Egyptian). This development, speeding up from 1956–1959, is partly linked to the Suez-Crisis, and its destabilising effect on the whole region. Finally, during the 1960s, the large American commercial banks were the most important newcomers to Switzerland. The massive number of American institutions established during the period can be explained by various reasons. Some argued that providing services to American holding companies in Europe was the

29 G. Jones (ed.), *Banks as multinationals*, (London/New York 1990), p. 5. See also K. E. Born, *Geld und Banken im 19. und 20. Jahrhundert* (Stuttgart 1977), p. 572.

30 According to Richard Dale, Switzerland hosted in 1970 eleven foreign branches of US banks out of a total of 93 European US branches. R. Dale, *The Regulation of International Banking*, (Cambridge 1984), p. 7.

31 R.M. Pecchioli (ed.), *The Internationalisation of Banking: the Policy Issues* (Paris 1983), p. 72.



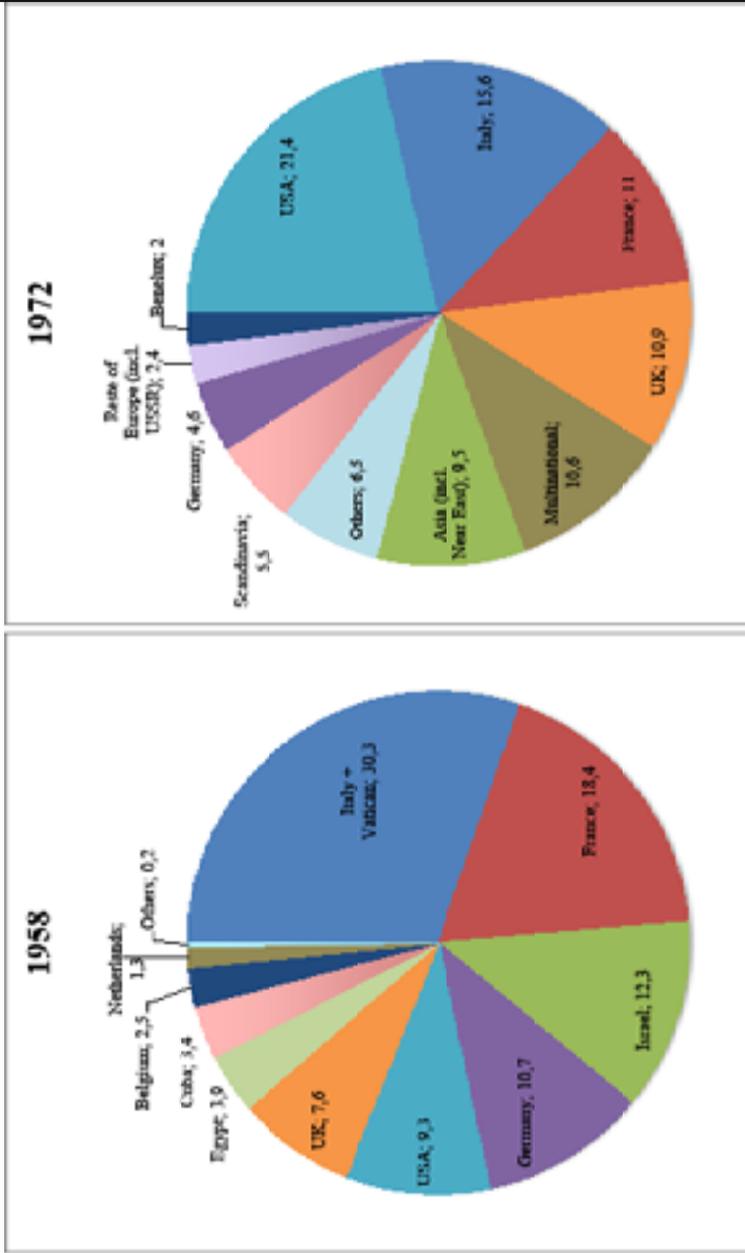
main factor;³² others claimed that Eurodollar investments were the cause of it.³³ This trend is evident in figure 5, which shows that the share of American banks in the total assets of foreign banks in Switzerland grew from nine per cent in 1958 to 21 per cent in 1972. Four American banks ranked amongst the 15 largest banks in Switzerland in 1969. More surprisingly, three out of the five largest banks came from the Near East and at that time had been established less than 20 years.

Another approach to considering the international integration of a financial centre consists in comparing the growth of foreign financial firms to the international expansion of banks from the host country. In this respect, it should be noted that there was, at least up to the 1970s, a certain discrepancy between the dynamic growth of foreign banks in Switzerland

³² Iklé, *Switzerland Finance Center*, p. 89.

³³ A. Matter, 'Die Auslandsbanken im Schweizerischen Bankensystem', (Conference Paper, 1975), p. 4.

Figure 5 – National origin of foreign banks in Switzerland (as share of total assets of foreign banks)



Sources: 1958: Author's calculations based on: FA, E6520(A), 1983/50, vol. 1, file 'Ausl. Banken 1959-1974'; 1972: Meyer, Die Ausländischen Banken, 24.

Rank	Name	Origin	Assets in millions CHF	Foundation Year
1	Lloyds Bank Europe Limited, London*	GBR	1360	1919
2	Banque pour le Commerce Suisse-Israélien	ISR	1219	1950
3	Banco di Roma per la Svizzera	VAT-ITA	1030	1947
4	Discount Bank (Overseas) Ltd	ISR	1026	1952
5	Banque pour le Développement commercial	LBN	905	1960
6	Banque de Paris et des Pays-Bas (Suisse)	FRA	877	1872
7	Dow Banking Corporation	USA	811	1965
8	First National City Bank, New York*	USA	733	1963
9	The American Express International Banking Corporation, New York*	USA	597	1921
10	Lavoro-Bank AG	ITA	553	1959
11	Internationale Genossenschaftsbank AG	DEU	551	1957
12	Banca del Gottardo	ITA	525	1957
13	Arab Bank (Overseas) Ltd	JOR	458	1962
14	Overseas Development Bank	USA/PAN	449	1961
15	Crédit Lyonnais, Lyon*	FRA	435	1876
* : branches of foreign banks				
Sources: FA, E6520(A), 1983/50, vol. 1, <i>Ausländische Banken</i> . Origin: ASBA, J.4 (1967–1969). Foundation Year: SNB, <i>Das schweizerische Bankwesen im Jahre 1971 + Meyer, Die Ausländischen Banken</i> , pp. 94-6.				

and the rather slow expansion of Swiss banks – in terms of branches and subsidiaries – at the global level.³⁴ In 1960, there were already 48 foreign banks active in Switzerland, while major Swiss banks only had twelve international representations. By 1969, those figures had risen to 87 and

34 See also E.F. Paltzer, 'Internationalization of Banking by Foreign Bases and Addresses', in: J.E. Wadsworth, J.S.G. Wilson and H. Fournier (ed.), *The Development of Financial Institutions in Europe, 1956–1976* (Leyden 1977), pp. 167–74, 168.

45.³⁵ This gap is related to some of the specificities of the Swiss financial centre during the first part of the twentieth century, which had become a major actor in international banking, despite, or thanks to, the absence of a network of international branches.³⁶ Interestingly, one of the reasons that can explain the relatively small international expansion lies in the fact that Swiss bankers feared that their presence abroad could be seen as a disadvantage in attracting flight capital. Indeed, foreign customers sometimes considered Swiss banks that did not have foreign representations as safer institutions.³⁷ Yet, it is noteworthy that the internationalisation of the Swiss banks took place with a slight delay. The expansion of the network of international agencies that started at the end of the 1960s – as shown on Map 1 – eventually allowed them to close the gap during the 1970s.

Why did foreign banks decide to settle in Switzerland? A major part of the answer to that question lies in the very liberal banking regulations.³⁸ Firstly, the 1934 banking law set extremely low barriers to entry: a minimum capital requirement, and statutes that specified the sphere of activity. As mentioned earlier, the law also included a provision requiring that branches of foreign banks could only open if the home country granted reciprocity to Swiss banks. However, this restriction only applied to branches of foreign banks, and not to subsidiaries. Under these conditions, the federal supervisory authority had only very limited powers to prevent a bank – Swiss or foreign – from opening.³⁹ Secondly, banking regulations in

35 Author's calculations based on Meyer, *Ausländischen Banken*, pp. 94–6, and the major Swiss banks' annual reports.

36 See Y. Cassis, 'Swiss international banking, 1890–1950', in : G. Jones (ed.), *Banks as Multinationals* (London/New York 1990), pp. 160–172; M. Mazbouri and M. Perrenoud, 'Banques suisses et guerres mondiales', in : V. Groebner, S. Guex and J. Tanner (ed.), *Kriegswirtschaft und Wirtschaftskriege* (Zurich 2008), pp. 233–53.

37 Mazbouri, Guex and Lopez, 'Finanzplatz Schweiz', p. 511.

38 On the Swiss supervision system in international perspective : P. Cooke, 'Some reflections arising from comparisons between the Swiss and other banking supervisory systems', in : U. Zulauf (ed.), *50 ans de surveillance fédérale des banques* (Zurich 1985), pp. 139–50.

39 T. Giddey, 'Gendarme ou médecin des banques? Les premières années d'activité de la Commission fédérale des banques (1935–1943)', *Traverse. Revue suisse d'histoire*, no 3 (2012), pp. 145–63.

Switzerland did not impose any separation of commercial and investment banking activities. The ability to practice any type of financial activity in a safe and discreet environment was certainly an important incentive in the choice of Switzerland. Of course, banking secrecy, which was considerably strengthened in the 1934 banking law,⁴⁰ formed a key component in this regulatory framework. In addition to these flexible regulations, Switzerland also offered a number of generally attractive features: its political stability and neutrality; its geographical location; a strong and freely convertible currency; low tax regimes; and qualified multilingual staff. Unsurprisingly, in a 1972 survey of foreign bank executives, which investigated the reasons for the site selection of Switzerland, wealth management business appeared as the second most mentioned answer.⁴¹ Banking secrecy, the tax environment, international trade as well as political and monetary stability were also among the given reasons.

Two specific examples illustrate the questions regarding the motivations of foreign banks in opening an agency in Switzerland. In 1957, a group of investors from Arab circles were trying to set up a Banque Arabo-Suisse in Geneva. When discussing this new opening, the governors of the Swiss National Bank pointed out that:

‘According to the founders, the planned institution aims to promote trade between Switzerland and the Arab states. However, in our view, there can be little doubt that the new institution will also be designed, in fact probably even primarily, to absorb flight capital from countries in the Middle East. Given the restless situation in the East and the associated risk of international conflict, there is a tendency in the

40 See S. Guex, ‘The Origins of the Swiss Banking Secrecy Law and Its Repercussions for Swiss Federal Policy’, *Harvard Business History Review*, vol. 74, (2000), pp. 237–66.

41 Meyer, *Ausländischen Banken*, pp. 12–7. The first reason being the obvious fact the Switzerland developed into an international financial centre.

Arab world to reduce pound and dollar assets and to take refuge in the Swiss franc.⁴²

In this case, Swiss authorities were aware of the hidden purposes concerning the establishment of this institution, which finally opened in Geneva under the company name Banque commerciale Arabe in 1958. The second example is the Compagnie de Gestion et de Banque, which was a subsidiary of the large Belgian bank, Société Générale. In 1956, this bank specialising in private wealth management set up in Geneva. More precisely, the directors of the Belgian parent company chose to open a subsidiary to resume the activities that had taken place until then in Tangier. In 1956, the international and free zone of Tangier was returned to the then newly independent Morocco and thereby lost its fiscal and customs privileges. With this new situation, the Belgian bank decided to relocate its private wealth management business to Geneva.⁴³ Other banks, such as the French Banque de l'Indochine, followed the same path. These two examples show that there was often a certain discrepancy between the publicly touted reasons and the real, hidden motivations. This difference is also related to the great diversity of banking operations that foreign institutions could perform in Switzerland. The foreign institutions often used their Swiss agency to practice the type of business they could not perform in their country of origin, or that was less profitable there (e.g. wealth management, participation in bond issuance, international trade financing, transactions on custody accounts). Daniel Bodmer, chief secretary of the Federal Banking Commission – Switzerland's banking supervision authority, shared this point of view in 1968:

42 FA, E6100(B), 1972/96, vol. 32, letter from Walter Schwegler and Hans Huber (SNB) to the Federal Banking Commission (thereafter FBC), 3 Sep. 1957. All quotations are translated from German by the author.

43 G. Vanthemsche, 'La Banque de 1934 à nos jours', in: H. van der Wee (ed.), *La Générale de Banque. 1822–1997* (Brussels 1997), pp. 287–526, 365; see also *Archives of the Swiss National Bank* (thereafter: ASNB), Minutes of the Governing Board, 23 Aug. 1956, no 907, p. 1228.

'Sometimes [the foreign bankers] quite openly declare that they wish to conduct from Switzerland the kind of business which is prohibited by the legislation of their mother country. This is also powered by capital flight from countries like Italy, the USA and France. [...] There are probably more frequently extra-economic motives which make Switzerland appear to foreign bank founders as a paradise.'⁴⁴

As this quotation already suggests, Swiss authorities did not remain impassive to the considerable wave of foreign bank establishments. The political and regulatory response of Swiss banking circles and authorities will be presented in the following section.

III.

In a broad outline, three phases can be distinguished in the attitude of Swiss authorities towards the increase of foreign financial institutions. At first, between 1956 and 1965, both the Swiss banking representatives and the monetary authorities became aware of the potential 'threat' represented by foreign banks. They initially adopted a set of indirect obstacles that were supposed to act as a deterrent. Thus, from the late 1950s onwards, when the number of authorisation requests gradually increased, the main actors in Swiss banking politics reacted negatively.

Already in 1956, the Swiss Bankers Association – the powerful bank interest group – frowned upon the establishment of the French Banque de l'Indochine in Lausanne. The bankers put forward four arguments against foreign institutions.⁴⁵ Firstly, they reckoned that the reputation of the Swiss financial centre was at stake. It was 'undesirable and embarrassing for Switzerland' to be considered on the same level as Tangier. Secondly, the

44 FA, E6520(A), 1983/50, vol. 1, Letter from Daniel Bodmer (FBC) to Martin Ungerer, 11 Nov. 1968.

45 ASBA, 713, Eidg. Bankenkommission Bankengesetz, Letter from Max Oetterli (SBA) to FBC, 9 Aug. 1956.

foundation of a wealth management company represented a 'sensitive and direct impairment of the domestic banking sector'. Switzerland was already over-banked and an additional competitor was not welcome. Thirdly, they remembered the experience of the Second World War, which had shown that the presence of foreign banks in Switzerland could increase international restrictions on the entire bank industry. Lastly, they stigmatised the risk of a domino effect, meaning that each new foreign establishment attracted more opening requests. It should be noted that, from the beginning, competition issues were central to the animosity towards the setting up of foreign banks.

The central bank governing board largely shared those concerns, yet pointed to the fact that the Federal Banking Commission, which was in charge of granting the authorisations, had no legal means to prevent the unwanted foundation of a bank. Moreover, central bankers had another cause of concern. Their reaction to the opening of the Banca del Ceresio in Lugano in 1958 was eloquent as they 'expected that the bank would primarily deal with the collection and investment of Italian flight capital'.⁴⁶ Yet their condemnation of Italian tax evasion was not caused by moral scruples, but rather by the monetary consequences related to it. More precisely, the central bank feared that the proliferation of foreign banks, which were considered to be using Switzerland as 'a storage station and marshalling yard for foreign flight capital',⁴⁷ would massively increase the inflows of foreign funds, thus generating adverse inflationary effects.

As for the Federal Banking Commission, it also worried about the substantial increase of requests. The banking supervisors regretted that the law did not impose stricter entry requirements for foreign banks. In the absence of a sufficient legal basis, they were all but powerless. However, in an internal report on the issue, the chief secretary of the Commission, Daniel Bodmer, emphasised that the question was very complex. In some cases,

⁴⁶ ASNB, Minutes of the Governing Board, 5 Jun. 1958, no 604, pp. 888–93.

⁴⁷ ASNB, Minutes of the Governing Board, 21 Aug. 1958, no 908, p. 1366.

he said, there is a tendency to 'dramatise things'. He added: 'Unfortunately, one cannot get rid of the suspicion that the opposition to foreign new foundations also often conceals unacknowledged enviousness'.⁴⁸

Yet in the late 1950s, Swiss authorities seemed to generally agree that the development of foreign institutions posed a threat. On the other hand, the question of the measures that should be taken to curb this development was unsettled. The banking industry was torn between two conflicting objectives. On the one hand, the Swiss Bankers Association intended to limit entry by tightening the requirements for foreign banks in order to hamper their expansion. On the other hand, they wanted to maintain, above all, a very liberal regulatory framework and very limited state interventionism. The secretary of the association, Max Oetterli, was well aware of the dangers related to a revision of the banking law:

'In any case, we must not publicly bring up for discussion demands that would ultimately lead to a revision of the banking law or the corporate law. Both laws have stood the test of time up to this day. If we wanted to revise them only because of a few shortcomings, we would run the risk of losing control of such a revision process very quickly. We should be aware that the demands that we could at best realise in a revision of the banking or company law are meaningless compared with the requests that would in all likelihood be made known by other parties in any such revision.'⁴⁹

In other words, launching a regulatory change amounted to a 'tightrope walk' for the bankers,⁵⁰ because they would take the risk of opening a Pandora's box that could induce unwanted reforms. Some legal modifications were nevertheless considered: the introduction of registered shares with restricted transferability, which would make the buyout of a bank by

48 FA, E6520(A), 1983/50, vol. 1, file 'Ausl. Banken 1959–1975', Report 'Zur Frage der Ueberfremdung des schweizerischen Bankgewerbes', Daniel Bodmer, undated [1959].

49 ASBA, Minutes of the Board of Directors, 23 Jun. 1965, p. 20.

50 ASBA, Minutes of Expert Committee, 28 Jan. 1966, Max Oetterli, p. 4.

foreigners more difficult or the setting up of a bank charter system with the necessity of acquiring a certificate of good conduct. But each of the proposed legal solutions appeared to have more disadvantages than advantages for the Swiss financial centre.

Therefore, in the first phase (1956–1965), Swiss authorities confined themselves to fighting the establishment of foreign banks by devious means. This deterrent strategy took different forms; three examples are particularly striking. The central bank refused to open so-called sight deposit accounts, which were bank accounts at the Swiss National Bank used for interbank payment and settlement traffic, for ‘undesirable’ foreign banks.⁵¹ As another example: the central bankers attempted to hinder the establishment of foreign newcomers by suggesting to the federal police for foreigners that they adopt a restrictive policy in granting or extending the residence permits of certain foreign nationals.⁵² The third example of indirect action is found in the constant foot-dragging tactics that were used by the Federal Banking Commission with regard to the authorisations given to foreign founders.

During this first phase, the manner in which the Swiss authorities dealt with the American First National City Bank – at that time, the third largest bank worldwide – which wanted to open a branch in Geneva, proves to be very enlightening.⁵³ In the discussion within Swiss banking circles, two new and problematic dimensions surfaced. Firstly, the Bankers’ Association stressed the fact that the establishment of the colossal commercial bank in Geneva would give rise to labour poaching, thus increasing the loss of qualified staff, and eventually leading to wage inflation.⁵⁴ Secondly – and more importantly – the setting up of an American bank involved the

51 ASNB, Minutes of the Governing Board, 5 Jun. 1958, no 604, pp. 888–93.

52 ASNB, Minutes of the Governing Board, 6 Sep. 1956, no 942, pp. 1314–1316. The FBC adopted the same tactic in their answer to American investors, letter to Franco Cattaneo, 11 Jul. 1966 (FA, E6520(A), 1983/50, vol. 2).

53 Cassis, *Capitals of capital*, p. 208.

54 FA, E6520(A), 1983/50, vol. 1, letter from the SBA to the FBC, 1 Aug. 1962.

risk that American bank inspectors would examine the Geneva branch. Indeed, American regulations allowed the Office of the Comptroller of the Currency to examine overseas branches of national banks.⁵⁵ Such inspections represented a threat to Swiss banking secrecy and conflicted with Swiss law. Following long negotiations, the branch eventually opened in March 1963.⁵⁶ The same issue resurfaced soon after. In 1965, when the Office of the Comptroller of the Currency set up a new regulation of overseas branches that involved the transmission of records to the parent company, Swiss diplomats in the USA took action to explain that those provisions were incompatible with Swiss law. Internally, the Swiss Bankers Association also intervened and sent a circular to American banks in Switzerland reminding them that the violation of banking secrecy was a criminal offence.⁵⁷ In 1967, when the Bank of America requested an authorisation to establish a branch, the strategy of Swiss bankers proved successful. With the help of Swiss diplomats in the USA, they succeeded in obtaining a capitulation from the Comptroller of the Currency, stating that they waived their right to demand reports from the Swiss branch of the Bank of America.⁵⁸ The bank association welcomed this success and hoped that a precedent had been set so that such a waiver should be required systematically. Faced with a potential threat to banking secrecy, Swiss authorities and bankers effectively managed to limit entry conditions for American banks, especially by mobilising the diplomatic corps.

During a second phase, between 1965 and 1967, the attitude of Swiss authorities towards the establishment of foreign banks changed considerably. Two important events brought about a turning point.

55 R.M. Robertson, *The Comptroller and Bank Supervision. A Historical Appraisal* (Washington 1968), p. 181.

56 See also Loepfe, *Aufstieg des schweizerischen Finanzplatzes*, p. 199.

57 FA, E6520(A), 1983/50, vol. 1, SBA circular n° 3414, 13 Feb. 1966.

58 FA, E6520(A), 1983/50, vol. 1, letter from the DPF to the other departments, 25 Jan. 1967.

The first significant event was the so-called ‘Muñoz Scandal’.⁵⁹ As a brief explanation, this financial scandal featured a Spanish businessman, Julio Muñoz Ramonet, son-in-law of the president of a large Spanish bank, who built a financial empire throughout Europe. From 1962 on, the Spanish financier was able to take over two middle-sized regional Swiss banks, the Banque Genevoise de Crédit et de Commerce and the Spar- und Kreditbank, in St. Gallen. Muñoz, who was also known as the wealth manager of former Dominican dictator Rafael Trujillo, had managed to ruin both banks, particularly by financing his own real estate business. The banks closed their doors in April 1965. Further investigations showed that the President of the Federal Banking Commission was seriously involved in the scandal since he had accepted a lucrative position as Muñoz’ financial advisor. The case, which had some repercussions in the international press,⁶⁰ seriously damaged the reputation of Swiss banks and political institutions. It was clear that banking supervision had not worked. Worse, the highest representative of the bank supervision authority was also directly associated with fraudulent acts.

The Muñoz case revived the question of a revision of the banking law. It also strengthened the position of those who considered the proliferation of foreign banks in Switzerland as a threat to the stability of the whole banking industry. In this instance, the discrete takeover of Swiss banks by a foreign group had resulted in losses for Swiss creditors.

A few months later, another piece of news came as a shock for the Swiss financial centre. In March 1966, the Swiss government authorised the Wozchod Handelsbank AG to open in Zurich. This institution was a company incorporated under Swiss law – i.e. not a branch of a foreign bank

59 On the Muñoz Scandal: Loeffe, *Aufstieg des schweizerischen Finanzplatzes*, pp. 183–8; D. Froidevaux (ed.), *La Suisse dans la constellation des paradis fiscaux* (Lausanne/Geneva 2002), pp. 107–8; T. R. Fehrenbach, *The Swiss Banks* (New York/London/Toronto 1966), pp. 104–11; N. Faith, *Safety in Numbers: The Mysterious World of Swiss Banking* (London 1982), pp. 190–8.

60 For example: *Time Magazine*, 11 Jun. 1965; *New York Times*, 3 Jun. 1965; *Frankfurter Allgemeine Zeitung*, 9 Jun. 1965; *Die Zeit*, 18 Jun. 1965.

– whose stock capital was owned by two Soviet banks, the Gosbank (55 per cent) and the Vneshtorgbank (40 per cent).⁶¹ Although Swiss banking circles had known for some months of Soviet intentions to establish a bank in Switzerland,⁶² the foundation of the so-called Russenbank still caused some anxiety. Yet, since the founders had chosen to open a subsidiary instead of a branch – as they had first planned – the Federal Banking Commission had no legal basis to refuse the authorisation. After delaying its decision for several months, the Federal Council could not evade the question any longer and finally granted the authorisation. The secretary of the Swiss Bankers Association summarised the considerations of the Ministry of Foreign Affairs: ‘the Russians cannot be denied what we have to concede to Arabs and other exotic foreigners.’⁶³ The case of the Soviet bank amplified the concerns of Swiss bankers for at least two reasons: on the one hand it drew international attention to Switzerland and strengthened American critics, who believed that Switzerland served as a transfer hub for Soviet trade; on the other hand, Swiss bankers feared that Moscow would use the Zurich-based company for economic espionage or to obtain confidential information. In actual fact, the Wozchod Handelsbank, established on the pretext of financing trade between Switzerland and the Eastern bloc, was mainly active in the gold market.⁶⁴

The Muñoz scandal and, to a lesser extent, the Zurich Soviet bank, led to a change in attitude on the part of Swiss authorities. Firstly, it resulted in the questioning of the role of the banking supervision authority. After several parliamentary motions, the Federal Banking Commission drew up a preliminary draft revision of the banking law in July 1966. However, the Finance Department initiated the legislative process of revision four

61 R. Husbands, ‘Soviet Banks Abroad: Legal and Economic Perspectives: 1917 to 1990’, unpublished PhD thesis (Geneva 1996), 264; (thereafter: Husbands, ‘Soviet banks’).

62 ASNB, Minutes of the Governing Board, 13 May 1965, no 612, 981–2.

63 ASBA, Minutes of the Board of Directors, 8 Dec. 1965, p. 30.

64 Husbands, ‘Soviet banks’, pp. 265–9; Loepfe, *Aufstieg des schweizerischen Finanzplatzes*, pp. 201–3.

years later, with different objectives from those originally proposed by the Federal Banking Commission. Secondly, the Swiss Bankers Association also reassessed the threats associated with foreign banks. In January 1966, leading Swiss bankers defined three major drawbacks: the increase of competition that could lead to a bad risk distribution; the advertisement abroad of the benefits of banking secrecy, which had a negative impact on the international standing of Swiss banks; and the inflow of foreign funds, which ran counter to monetary policy.⁶⁵ As a revision of the banking law seemed more and more inevitable, Swiss bankers moved towards a more cooperative attitude and decided to collaborate on the process, as long as it included some of their priorities. The head of the Basel cantonal bank, Ludwig Butscher, expressed this view as follows: 'I support any measure to prevent foreign banks from setting up, unless further state intervention is involved. Since this seems obviously impossible, we have to choose here between two evils'.⁶⁶

The third phase of the reaction of Swiss authorities extended from 1968 until 1969. In March 1969 it led to the promulgation by parliament of a federal decree 'establishing the system of licenses for foreign-controlled banks'. Choosing the lesser of two evils, the Swiss Bankers Association triggered the legislative impetus. At first, it carried out a comparative survey on the regulation of foreign banks in West Germany, Austria and the state of New York.⁶⁷ This study was meant to show what kind of measures could be taken in Switzerland, which appeared to have at that time the most liberal regulation for foreign banks.⁶⁸ Secondly, the association tried to assess the 'foreign influence' over the Swiss banking industry. Several well-informed bankers were asked to provide a list of banks that

65 ASBA, Minutes of the Expert Committee, 28 Jan. 1966, p. 2.

66 ASBA, Minutes of the Expert Committee, 28 Jan. 1966, p. 7.

67 ASBA, J.4.1, Ausländische Bankengesetze Dez. 1960 – 76, Internal report, 10 Jan. 1966.

68 For a more complete view on foreign banks regulations in Europe, see also J. Welch (ed.), *The Regulation of Banks in the Member States of the EEC* (The Hague/Boston/London 1981), section 15 and 16.

were under foreign control or presumed as such. Based on these investigations, a conference was held in May 1968 with representatives of the Swiss Bankers Association, the Swiss National Bank, the Finance Department and the Federal Banking Commission. The representative of the Federal Banking Commission had to admit – quite bitterly – that representatives of the banking industry, with the support of the central bank and the finance administration, had managed to fundamentally change the agenda of a revision of the banking law. Indeed, the shift of priority was obvious. Whereas the 1966 draft provided for a general strengthening of supervisory powers concerning all Swiss banks, in 1968 the discussions were only about the best way to slow down the establishment of foreign banks.⁶⁹ In October 1968, the small committee favoured the legal option of an urgent federal decree. This type of legal order was more flexible and quicker to pass than a proper law or law amendment. Furthermore, the number of authorisation requests kept increasing. After having to grant six authorisations in 1967, the banking commission had to concede to seven new bank establishments in 1968, while twelve requests were still on hold.⁷⁰ The supervisory authority was in an uncomfortable position, because it could not delay its decision-making long enough for an ordinary legislative process.

The following parliamentary debates were rather hasty; opposition was very weak and the few issues were settled within four months. Media attention was also insignificant. In March 1969, the federal decree was adopted.⁷¹ It set up a two-tier regulation system, meaning that entry requirements were higher for foreign-controlled than for Swiss banks. Foreign-controlled banks were defined as banks in which the direct or indirect foreign participation amounted to more than half of the share

69 FA, E6520(A), 1983/50, vol. 2, internal note from Hans Manz to Daniel Bodmer (both FBC), 10 May 1968.

70 'Message du Conseil fédéral à l'Assemblée fédérale à l'appui d'un projet d'arrêté fédéral urgent instituant le régime du permis pour les banques en mains étrangères, du 13 novembre 1968', in : *Feuille fédérale*, 1968, vol. 2, no 48, p. 783.

71 'Arrêté fédéral instituant le régime du permis pour les banques en mains étrangères, du 21 mars 1969', *Feuille fédérale*, 1969, vol. 1, no 12, pp. 625–8.

capital or voting rights. In order to obtain a license, a foreign-controlled bank had to meet four additional conditions:

1. The home country should grant reciprocity to Swiss banks.
2. The company name should not suggest any Swiss origin.
3. Inopportune advertisement with the Swiss head office should be avoided.
4. The bank had to certify that it would respect Swiss monetary policy.

It is noteworthy to point out that the second requirement was directly aimed at foreign banks who used their Swiss branch as an international advertising claim, praising the virtues of Swiss banking secrecy and numbered accounts. Interestingly, Swiss banks sometimes used this kind of advertisement themselves, and the Swiss Bankers Association had to issue several recommendations to its member banks in order to limit international advertisement of banking secrecy.⁷²

During the parliamentary debates, few of these provisions gave rise to a debate. In short, mainly three aspects were discussed.

Firstly, the definition of 'foreign influence' over a bank was not as simple as it might seem at first glance. It was a thorny issue for two reasons. On the one hand, the bankers wanted to avoid the introduction of registered shares with restricted transferability, because this kind of share system could hinder stock market operations. On the other hand, setting a broad definition of 'foreign influence' entailed a risk of revealing the foreign character of certain Swiss banks whose capital was scattered.⁷³ A solution was found to circumvent this problem: banks were supposed to voluntarily disclose to the authorities the presence of foreign domination.

72 For example in 1957 (*Circular* no. 107, 12 Jul. 1957) and 1967 (*Circular* no. 3580, 9 Mar. 1967). ASBA, Minutes of the Governing Board.

73 *FA*, E6520(A), 1983/50, vol. 5, Minutes of the Federal Banking Commission, 23 Oct. 1968, p. 169.

Secondly, the requirement to explicitly mention the foreign character in company names raised fears in some sectors of the Swiss economy. Representatives of the chemical sector argued that this provision would lead to international retaliatory measures against Swiss industries, or even worse, that it would inspire foreign legislators and eventually force Swiss industries to disclose their foreign interests. This measure was considered highly discriminatory and was even compared to a 'star of David' that 'acts as a deterrent'.⁷⁴ Finally, the provision was mitigated to a certain extent in so far as a company name should not explicitly reveal its foreign character but only refrain from any suggestion of Swiss origin.

Lastly, the constitutionality of the decree was discussed. Some bank representatives feared that the constitutional basis, which the decree relied upon, would allow the state and the central bank to intervene more deeply in the banking sector on another issue that was debated at the same time. Indeed, as mentioned above, the issue of the tools of monetary policy to curb inflation was discussed in parallel with the decree. In the end, the bankers obtained an informal promise from members of parliament, who agreed that their approval of the constitutional basis of the foreign banks' decree would not influence the legislative debate concerning the constitutionality of the monetary policy.⁷⁵

The federal decree on foreign banks was later integrated into ordinary law during the 1971 amendment of the banking law. Its short-term impact was fairly small. According to the Federal Banking Commission, its effect on the number of requests from foreign founders was very limited. Between 1969 and 1971, the Commission granted 19 new authorisations to foreign banks and could refuse only three requests.⁷⁶ Those three refusals were justified by the fact that the country of origin did not grant reciprocity to

74 ASNB, 1.3/1229, 131.25, letter from Etienne Junod, chairman of the Swiss Society of Chemical Industries, to the Swiss National Bank, 10 Dec. 1968.

75 ASNB, Minutes of the Bank Committee, 17 Jan. 1969, 4; FA, E6520(A), 1983/50, vol. 5, Minutes of the Federal Banking Commission, 4 Feb. 1969, p. 3.

76 FA, E6520(A), 1983/50, vol. 1, letter from the FBC to the Finance Department, 8 Jun. 1972.

Swiss banks. In fact, the issue of reciprocity turned out to be the only active obstacle to the opening of foreign banks. Yet its impact was mitigated by the fact that it was interpreted by the Ministry of Foreign Affairs as a means of expansive action, to promote access to new markets for the major Swiss banks.⁷⁷ In the case of Japanese banks, for instance, the three major Swiss banks agreed on a common schedule regarding their expansion in Tokyo. Negotiations with Japanese representatives were conducted in order to obtain an authorisation for all three banks, in exchange for the opening of the Bank of Tokyo and Fuji Bank branches in Zurich.⁷⁸ Another consequence of the foreign banks' decree was the foundation in 1972 in Zurich of the Association of Foreign Banks in Switzerland, which aimed to defend the specific interests of these institutions and improve their public visibility and political influence.

IV.

For the purpose of synthesising, it is noteworthy to recapitulate the various reasons that encouraged the Swiss ruling circles to intervene against the expansion of foreign banks.

The factors in favour of stronger regulation can be divided into four categories. Firstly, Swiss authorities considered that the expansion of foreign banks threatened the good reputation of Swiss banking. Swiss authorities interpreted events such as the Muñoz scandal as an expression of the disrespect of some foreign bankers for the traditions of Swiss banking. Therefore, strengthening the regulation of foreign banks was presented as an improvement of Swiss depositors' safety. More importantly, Swiss bankers had concerns about international advertisements, which praised

⁷⁷ FA, E6520(A), 1983/50, vol. 1, Memorandum of the discussion on reciprocity, 13 Jul. 1970.

⁷⁸ Loepfe, *Aufstieg des schweizerischen Finanzplatzes*, pp. 281–3. See also, FA, E 2001 E–01, 1982/58, vol. 151, letter from Daniel Bodmer (FBC) to the general direction of UBS, 4 Feb. 1972.

the virtues of Swiss banking secrecy and numbered accounts. Although Swiss banks sometimes used this kind of advertisement themselves, they feared that a worldwide exposure of those advantages would incite more international criticism. In that sense, they favoured regulatory intervention that could be seen internationally as a positive step towards the more cooperative attitude of Switzerland. Regardless of the suspicious transactions linked to organised crime or dictators' funds per se, Swiss authorities mostly worried about the deterioration of Switzerland's image as a financial centre.

Secondly, Swiss bankers were well aware of the fact that foreign banks increased competition within the Swiss financial market. As an example: some foreign banks participated in the issuance of bonds outside of the so-called 'major banks' cartel.⁷⁹ A few also offered higher interest rates and did not always respect the cartel agreements issued by the Swiss Bankers Association. Moreover, in the context of staff shortage, foreign banks were accused of labour poaching, resulting in a general wage increase.

Thirdly, the Swiss National Bank felt that an expansion of foreign banks reinforced the increasing inflow of foreign capital and the international use of the Swiss franc, and therefore contributed to an inflationary trend.

Lastly, the Swiss supervisory authorities and banking representatives feared that the establishment of a growing number of foreign institutions could become a threat to banking secrecy. Indeed, foreign supervisory authorities would increasingly enquire about the activities of their fellow citizens in Switzerland, and even try to conduct supervisory operations, thus creating a potential loophole in the unassailable banking secrecy.

By and large, the 1969 federal decree on foreign banks was the outcome of those concerns. As mentioned above, it turned out to be rather ineffective. The reciprocity clause was the only hindrance in preventing a foreign

79 This group formed by the biggest commercial banks and the cantonal banks (the public institutions controlled by the various Swiss cantons) in 1911 agreed on a monopolistic collaboration on the issuance of loans.

institution from opening a bank in Switzerland. In conclusion, the passing of the 1969 decree met the needs of Swiss banking interests in four ways:

First of all, it was an attempt to quickly limit the expansion of new competitors – a competition that was particularly fierce in the area of wealth management – without necessarily questioning the very liberal regulatory framework. Moreover, by focusing on the issue of foreign banks, between 1966 and 1971, the Swiss Bankers Association managed to change the agenda concerning the amendment of the banking law. The question of the limitation of foreign banks played an important role in the delay in the revision process of the law. In this regard, foreign financial institutions played the role of scapegoat, and were accused of practices that were also common for Swiss banks. Furthermore, at the international level, the decree can be considered as an effort to silence international criticism directed against the Swiss banking haven, by imposing slightly higher entry conditions for foreign banks. The requirement that limited advertising for foreign banks is very eloquent in this respect. Finally, the reciprocity clause included in the decree was used simultaneously as a protectionist measure to prevent the establishment of new competitors and as a diplomatic tool for the expansion of major Swiss banks. In fact, the expansion of the international network of Swiss banks took place mainly in the 1970s.

Some scholars have argued that regulated industries can have two possible interests: either they might favour strict supervision to create barriers for entry, or they might use their political influence to press for a lax supervisory system.⁸⁰ The 1969 regulation of foreign banks in Switzerland has shown that a domestic industry can have its cake and eat it too: Swiss bankers managed to set higher entry requirements for foreign competitors and at the same time maintained a very liberal and lax regulatory framework.

⁸⁰ F. Heinemann and M. Schüler, 'A Stiglerian view on banking supervision', *Public Choice*, vol. 121, (2004), pp. 99–130.

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International Experiences of Insurance Institutions



INSURANCE ABROAD AND COMMUNICATION WITH THE HOME FRONT: 1850–1940

INGRID ELFERINK

Abstract

The paper deals with the foreign activities of De Nederlanden van 1845. This small Dutch fire insurer started opening agencies in 1857 and, within thirty years, had more than four hundred representations all over the world. The company's ultimate objective in pursuing geographic diversification was to compensate losses in the domestic market. Drawing on the archives, a reconstruction is given of the communication between the various main protagonists in this period. Inspectors were appointed to make inspection trips to foreign agencies. The reports of these inspectors, together with the financial figures provided by the agencies, were used to assess the results of the foreign operations. The aim of the research is to examine to what extent the management in the Netherlands was able to form an accurate picture of the actual activities, given the scant means of communication in those days.

Introduction

De Nederlanden van 1845, a fire insurer from Zutphen (a small town in the east of the Netherlands), formed the ambition soon after its incorporation to expand the scope of its operations. Not just in the Netherlands, but also in the Dutch East Indies, Europe and the rest of the world. The first foreign agencies were set up from 1857 onwards. The number rapidly grew to more than 400 representatives and agents in 1900.

How could this small insurer obtain and maintain a clear and accurate picture of these worldwide activities? It had to communicate with a great many parties and collect information from diverse sources in order to carry out its work as safely and reliably as possible. In an era of limited means of travel and communication, this was no easy task. Inspecting the agents in faraway countries was difficult and challenging.

How did De Nederlanden van 1845 secure the information it required and how was that information processed? What information flows existed and to what extent could these provide valuable input for foreign policy? Based on the documents in the historical archives, I have tried to reconstruct the activities and means of communication of this episode in the history of the fire insurer.

This paper consists of five sections. The first section contains a brief history of De Nederlanden van 1845 right up to the present day. The second section provides an overview of the fire insurer's foreign activities. Section three describes the foreign department and its activities, together with the most important protagonists. Section four discusses the written communication between these players, and section five ends with an overview of the archives from which the history of the foreign activities can be pieced together. The paper ends with a conclusion.

I. A Brief History of De Nederlanden van 1845

Previous History

Until 1830 the most important players in the Dutch insurance market were mainly based in the southern half of the Netherlands, which is now Belgium. After the South separated from the North, various fire insurance companies were set up in the Netherlands to fill the gap left by the Belgian companies. One of these new companies was the Nederlandsche

Maatschappij van Brandverzekering (fire insurance company), which was established in Tiel in 1833. Gerrit Jan Dercksen, a trader in wood bark and a stockbroker, became an agent for this company in Zutphen and its surroundings. He was assisted by his cousin Christiaan Marianus Henny. They appointed sub-agents to acquire customers in exchange for part of the commission. In 1844 the management of the Tiel-based company decided to appoint the sub-agents as independent agents. As this would restrict Dercksen's activities to the city of Zutphen, he and Henny decided to break away and set up their own insurance company. This new company, which was called Assurantie Maatschappij tegen Brandschade (fire insurance company), was founded on 12 April 1845.

The First Years 1845–1900

Their first move was to create an extensive agency network. Very soon, authorised underwriting agents were appointed in the most populated commercial centres of the Netherlands in Amsterdam and Rotterdam.

During the nineteenth century a lively trade was carried on between the Netherlands and the Dutch East Indies. The Nederlandsche Handel-Maatschappij (NHM, Netherlands Trading Society) was a pivotal player in this overseas commerce. The NHM divided the goods and transport insurance business between various insurance companies in the Netherlands, which were able to demand a high premium for their services. Dercksen and Henny were keen to capture a larger slice of this highly profitable insurance business from the NHM. So they set up a second company in 1859, De Nederlanden van 1859, to act as a reinsurance company. However, running two separate businesses was an administrative burden, so the two companies were merged in 1888 into Assurantie Maatschappij tegen Brandschade De Nederlanden van 1845 (or De Nederlanden for short).

De Nederlanden was strongly represented abroad. As early as 1857 the first agent was appointed in Batavia. In 1900 De Nederlanden had no less than 400 agencies spread across the entire world. In 1894 Carel Henny, the son of Christiaan, became Director of De Nederlanden. Carel Henny was a forward-looking man who visited Denmark and Great Britain during his training to study the most modern business administration methods. Back in the Netherlands, he improved the administrative organisation by introducing a simpler bookkeeping system. He also appointed an external agency to audit the company's books. This was unknown in the Netherlands at the time. The intention was to inspire trust among consumers and shareholders.

In 1867 a fire insurance company in Utrecht called Zekerheid geeft Rust, which had run into trouble, was taken over. This greatly increased the number of customers and agents at a single stroke. Now that the company was much larger, with representatives at home and abroad, it started to look for a more central location for its headquarters. This finally led to the company's relocation from Zutphen to The Hague in 1897.

Expansion 1901–1939

Until the start of the twentieth century De Nederlanden exclusively operated as a fire insurer. This changed in 1903 when it expanded into life insurance. To prepare for this move, several employees were sent to Denmark for specialised training. In 1914, the year that the First World War broke out, the life insurance arm was transferred to a separate company. This was to avoid the provisions for life insurance being severely eroded by claims for war damage. Seven years later, such a separation between life and non-life insurance activities became obligatory under the new Act on Life Insurance Business. In this period De Nederlanden also took over the business insurer Labor, the accident insurer Fatum and the accident and

transport insurance company Binnenlandsche Vaart Risico Sociëteit. The company could now offer a comprehensive range of insurance services. After 1925, it proudly adopted the motto 'All Insurances' to underline this fact.

During the Great Depression in the 1930s the company's premium income suffered a decline, but things started to look up after 1938. In 1938 the company made its first foreign acquisition, De Vaderlandsche (the national) in Belgium. Until then, De Nederlanden had exclusively operated abroad through agents working on a commission basis. The Amsterdam-based life-insurer Victoria was also taken over.

After the Second World War, the emigration of large numbers of Dutch people to Canada and Australia opened up a new market. De Nederlanden decided to follow the emigrants. The takeover of many local life and non-life companies in Canada led to considerable foreign expansion, and gave De Nederlanden a powerful impulse.

Merger into Nationale-Nederlanden 1963–1970

In the early 1960s, De Nederlanden and the Nationale Levensverzekering-Bank (life insurance) from 1863 were both losing market share. In response, they decided to expand via a merger or acquisition in order to prevent being overtaken by competitors or becoming the victim of a hostile takeover.

After months of difficult negotiations, De Nederlanden and de Nationale finally announced in October 1962 that they would join forces. The two insurance groups, which were roughly the same size, had come to the conclusion that cooperation would be better than a fierce and mutually damaging battle for supremacy. Moreover, the growing need to internationalise their operations called for larger organisational units.

Thanks to the international experience of De Nederlanden and the strong home presence of de Nationale, the newly-merged company was more than the sum of its parts. In addition, automation was coming to the fore and the associated high costs could now be borne jointly. Having already gained experience with cooperation in the field of collective insurance services, the two groups now expanded their partnership across the entire range of insurance activities.

For a long time after the merger, the two groups continued operating under their own name. The general public and employees initially noticed very little of the merger. The physical merger only took place when the new head office in The Hague was finally completed in 1969, ten years after De Nederlanden had started the preparations for the building. The life departments of both groups went to Rotterdam, whereas the non-life departments were concentrated in the new head office in The Hague. This created a fairly unique situation of a single group with two head offices situated only thirty kilometres apart. Between 1968 and 1970 the old life and non-life organisations were transformed into two companies operating within a single group: Nationale-Nederlanden, with a new logo, the well-known orange coloured N.

Consolidation and Expansion

Nationale-Nederlanden was a prominent global player in the world of financial services. But the competition was always a threat. Quality improvements and closer contacts with the consumer were seen as the answer to this danger. Extensive advertising campaigns and sponsorship programmes, including high-profile sports sponsorship, were carried out to boost the company's appeal and brand recognition. In addition, the range of products was expanded. New financial services such as savings and loans were added to the existing insurance and investment services.

When it became clear that the insurer AMEV was planning to merge with the VSB savings banks, Nationale-Nederlanden also started to search for merger partners in order to bolster its competitive position. Nationale-Nederlanden was not alone in this quest. Its competitors were also looking for partners. After several failed attempts, Amfas was taken over in 1984.

The merger created ample financial scope for international expansion. The Executive Board had already mapped out a policy for this in the mid-1960s. The main reasons for international expansion were to diversify risks, increase profits, grow the operations and build 'international prestige'. The process started with takeovers in Great Britain, Greece, South Africa and Australia, but the biggest acquisitions took place in the United States. Peerless, First of Georgia, Excelsior, Wisconsin National Life and Midwestern United Life are just a few of the life and non-life companies that were purchased.

In the late 1980s Nationale-Nederlanden was one of the largest insurers in the Netherlands with extremely extensive interests abroad. But to remain viable and competitive, particularly in the Dutch market, it had to continue strengthening its distribution and sales channels.

Merger with NMB Postbank Group 1991–2011

The idea to cooperate with a bank was not new for Nationale-Nederlanden. Banks traditionally acted as intermediaries for insurance companies and their large branch networks in the Netherlands provided an interesting channel for acquiring customers. A bank would therefore be an ideal partner for Nationale-Nederlanden to expand its financial services. A merger partner was found in the NMB Postbank Group. This bank's network was a good distribution channel for selling insurance. In addition, by combining their strengths, the two companies would be better able to pursue international expansion. In 1991 this merger became reality and

the new company was named Internationale Nederlanden Group, which was soon abbreviated to ING Group.

The newly merged company rapidly started to build its expertise and financial power, which enabled it to capture a stronger market position in international markets. The takeovers of the British merchant bank Barings in 1995 and the Belgian Bank Brussel Lambert in 1997 are good examples of this.

ING Group is a holding company consisting of two legal entities, ING Bank NV and ING Verzekeringen NV. All national and international activities were carried out by business divisions. The two merger partners continued to provide services under their own name. The international expansion continued with many acquisitions until the start of the new century. From 2002 all international business divisions were 'rebranded' to ING, and the original company names disappeared.

Still Nationale-Nederlanden 1991–2011

ING grew into one of the largest international financial service providers in the field of banking, insurance and investing. In the Netherlands, Nationale-Nederlanden continued to perform insurance activities under its own name. However, loss of market share forced the company to adopt a new strategy in order to become stronger and more competitive. Apart from a major restructuring and mergers with subsidiaries, the new strategy was aimed at improving the distribution channels, greater efficiency and more customer-focused services. During the credit crisis in 2008, ING was compelled to take out a large loan from the Dutch state. Partly for this reason, the European Commission decided in 2009 to force ING, which in its eyes had grown too big, to split into a bank and an insurer. This split was operationally effectuated at the start of 2011. Today, in 2013, Nationale-Nederlanden forms part of the insurance arm of ING. In the course of

2014, it will be entirely split off from ING as an independent European wealth management and protection company.

II. A Brief History of the Foreign Operations

The fire insurance company operated from Zutphen, in the east of the Netherlands (hence the name de Zutphense). Very soon agents were appointed in Amsterdam and Rotterdam, and expansion to the rest of the Netherlands followed not long afterwards. Through its activities as an insurer of goods and merchandise for the Nederlandsche Handel-Maatschappij (Netherlands Trading Society), de Zutphense was also able to gain a foothold in the Dutch East Indies. The first agents were appointed in Batavia in 1857, followed by Sumatra, Surabaya and Semarang. Closer to home, agents were also appointed in Europe in major commercial centres such as Hamburg, Bremen, Copenhagen, London, Paris and Antwerp. In the second half of the 19th century, free trade burgeoned, and more and more markets opened up. Eager to tap into this global economic expansion, the company cast its net even wider to Latin America, Africa and South-East Asia.

To keep a grip on its spreading agency network, branch offices were set up both in the Netherlands and abroad; the first in Amsterdam in 1882. From 1899 onwards, foreign branch offices were opened in Christiania (later Oslo), Copenhagen, Brussels, New York and San Francisco. The branch offices also helped to make the company more widely known in the various regions. Alongside the branch offices, inspectors also played an important role in appointing and monitoring agents as well as determining the value and risks of insured buildings. In 1900 de Zutphense had more than 400 agencies and representatives all over the world. The sister company, De Nederlanden van 1859, that acted as reinsurer for de Zutphense, had its own agencies abroad.

From the outset, the company actively sought to close reinsurance contracts with other insurers. This was not easy, as reinsurance was still in its infancy. In 1884 the first partnership with a Russian fire insurer was realised through German agencies. This move was also designed to gain entry to the Russian market. Deputy director Carel Henny made a special trip to St Petersburg, Moscow and Warsaw to raise his company's profile there.

Not much is known about the foreign results in the initial years. The Netherlands was certainly by far the most important market between 1860–1880. The share of the foreign premium turnover amounted to about 30 per cent of the total. This changed in subsequent years: in the final decades of the nineteenth century, the premium turnover from abroad swelled to about three quarters of the total, partly because of the stagnation in domestic premium income at the time.¹ The star performer was the Dutch East Indies, particularly in the years 1856–1890: high premiums and low claims led to fat profits. In this way, losses in the domestic market could be compensated with good results from abroad. But the reverse also happened in other periods. The geographical diversification of risks had clearly borne fruit.

Due to the widespread activities and numerous agencies across the world, contracts with agents, reinsurers and other parties underwent frequent and extensive changes. When large losses occurred, extra measures needed to be taken in the affected cities and countries. Sometimes the activities were entirely discontinued. One example of this is the United States. Despite the extremely high premium income in 1899, the overall results were so disappointing and the risks so great that the company pulled out of New York in 1904 and, not much later, from the United States as a whole. As a result, De Nederlanden escaped the consequences of the earthquake in San Francisco in 1906. But the company was not always so lucky, suffering severe losses

¹ J. Barendregt and T. Langenhuyzen, *Onderneming in Risico, bedrijfsgeschiedenis van Nationale-Nederlanden 1845–1995* (Amsterdam 1995), p. 45.

from other large conflagrations such as in Sundsvall, Sweden (1888), New Foundland (1892) and Baltimore, United States (1904).

Each country had its own laws and rules for foreign companies. To obtain licences to operate in these countries, the company was often required to put up collateral in the form of large cash or securities deposits (ranging from as much as \$45,000 to \$200,000 per country). De Nederlanden did not always agree to these demands and therefore sometimes withdrew entirely.

The First World War was a troubled time with many setbacks. In countries that remained neutral, and wherever German competitors had withdrawn, the company managed to strengthen its position and do more business. But elsewhere many agencies were lost because De Nederlanden was often represented by German and Austrian agents, particularly in China and Japan, but also in South Africa and on Barbados. The premium income did increase in these war years, but this was largely inflation-driven. The post-war period brought renewed stagnation, which was further aggravated by the deep crisis in Germany. In the United States, where De Nederlanden had meanwhile resumed its operations, net premium income also went into sharp decline. Pressed by the need for radical cost reductions, the company curtailed its domestic and foreign reinsurance business, which led to an improvement of the overall results.

In 1920 De Nederlanden became a member of the fire offices committee (FOC), the body responsible for regulating the fire insurance industry at a global level. The FOC kept members informed about regulations, taxes and premiums in various countries. It also acted as a mediator in cartel and price-fixing disputes. The company had already been a member of the FOC 25 years earlier, but had withdrawn in protest at the 'unfair behaviour of British companies'. Ever since starting its foreign activities, De Nederlanden had been a member of almost all national and local premium rate-setting organisations of local insurers. The meetings were attended (either by the local agents or representatives, or by the management itself)

in order to have a say in the discussions and, of course, the premium rate-setting arrangements.

In the 1930s the life business of De Nederlanden flourished and more funds became available for investment. However, these were also times of crisis and great uncertainty, and government debt and other bonds were not seen as a safe investment. Instead, the company decided to take over several Dutch non-life insurers. Many of these companies were also active abroad already, which enabled close cooperation in the foreign markets. The Second World War was a time of major upheaval. When the Germans occupied the Netherlands, the official head office was relocated to Batavia and later to Curaçao. The ties with most agencies were severed. As a result, the activities immediately after the war were mainly restricted to the markets in the Dutch colonies (Dutch Antilles, Suriname and (from 1948) Indonesia). A change of tack was necessary to revitalise the company: De Nederlanden decided to follow the wave of Dutch emigrants to Canada and Australia and opened its own offices there to offer insurance to its compatriots in their new homeland.

Slowly but surely, the strategy was adjusted. Instead of working through local agents, the company increasingly took over foreign companies (both life and non-life). This marked the start of a period of major international expansion that was continued by ING after the merger in 1991.

III. Foreign Department

Though initially not a large company, de Zutphense rapidly expanded its activities both within the Netherlands and abroad. The director did much of the work himself, assisted by a handful of employees (including a book-keeper) and a field staff consisting of inspectors and agents.

In 1877 the company's activities were streamlined, giving rise to a new organisation comprising four departments: Domestic Operations,

Foreign Operations, Reinsurance and Bookkeeping & Accounting. Almost the same number of people worked in the Domestic and Foreign Departments. In 1901 the Foreign Department numbered 23 employees. A summary of foreign fires and burglaries from 1919 contains a description of the department's various activities. A distinction was made between indirect and direct business, both in terms of premium income and the amount of work devoted to the policies. The indirect business concerned the contracts with foreign (re)insurers. The employees kept these contracts up to date, adjusted the premiums and checked the calculations. Only large risks, such as timber-built towns in Norway, underwent a more rigorous inspection. Still less time was devoted to the direct business, which was closed through branch offices or agencies. In these cases, the representative/agent assessed the risks and drew up the policies. A copy was then sent to the Netherlands, where the policy underwent a final inspection and, in some cases, was reinsured.

Clearly, all sorts of matters needed to be recorded and documented, such as the power of attorney agreements with the agents. An *Agentenboek* (Agents Book) was also made to keep a record of the details of all agencies and appointed agents. The entries were in alphabetical order of the agency's locations. The Foreign Department was also required to ensure that the agencies were provided with the required documents for conducting their insurance business. These documents were sent by mail and included policies, balance sheet details, booklets with insurance rates, instructions, agreements and also advertising materials such as calendars and posters carrying the logo of De Nederlanden. These advertising materials were produced in various languages for the foreign agencies. In 1900 no fewer than 6000 calendars and 2000 posters were sent all over the world. To promote their services, the agents could also advertise in newspapers and hang up advertising signs and billboards.

In 1896 the company opened a branch office in The Hague, which was also to house the Foreign Department. Director Henny saw The Hague as

a more prestigious location and believed that an office there would give the company and its foreign activities a higher profile. Henny also moved from Zutphen to head the office in The Hague, clearly signalling the importance attached to the Foreign Department. Not long afterwards, the head office was also officially relocated to The Hague.

Agents

De Nederlanden carried out its foreign operations with agents and representatives of European origin, not just Dutch nationals, but also many Germans. It was not until much later that local native agents were appointed. Agents could work on their own, but there were also agencies that acted as representatives. These were usually trading firms, which could also represent other insurers. Many had long-standing relationships with the Dutch insurer. Examples of these representatives are Anemaet&Co in Surubaya, the Nederlandsch Aziatische Handelmaatschappij (trading company) at Kobe, and the Gossler Brothers from Hamburg. These firms had a good reputation, were generally well-organised and were conscientious in their record keeping, though there were also exceptions. Some acted as the sole representative in an entire region, such as the Transvaalsche Handelsbank (merchant bank), an offshoot of Baerveldt&Heyblom, and representatives for De Nederlanden in Johannesburg since 1898. They celebrated their twenty-fifth anniversary in 1923. Inspector Prior became an employee of this firm. It was not until 1943 that the agency was dissolved and continued as a branch office, later becoming the head office for the whole of South Africa.

Agents who worked on their own were often European businessmen with an intimate knowledge of the country and its customs. The appointments were made by the inspectors during their visits or via the branch offices or other agencies. In 1907 G.J. Henny appointed an agent for

Bencoolen (present-day Bengkulu), ‘though there will not be much to do in Bencoolen.’ Henny received the recommendation for this agent on a mail boat during one of his trips.² The company also asked consulates for recommendations, particularly in unknown regions. In November 1898, for instance, requests for information were written to the Dutch consuls in ‘Bombay, Calcutta, Buenos Aires, Peking, Madras, Quilimane, Hong Kong, Mauritius, Rangoon, San Salvador, Venezuela, and the Cape Verde Islands.’ But this led to only five new agencies, three in India (Calicut, Cohin and Pondichery), one in China and one in Rhodesia.³

The agents did not always satisfy. Many produced sloppy work or did nothing to generate new business. In extreme cases, this could lead to dismissal. Mostly, however, the company continued to use their services for lack of a better alternative. William Bell, who was an agent in Bombay since 1886, was a case in point. According to the *Agentenboek* (Agents Book) he ‘showed little interest in our agency’,⁴ but still stayed on until 1905, and even received a special farewell visit from inspector Scheltema when he left.

The agents generally received a remuneration consisting of a commission and a ten to twenty per cent share in the profits, but differences existed between agencies. Agencies with small premium incomes had a different remuneration structure from the large agencies or trading firms. The negotiations about the remuneration could be long and hard, sometimes prompting the company to part ways with the agent or firm. Cancelling the contract was more difficult for the agent, who was required to give a certain period of notice, and easier for De Nederlanden, which could dissolve the agency at any time and without stating reasons. Though the conditions for the agents improved over the years, this freedom to hire and fire does explain why it was so easy for the company to appoint agents.

2 G. Henny, *Reisverslag Nederlands-Oost-Indië* (1904).

3 *Kronieken Buitenland* 1899, Overview of Inspection Trips.

4 *Agentenboek*, 1906.

Inspectors

Inspectors were of great importance to De Nederlanden. They valued the buildings for insurance purposes, assessed the risks and supported agents. Around 1894 there were about fifty inspectors working in the Netherlands. Inspectors were also necessary for the foreign agencies. Communication between these foreign inspectors and the foreign agents was not always easy. And not just because of the limited means of communication in those days. Many agents did the agency work as a sideline and were apt to neglect their work. The only way to obtain an accurate picture of the local situation was to make inspection trips to the location in person. The inspectors made so called 'Travel Reports' of these trips.

Not many inspectors worked for the Foreign Department. Some were specially appointed from the outside, others were simply picked from the company's own ranks. These foreign trips can possibly be seen as a kind of management development *avant la lettre* – because some inspectors actually ended up as directors.

Bernard Dercksen was not one of them. He was a Dutchman raised in England, where he had also done his professional and practical training. Dercksen made the company's first overseas trip, setting sail in March 1885 for New Zealand to explore the potential market for fire insurance business for De Nederlanden. After a promising start, he came back empty-handed.⁵ In 1886 he left for Asia, where several agencies already existed. He replaced some, and set up others. After his return, Dercksen worked for a while at the head office in Zutphen before travelling, via New York, to San Francisco where he worked as a manager for SkÅne, a Danish agency that served De Nederlanden in the United States. This venture came to nothing however; the agreement with SkÅne was cancelled in 1892 and Dercksen returned to London.⁶

5 *Kronieken Buitenland*, 1899–1909, Overview of Inspection Trips.

6 *Dossier Concept Gedenkboek*, Handwritten Overview of Foreign Operations, 1920.

Ferdinand Prior did not become a director either. This Dane joined the company on 1 June 1890 and was trained in the Netherlands.⁷ He made a total of six trips for De Nederlanden. In 1896 his renewed contract was confirmed in writing before his trip to South Africa. In this contract, geographical regions were accurately demarcated to the exact degree. Prior was to receive NLG 2,000 per year plus expenses (equipment plus travelling and accommodation expenses). Prior also negotiated a ten per cent cut of the profits of agents he appointed in that region. On top of this, he was given permission to look for another permanent post, provided it did not interfere with his work for De Nederlanden.⁸ Prior actually did find another job in 1897 with Baerveldt & Heyblom, an agency for De Nederlanden in Johannesburg. Prior wrote his reports in Danish, and his correspondence with director Carel Henny was also in Danish. Henny replied in Dutch, but he was able to speak and read Danish thanks to his traineeship as well as his contacts in Denmark.

In 1892 Gerrit Teerink, employed since 1882 and director-in-chief from 1919, left for his first trip to Constantinople, Egypt and Smyrna, before proceeding to Bombay, Singapore and surrounding cities. In 1894 and 1895 he made a further trip to several French cities. In 1896 he was appointed as a general power of attorney holder. His last trip as inspector was to the United States from May to October 1899. After this, he made many more trips in his capacity as director.

J.F.D. Scheltema, employed since 1897 and director from 1912, made his first trip in 1903 to Paramaribo and Barbados. Towards the end of 1904 he departed on his 'great journey to the East' (Asia), including Bombay in order to bid farewell to Agent Bell. He also made descriptions of the places that Dercksen and Teerink had visited before him. In 1911 and 1916 Scheltema also travelled to Mexico and Argentina.

⁷ *Dossier Concept Gedenkboek*, Handwritten Overview of Foreign Operations, 1920.

⁸ Correspondentie Prior, 1896–1897, 19 February, 12 March 1896.

After the First World War, when travelling was virtually impossible, deputy director J.P.C.E. Waterman set out on his journey 'around the world with the intention of successively visiting Chicago, Japan, China (...), Voor-en Achter Indië (Indian subcontinent and the mainland of South East Asia) and Egypt'.⁹ On 21 June 1921 he returned to the Netherlands. In subsequent years, he made further trips to such distant regions as Africa in 1924 and Brazil, Argentina and Chile in 1928.

The inspections in the Dutch East Indies differed slightly from those in the rest of the world. Since as early as 1870, so-called *Generale Gevolmachtigden* (general authorised agents) were appointed in the Dutch East Indies. These authorised agents all belonged to the relatives of director Henny. Their task was to keep an eye on the company's interests as well as to appoint, inspect and advise agents. They were, to all intents and purposes, permanent local inspectors. In 1877 a permanent inspector was also appointed for the entire west coast of Sumatra. This former notary was accountable to the authorised agents in Batavia. In 1904 the company discontinued the use of general authorised agents and set up a branch office instead. As a consequence, very few ordinary inspection trips were made to the Dutch East Indies. However, G.J. Henny did travel to Batavia in 1904 to open and manage the branch office there. Later he also visited such places as Sabang, Aceh, Penang, Singapore and Java, and made reports of these trips.¹⁰

⁹ *Kronieken Buitenland*, 1920.

¹⁰ *Kronieken Buitenland*, 1904.

Inspection Trips

The first inspector who made a foreign trip was Bernard Dercksen. He left in March 1885 for New Zealand, but returned with nothing to show for his efforts.

The aim of the inspection trips was to consolidate and expand insurance activities in the various countries. This meant acquiring new agents, visiting and inspecting existing agencies, adjusting premium rates, and inspecting and building the portfolio of insured property. This was far from easy in an unfamiliar country, with completely different customs and rules. It also meant working long and arduous days in an uncongenial climate.

The trips were generally long, drawn-out affairs, often taking in a whole continent in one go. From May 1886 to February 1887 Dercksen made a tour of the 'Asian port towns', visiting more than sixteen towns. Scheltema made the longest trip, departing on 28 December 1904 and only returning on 4 March 1906. The initial journey to faraway destinations was made by sea or air (the zeppelin and later the aeroplane); the car or train was used for local travel from place to place. The expenses were reimbursed. In 1903 Scheltema's two-month journey to Barbados and Paramaribo cost NLG 1,300.¹¹ The inspectors' journeys took them all over the world, both to major metropolises like Bombay, Constantinople and Valparaiso as well as to remote regions such as Zanzibar, Patagonia and Puebla in Mexico. Though the travel reports are fairly business-like, a personal note occasionally shines through, particularly in observations about the local population and traditions.

Apart from the inspectors, also the directors sometimes visited the agencies abroad. These other trips were also described alongside the inspectors' trips under the special heading of *Inspectie Reizen* (inspection trips) in the *Kronieken Buitenland* (foreign chronicles). The director, deputy director and head of the Foreign Department made regular trips,

¹¹ *Kronieken Buitenland*, 1903.

but usually within Europe. Director Henny also did this, sometimes combining business and pleasure by calling in at local agencies when returning from his holidays in Denmark. Apart from visiting branch offices and agencies, the directors also attended meetings and conferences (including premium rate-setting meetings for the *Hansestädte* (Hanseatic Cities) and the annual meetings of reinsurers of Russian companies).

IV. Archives

The foreign activities were started up shortly after the company was founded. What traces of this can be found in the archives? Though the archives of De Nederlanden van 1845 are reasonably complete, many documents have not survived. Below you can read the results of the search for traces of the foreign activities in the archives.

The minutes books of the meetings between the Supervisory Board and the Management, which are present since 1845, only make sporadic reference to these foreign activities. Mention is made of the negotiations to establish agencies in Hamburg in 1847,¹² and 18 months later in Hanover and Osnabrück. There must have been communication about this too, either in writing or otherwise. The archives contain only one ‘*Copieboek*’ (copy book) with handwritten outgoing letters, and a register, mainly directed to agents in the Netherlands for the years 1847–1848. This, however, contains no letters about the offices in Germany.

One matter-of-fact comment in the minutes about the oldest agencies in Batavia, Semarang and Makassar says: ‘will be granted a power of attorney’. There are two *Volmachtboeken* (power of attorney books) in the archives. These contain, in chronological order, handwritten copies of power of attorneys to agents abroad (and also to a few domestic agents). The books cover the period 1859–1896. The first entry concerns

¹² Notulen Raad van Commissarissen en directie van De Nederlanden van 1845, 13 August 1847.

Batavia, with the agency Tiedeman & Van Kerchem. The original power of attorneys (contracts) are sporadically present; these are loose inserts in the *Agentenboek* (agents book).

Agents were registered in the *Agentenboek* (agents book). This lists (in alphabetical order of the agency's location) the agency, the agent's name, the date of appointment/dismissal and any other representation by the agent. There is also a space for comments. The book was probably made retrospectively around 1906. Not all agencies are listed; one omission concerns the very first agency set up in 1857. Apart from the *Agentenboek*, you would also expect files for each agency. However, there are no direct indications that they ever existed, and they are certainly not present in the archives.

Other documents concerned the *Rekening-Courantboeken* (current account books), in which annual records were kept of each agency's number of policies, commissions and debit and credit details. Only the volume for the year 1845 has survived.

The agents themselves kept *Registers van Inschrijvingen* (registers of policies). In these registers they were required to record the name of the insured, date, description of risk, insured sum and other relevant details for each policy. A few of these are present in the archives, but only of Dutch agencies. When a customer applied for insurance, the agent sent an application form to the head office, where the application was assessed and accepted if satisfactory. A policy was then sent to the agent, which the insured had to sign, after which the policy was entered into the register. This procedure suggests that there must also have been a central registration of all these policy data at the head office. After all, this is where the policies were issued and numbered. But no such central policy book has survived. You would also expect an extensive correspondence with the various agents and branch offices abroad, but there are no traces of files for individual agencies.

There are also *Statistiekboeken* (statistics books) in which annual records were kept of all premiums and claims of the direct and indirect insurance business, including the foreign activities for the years 1876–1938.

One special item in the archive is a photo album containing photographs of foreign agents, which was probably compiled around 1906. The names of the agents are written in the same calligraphic script as the *Agentenboek*. The album is organised by continent: Northern Europe, South America, Asia. The name and location of the agents is stated with the photos. Several pages are empty. The agents were probably asked to send photographs, with the intention of steadily completing the album. However, some gaps remain; perhaps the photos were never sent, or the agents had already left the company.

The most important source for information about the foreign activities consists of the *Kronieken Buitenland* (foreign chronicles); the first was made in 1899 and they continue until 1930. This appears to be the beginning of a series that did not previously exist. Each year in July, a chronicle was written about the previous year (and signed by the head of the department). Until 1919 they were handwritten in a book; subsequently, they were typed and bound in a cover.

The lay-out remained roughly identical from year to year, with the following subjects being described in detail:

- New branch offices
- New agencies
- Changes to existing agencies
- Dissolved agencies
- Attempts to obtain new agencies
- Number of agencies
- Agent's remuneration
- Reinsurers (new, dissolved, changes)
- Contracts
- Insurance rates

- Wars, revolutions and other events
- Inspection trips
- Received visits
- Advertising
- Major fires
- Direct and Indirect premium income (per country)

The authors of the chronicles must have drawn on information from correspondence with the agents and branch offices, travel reports, reports on interviews held during visits and financial data. Regular reference is made to a letter or an interview, either with an exact date or only the month and year. As already noted above, none of these documents have remained in the archives. So the chronicles constitute an interesting and rare source of information about the foreign activities.

Another important source consists of the *Reisverslagen* (travel reports). The inspectors made reports of their findings regarding the agents and the visited regions, and sent these to the head office in the Netherlands. The subjects covered by category included the living conditions of the local population, climate, laws and regulations, industry and fire hazards. As a result, the *Reisverslagen* are also a rich source of information about the specific circumstances in the various countries from an insurance point of view.

The reports were either sent from the foreign location to the Netherlands or brought home at the end of the visit. The contract concluded with inspector Prior stipulating that Prior ‘shall not delay the writing of your written reports, and shall send the report about the place in question insofar as possible before leaving that place.’¹³ In the Netherlands, these reports were compiled, together with photographs, newspaper articles and other documentation, into leather-bound travel reports. These volumes were then provided with the inspector’s name and a serial number (if

¹³ Correspondentie Prior, 1896–1897, 19 February 1896.

the inspector had made several trips). Apart from the travel reports, the mutual correspondence was also bound, sometimes together with the travel report.

It is not certain whether these documents were bound immediately after arrival or (re)bound at some later time. The volumes look very similar, despite the distance in time between their official dates. There are 21 reports in total, but they are not complete. Thanks to the chronicles, we know of other trips and travel reports. There are also gaps in the serial numbers. For instance, two reports from Scheltema are numbered *Scheltema 4 and 5*, so volumes 1–3 are missing. Several later reports are not bound in this manner, but have a cloth archive cover.

The reports were entirely restored and digitised ten years ago.

V. Communication

During their trips the inspectors kept up frequent correspondence with the head office. Some of these letters were bound in volumes. Apart from the inspectors' letters written from various cities, they also contain the drafts of the letters from the directors. This correspondence, which also contains commentary on the local situation in the form of questions and answers, exists alongside the travel reports on these countries. Very often, the reports were sent along with the letters.

Amongst other things, there are two bound volumes of correspondence between the inspector Ferdinand Prior and the director and deputy director Christiaan and Carel Henny during the 1892–1894 and 1896–1897 periods. Prior's letters are in Danish, while those of the two Hennys are in Dutch. Another bound volume contains correspondence from Teerink when he was travelling to Constantinople, Egypt, India and the Dutch East Indies between 1892–1893. Teerink wrote more than two hundred pages to Zutphen and often received a reply by return of post, so there

were letters every four to five days. In addition, telegrams were sent with brief messages of an urgent or logistical nature; 'Leave London Monday night. Prior. 21/1/1892.' Also information for the inspector himself was sent by mail. Teerink, for instance, wrote to Director Henny that he had finally received the instructions and a city plan of Istanbul.¹⁴ Letters and parcels regularly failed to arrive, which meant that copies had to be sent. Teerink gave the advice not to send large items as post parcels, but as *Geschäftspapiere* (business mail) which, he claimed, went more quickly and did not need to go through Customs.

Correspondence must also have taken place between the agents abroad and the head office in the Netherlands (but there are no records of this). First of all, there must have been letters of application from prospective agents, letters of appointment, documents outlining the terms of employment and, finally, the signed contracts of employment.

Visits were also exchanged. Agents and representatives came to the head office, probably because they were visiting family in the Netherlands or elsewhere in Europe. These visits are briefly discussed in the *Kronieken Buitenland* (foreign chronicles) under the heading of *Ontvangen Bezoeken* (received visits). Very often these were courtesy visits and, of course, if you work for the same company, it makes sense to become acquainted with each other. Occasionally, the agents had 'important announcements' to make about political or other matters in the various countries. Sometimes an agent, such as Mr De Grijs, agent at *Quelimane* (Mozambique), not merely paid a visit to introduce himself but, because he had just resigned, also to collect his outstanding pay.¹⁵

The other contacts probably took place via the inspectors and the branch offices.

14 Correspondentie Teerink 1892–1893.

15 *Kronieken Buitenland*, 1902.

Conclusion

De Nederlanden van 1845 wanted to spread its risks and an extensive foreign agency network was an excellent counterweight to domestic activities. Over time, domestic and foreign operations made a roughly equal contribution to the results, though generally speaking the foreign premium turnover was higher than that of the domestic operations. The company was very enterprising in opening new agencies abroad, and only pulled out from countries or regions on account of specific circumstances, such as large claims due to natural disasters and wars. Local legislation could also be a reason to withdraw. Though not always equally successful, the foreign activities generated considerable growth for the company right up until the Second World War.

De Nederlanden consequently also had a high international profile. Through its over four hundred agencies and representatives, contacts were maintained with authorities, consulates and financial institutions all over the world.

During the inspection trips, agencies were opened, premium rates adjusted and risks assessed. Thanks to its physical presence, the company was able to achieve a lot in these distant regions. Apart from appointing new agents, inspectors could also immediately adjust large risks and conclude new policies. The trips thus played a crucial role in keeping the foreign activities running smoothly. However, unlike in the Dutch East Indies, the company never decided to set up more branch offices to enable permanent inspection abroad. As the inspectors did not visit the agencies annually, there was no continuity in the inspections. In the intervening period, the head office in the Netherlands had to rely exclusively on the financial information sent from the agencies.

By means of frequent trips and intensive communication, the company sought to obtain a good picture of all its activities. All information was carefully recorded, documented and kept on file in the Netherlands. The

inspectors' reports prove to have been the most important source of information. The chronicles provide a good retrospective picture, but whether they were used to determine the foreign policy is doubtful. There is no evidence to suggest that a specific strategy was ever deliberately mapped out in terms of e.g. choice of regions, number of agents, maximum premium turnover and so forth. Risk diversification was the sole objective and the results were all-decisive in determining whether to remain active in a specific country or region.

All in all, the archives provide a good picture of these foreign activities and merit further study.

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OPPORTUNITIES IN THE ASIA-PACIFIC REGION FOR CANADIAN LIFE INSURANCE COMPANIES IN THE EARLY 1990s¹

JOSEPH E. MARTIN

Abstract

The genesis of this paper was a presentation to the 1993 annual general meeting of the Canadian Life and Health Association (CLHIA). For a 30 year-period the Canadian life insurance industry had existed in an almost somnolent state. In late 1957 the government of Canada had passed legislation permitting mutualisation which provided the industry with protection from American insurers. Thirty years later Canada had a 'little bang' in its financial system which destroyed the traditional four pillars of chartered banks, life insurance companies, trust companies and investment dealers and permitted the chartered banks to sell life insurance. In addition, provisions were made for greater foreign competition in the Canadian market. As a consequence CLHIA re-organised itself and decided to look outward to other parts of the world including Asia Pacific. In order to understand this tempestuous period in Canadian life insurance history it is necessary to look at the roots of the industry in the nineteenth century, both in terms of public policy and in terms of early experience in Asia Pacific. It is also useful to examine what has transpired since 1993 in terms of demutualisation, consolidation and Asia Pacific.

I. Introduction

¹ This paper had its genesis in 1993 when the Canadian of Life and Health Insurance Association (CLHIA) invited Braxton Associates, The Strategy Consulting Division of Deloitte & Touche to give a presentation to their annual meeting on the topic of 'Asia-Pacific: Threat or Opportunity'.

The 1987 'Little Bang'² in Canadian finance was the catalyst for significant change in the Canadian life insurance industry, a sector that had not changed significantly in 30 years. The 'Little Bang' resulted in the destruction of the historic 'four pillars' of Canadian financial services – chartered banks, investment dealers, trust companies, and life insurance providers. Prior to the 'Little Bang' the four sectors were kept separate, not only by custom, but because the banks and the life insurance industry were regulated federally whereas investment dealers and trust companies were regulated provincially.

The 'Little Bang' was the first major piece of government legislation relating to the life insurance industry in three decades. In the late 1950s the government of Canada had introduced legislation which permitted large scale mutualisation of the life insurance industry to protect the industry from takeover by American investors. Suddenly a protected industry was thrown open to the possibility of take-over by American life insurance companies and threatened by competition from the Canadian chartered banks.³

The dramatically changing scenario resulted in the leadership of the Canadian Life and Health Insurance Association (CLHIA) to undertake a complete re-organisation, a re-organisation that was more outward looking and one that sought out opportunities for their members in other fields, including opportunities in the rapidly emerging Asia Pacific region.

This paper will trace:

1. the evolution of the Canadian life insurance industry, with a focus on the issues of why the industry crossed borders;
2. the attitudes of the Canadian government to the issue of foreign, principally American life insurers, selling life insurance in Canada;

2 So named in juxtaposition to the 'Big Bang' in London, which was even more explosive than the 'Little Bang' in Canada.

3 Although Canadian banks were allowed to sell life insurance they were not allowed to sell life insurance from their huge network of branches throughout the length and breadth of Canada.

3. the findings of the 1993 Braxton research study which identified far more opportunity than threat in Asia Pacific for Canadian life insurance companies;
4. major developments since 1993, including demutualisation and consolidation of the Canadian life insurance sector, in terms of the Asia Pacific opportunity.

II. The Life Insurance Industry in Nineteenth-Century Canada

The Canadian industry, like the American industry, began in the 1840s. In 1842 Mutual of New York (MONY) received a charter and the next eight years saw a boom in the founding of other insurance giants like Aetna, Massachusetts Mutual and New York Life. In 1847, in what was then Canada West and is now the province of Ontario, Canada's first life insurance company, fittingly called Canada Life was established in the city of Hamilton, 70 kilometres west of Toronto.⁴ Over the next five decades other Canadian life insurance companies would be founded, mostly joint stock rather than mutual. The industry would come to be based in the province of Ontario, principally in the city of Toronto but also with major companies such as Sun Life in Montreal and Great West Life in western Canada.

Since life insurance is an important financial service, it was regulated by government. This paper will examine both public policy and the industry in each of the time periods.

⁴ The company was established by H.C. Baker, the Hamilton branch manager of the Bank of Montreal, Canada's oldest and at that time largest bank. Baker had an asthmatic condition. When he married he decided he needed insurance. The closest agency was in Quebec City, over 850 km away, whereas New York City was not only 120 km closer but also more accessible as the result of the opening of the Erie Canal. So Baker travelled to New York where he dealt with a British firm who chose to charge him a premium to cover the 'hazards' of the Canadian climate.

Public Policy Affecting Life Insurance

On 1 July 1867 the British North America Act (BNA) established the Dominion of Canada, the first self-governing colony in the British Empire. In 1868 the Dominion Insurance Act was passed, which required a deposit of \$50,000, rising to \$100,000 for non-Canadian companies in order to obtain a license to sell insurance.

In the mid-1870s the government of Canada passed additional legislation relating to life insurance. The office of the Superintendent of Insurance was established⁵ in the Department of Finance.⁶ Legislation was also passed requiring that federally incorporated companies provide annual statements, actuarial reserves, and mortality tables and that companies doing business in Canada had to maintain sufficient assets to match liabilities.⁷

The Canadian Life Insurance Industry

In 1869 the life insurance industry was dominated by British and American insurers who held over 45 per cent and nearly 40 per cent respectively of the business in force with the remaining 15 per cent held by Canada Life.

However, as a consequence of legislative provisions relating to deposits and to asset/liability matching, many foreign life insurers departed the scene, believing that they had better uses for their capital. This left a void, which was soon filled by new Canadian companies. By 1900 Canadian

5 The first Superintendent was J.B. Cherriman. Cherriman was English born and Cambridge educated and came to Canada as Assistant Professor of Mathematics at the University of Toronto. He left the University in 1875 to become the first Superintendent of Insurance, a position he held for a decade.

6 There would be no comparable position for banking for another half century.

7 E.P. Neufeld, *The Financial System of Canada, its Growth and Development* (Toronto 1972), pp. 234, 236.

insurers held over 60 per cent of all the business, American firms were down below 30 per cent, and British firms were below ten per cent.⁸

By century end Canada Life was not only the oldest life insurance company but also the largest with assets in excess of \$20 million, more than twice the size of the next largest company. It had expanded from Ontario into Quebec and western Canada, and in the 1880s it had expanded into the United States.⁹

The next three insurers, Sun Life, Confederation Life and Mutual Life were much smaller than Canada Life and each had its own strategy.¹⁰ Smaller companies such as North American Life and Manufacturer's Life were also making their presence felt.¹¹ In terms of this paper the two most interesting companies are Sun Life and Manufacturer's Life.

Sun Life was based in Montreal, the only large Canadian insurer based in that city. While it received a charter in 1865, it did not begin operations until 1871. In 1880 the company began to expand internationally when it opened an agency in the British West Indies. This agency was followed by a flurry of international activity befitting the company's name. In the early 1890s it expanded into Asia Pacific and South America. In 1892 Sun Life was selling insurance in Japan, China, India, Malaysia, Hong Kong, and Singapore prior to their appearance in the United Kingdom in 1893.¹²

8 *The Statistical Year Book of Canada*, 1902.

9 The Canada Life Assurance Company, *The Financial Post Corporation Service*, 7 April 1932.

10 The three were similar in size to four American firms doing business in Canada – Equitable, New York Life, MONY, and Aetna and the British firm Standard Life as measured by death payments.

11 An unusual feature of early Canadian life insurance companies, at least by modern standards, was that they often turned to prominent politicians to serve on their boards and sometimes act as president because the appearance of probity was so important. Sun Life's first president was a prominent Montreal businessman who was also a Member of Parliament, Thomas Workman. Confederation Life appointed Sir Francis Hincks, Canada's Minister of Finance as its first President. North American Life appointed former Prime Minister Sir Alexander Mackenzie as president. Manufacturer's Life trumped this by appointing the incumbent Prime Minister, Sir John A. Macdonald, as president. George Albertus Cox was a Senator when he became President of Canada Life in 1900 but he more or less appointed himself rather than being chosen by the board.

12 Jeffrey Norman, *The Path of the Sun, An Informal History of Sun Life Assurance Company of Canada* (Toronto 1996), xxi.

One of the reasons for Sun Life's success was that they were prepared to sell insurance to Chinese nationals in China and to 'freely accept native lives' in India.¹³ In 1895 it opened an office in Detroit, the first in the United States, and in the same year the company started selling life insurance in the Philippines, Vietnam [French Indochina] and Thailand.

Manufacturers Life Insurance Company was founded in 1887 in Toronto, the future life insurance capital of Canada. Manufacturers was like Sun in that they sought out opportunities in Asia Pacific. They had their first sale in China in 1897. However, the board of directors was nervous about the market and passed a resolution stating that 'No further business be accepted from the Chinese empire without approval of the Board.'¹⁴

The distinguished Canadian historian Michael Bliss has noted that as the 19th century drew to a close a number of Canadian life insurance companies found the Canadian market too small and by 'the 1890s Canadian life insurance salesmen traveled the world, opening new markets for their policies, importing capital to Canada where their companies could invest it profitably'.¹⁵ This was certainly true of Sun Life and Manufacturers Life. 'It is often said that the first policy was sold in China by Sun Life of Canada which appointed its first full time manager in Shanghai in 1894.[...] Aside from Sun Life, pioneering development for an extensive market was made by Manufacturers' Life [Canadian], which had a general manager appointed in Shanghai in 1897.'¹⁶

III. From the Dawn of the Twentieth Century to Demutualisation in 1958

13 Peter Borscheid and Niels Viggo Haueter (eds), *World Insurance, The Evolution of a Global Risk Network* (Oxford 2012), pp. 423, 446.

14 Rod McQueen, *Manulife, How Dominic D'Alessandro Built a Global Giant and Fought to Save It* (Toronto 2009), p. 107.

15 Michael Bliss, *Northern Enterprise; Five Centuries of Canadian Business* (Toronto 1987), p. 270.

16 Borscheid, p. 477.

In the early part of the twentieth century Canada moved from being a colony of Great Britain to being a truly independent nation. In spite of participation in two world wars and the negative experience of two great depressions,¹⁷ Canada did well.

The Canadian life insurance industry also did well, growing and prospering both domestically and internationally, in spite of an investigative Royal Commission early in the twentieth century and the near default of Canada's largest insurer in the Great Depression. 'However, in the decades after the Second World War they retreated...with the percentage of assets held abroad decreasing for the first time since their internationalization began in the late nineteenth century.'¹⁸

In mid-century the government of Canada reacted negatively to American take-overs of Canadian life insurance companies. In response the government, with the cooperation of the Canadian industry introduced mutualisation, a poison pill for U.S. acquirers in order to protect the Canadian industry.

¹⁷ The Great Depression of the 1930s hit Canada, an export dependent nation, harder than any other in the Industrial world.

¹⁸ Borscheid, p. 262.

Public Policy Affecting Life Insurance

In the period 1900 to 1960 there were three major events that shaped the life insurance industry as a result of the government of Canada's response to developments in the life insurance industry. They were:

1. the McTavish Royal Commission of 1906 appointed to investigate the industry;
2. specific provisions relating to insolvency introduced during the depths of the Great Depression;
3. the mutualisation of the industry in the late 1950s as the result of concerns about American take-overs.

Of the three, the most important in terms of this paper and this conference is mutualisation.

Early in the twentieth century 'the life insurance industry in the Western world came in for close public scrutiny [...] It began in New York State with the 'Armstrong Committee' [...] This investigation prompted an investigation of the industry in the United Kingdom [...] which in turn led to the appointment of a Royal Commission on Life Insurance in Canada in [...] 1906.¹⁹

The Armstrong Enquiry resulted in regulations that restricted growth, which in turn led to opportunities for Canadian insurance companies as American companies 'began to concentrate their efforts entirely on the development of domestic business and to close off their foreign operations.'²⁰ In Canada recommendations similar to those of the Armstrong Enquiry, but not as restrictive, were put forward by the Commission. The 1910 legislation, which flowed from the Commission 'actually widened the

¹⁹ Neufeld, p. 238.

²⁰ Norman, p. 25.

investment powers of the company while extending government powers of supervision.²¹

Most Canadian life insurers adopted conservative investment policies. Generally speaking, they tended to invest principally in bonds, both government and corporate. While they might have had 15 per cent of their investments in stocks, the great majority of those investments would have been in preferred rather than common stock. Sun Life, which had become the largest Canadian insurer early in the century, adopted a much more aggressive, less conservative investment policy. From the beginning Sun Life had looked beyond Canada's borders and in the early twentieth century they continued to do so with a particular focus on the United States market. Not only that but they also invested heavily in U.S. equities, which was good news until 1929.²² As a consequence, the company came close to insolvency, when their net surplus declined by over 90 per cent from \$60.3 million in 1929 to \$5.9 million in 1934.²³

The government of Canada, presumably deeming Canada's largest life company as being 'too big to fail,' stepped in and amended the legislation governing the insurance industry. Prior to the amendment securities of insurance companies were required to be taken into account at market value as published by the Superintendent of Insurance. However, the Minister of Finance was permitted, under section 67 [2] of the Act, to authorise 'the use of values in excess of the market value for companies desiring to use the same.'²⁴

Mutualisation

21 Norman, p. 25.

22 Investments in common stock grew from 3.3 per cent of assets in 1920 to 53.9 per cent in 1929 when the stock market crashed.

23 Sun Life Assurance Company of Canada, *The Financial Post Corporation Service*, 29 Dec. 1945.

24 Sun Life Assurance Company of Canada, *The Financial Post Corporation Service*, 29 Dec. 1945; As a consequence of the near bankruptcy of the Sun Life, the federal government passed legislation, restricting Canadian life insurance companies' equity investments to 15 per cent of assets.

The major public policy decision relating to the theme of this conference was the decision of the government of Canada in 1957 to introduce provisions for the mutualisation of life insurance companies in order to prevent them from falling into American hands.

At the time at least five smaller Canadian companies had been taken over by foreign investors and there was a concern that some of the biggest Canadian companies would soon face the same fate.²⁵ The Canadian Life Insurance Officers Association (CLIOA), a predecessor to CLHIA developed a consensus that the Canadian life insurance industry needed mutualisation to protect Canadian companies from foreign (American) takeover. The consensus was presented to the government and in November 1957, the Canadian government moved to block the possibility of takeover by amending the governing legislation to permit mutualisation. In addition, the legislation stipulated that the majority of the board of directors of every insurance company had to be Canadian citizens and the board of directors could disallow the transfer of shares out of Canada.²⁶ Major Canadian life companies, representing 25 per cent of the insurance sold in Canada, took advantage of the provision to mutualise, including Sun, Manufacturers, Canada and Confederation, although Great West Life and London Life did not.

It is an ironic and little commented upon fact, that Canada was on the one hand, amongst the most welcoming of all jurisdictions of foreign direct investment [FDI], particularly from the United States in the non-financial sector; that it was hostile to foreign ownership of life insurance companies and banks, although not non-life insurance companies.²⁷

25 Norman, p. 65.

26 Neufeld, p. 247.

27 Two of the three largest industrial corporations in Canada were American controlled – General Motors and Imperial Oil (Exxon). Big Auto and Big Oil in Canada were dominated by foreign owned companies as was much of the mining sector.

The Canadian Life Insurance Industry

The life insurance industry experienced explosive growth in the first six decades of the twentieth century. At the beginning of the century the life insurance industry represented 12.5 per cent of all private Canadian financial intermediary assets. By the 1950s the industry represented over 18 per cent of all financial intermediary assets, having grown at more than twice the rate of the large Canadian banks.²⁸ Perhaps because of the opportunities within Canada the industry had, in the words of Darroch and Kipping, focused inward. So, while the industry had grown and there were more large life insurance companies, they were much more focused on North America than they were the rest of the world.

Sun Life, which had become by far the largest of Canadian insurers, became less globally oriented. They did not re-enter Japan after WWII, where they had been one of the largest foreign insurers and they were kicked out of China in 1946 and of India in 1956 by nationalistic governments. In addition, they closed their operations in Thailand, Myanmar, and Ceylon in the Asia Pacific region as well as some of their operations in South America and the Middle East.²⁹

The Manufacturers Life Insurance Company emerged as the second largest Canadian life insurance company and the largest of the companies based in Toronto. Manufacturers, unlike Sun were expanding beyond Canada. By 1960 they were transacting business in 36 states and the District of Columbia, in South and Central America, the West Indies, the United Kingdom, Africa and Asia. In Asia they wrote business in Malaya, Hong Kong, the Philippines and Singapore and had renewal business in

²⁸ Joe Martin, *Relentless Change, A Casebook for the Study of Canadian History* (Toronto 2010), p. 85.

²⁹ Borscheid, p. 263.

India, Indonesia, and Ceylon.³⁰ Like Sun Life they were forced to depart Japan at the beginning of World War II.³¹

Most of the other major Canadian life insurance companies restricted their 'international' operations to the United States and/or the United Kingdom. Indeed, in the case of some of the major companies they restricted their operations to Canada.

IV. From Mutualisation to Canada's 'Little Bang' 1958–1988

From the time of mutualisation in the late 1950s to Canada's 'Little Bang' of the late 1980s things were quiet for the Canadian life insurance industry, almost somnolent, both in terms of public policy and commercial activity.

Public Policy Affecting Life Insurance

In 1965 the government of Canada moved further in the direction of protecting national interests and against foreign interests in the life insurance industry by restricting total foreign ownership of federal incorporated Canadian life insurance companies to 25 per cent. The government also restricted foreign ownership of any one shareholder to ten per cent.³²

For the next two decades matters were quiet on the public policy front. And then the noise began – first with a Big Bang in London in 1986 and then a Little Bang in Canada in 1987. While the Bang is most closely associated with regulatory changes, which permitted the chartered banks

³⁰ The Manufacturers Life Insurance Company, The Financial Post Corporation Service, 7 September 1961.

³¹ McQueen, p. 117.

³² Neufeld, p. 248.

to acquire investment dealers, the Bang had huge implications for the life insurance industry.

Prior to the Little Bang,

‘the Canadian financial system was defined by its longstanding traditional structure: the Four Pillars. Chartered banks, life insurance companies, trust companies and investment dealers, all operated as separate sectors, with laws prohibiting companies from doing business in more than one sector. Strict federal regulations guided chartered banks and insurance companies, while equally rigid provincial regulations governed trust companies and investment dealers. These regulations prevented financial institutions from competing with firms from other sectors – in other words, a chartered bank could not offer insurance services to its customers, even if it had the resources and capabilities necessary to do so.’³³

The Four Pillars tumbled quickly in the late 1980s. On 18 December 1986, the government of Canada released a strategy paper entitled ‘New Directions for the Financial Sector’. ‘There was one terse sentence in a short paragraph on financial subsidiaries: ‘They [banks, trust, loan and insurance companies] will be permitted to own securities dealers’. The announcement had all the earmarks of a late addition to the text.³⁴ Legislation was quickly followed by the integration of the offices of the Inspector General of Banks and the Superintendent of Insurance into a single Office of the Superintendent of Financial Institutions [OSFI]. What had been four separate ‘pillars’ – commercial banking, investment banking, trust business and life insurance – would now be integrated.³⁵

As one shrewd observer of the Canadian financial system wrote:

33 Ashwini Srikantiah, *The Toronto-Dominion Bank and Canada’s ‘Little Bang’ of 1987*, A Case Study (Rotman School of Management 2012), pp. 1, 2.

34 Robert MacIntosh, *Different Drummers, Banking & Politics in Canada* (Toronto 1991), p. 277.

35 However, banks were not allowed to sell life insurance from their branches and still are not.

‘Although everyone has been given expanded powers, the obvious reality of the situation is that not everybody will be able to expand [...]. The general view [...] is that the banks are the big winners because of their size, while the non-bank financial institutions will be put at a competitive disadvantage.’³⁶

While this may have been true it was also a clear sign that Canada was more open for business in the financial sector than it had been in the past. There would be much more change in the near future than there had been in the recent past.

The Canadian Life Insurance Industry

In the period from the late 1950s to the late 1980s there was little change in the Canadian life insurance sector.³⁷ The industry was not particularly dynamic,³⁸ although the big non-mutualised companies grew faster than the mutualised companies with the notable exception of Manufacturers. One notable change was the arrival of three foreign-owned companies among the large Canadian insurers.³⁹

Sun Life was still the biggest life insurer but no longer the dominant force it had been within Canada. Internationally there had been further retreats in the 1960s both in Asia Pacific (Malaysia, Dutch East Indies and Singapore) as well as in the Caribbean and Africa.⁴⁰ However, there had been growth in the UK and the US, departures from and returns to Hong

36 Hon. Henry N.R. Jackman, *The Jackman Diaries*, vol. 11 (Toronto 2010), p. 183.

37 The same seven companies were the largest life companies in the 1980s as had been in the 1950s. Furthermore, they were in practically the same rank order.

38 The seven largest life insurance companies grew only 6.5 times, compared to Big Bank growth rates of 20 to 26 fold.

39 Scottish-based Standard Life, which claimed to be the oldest insurer in Canada, and two US-based firms, mutually owned Metropolitan and investor-owned Prudential.

40 Borscheid, p. 263.

Kong, and more than a four-fold increase in insurance in force between 1979 and 1987 in the Asia Pacific Region.

Manufacturers Life was growing much faster than Sun but there was concern at the highest levels that the mutual culture was inhibiting dynamic performance.⁴¹ In Asia its Hong Kong office, first established in 1931 continued to do well and Manufacturers entered into joint ventures in Singapore and Indonesia. But for the industry as a whole there was not a great deal of activity in Asia Pacific. Most of the focus outside of Canada was in the US and UK.

V. Change Begins 1988–1993

In this short period of time a number of things happened, one related to the industry, the other to the industry association, the CLHIA.

First of all, the major life insurance companies in Canada began to feel pressure from the big banks. Even though the banks were not legally allowed to sell insurance from their branches they were allowed to develop their own life insurance companies.

In addition to challenges within Canada, Canadian companies were starting to look for opportunities beyond Canadian borders. For example, Manufacturers Life became the first Canadian life insurer to open a representative office in China (Beijing). Branch operations were also established in Taiwan.

In this environment of change the CEOs of the major life insurance companies were starting to wonder whether their trade association, CLHIA, was up to the challenges presented as a result of the 'Little Bang'. In 1988, Earl Orser, the President and CEO of London Life, was elected Chairman of CLHIA. Orser was a no-nonsense executive with a background in accounting and retail as well as life insurance. He initiated the

41 McQueen, p. 60.

hiring of a major management consulting firm to review all aspects of CLHIA's operations.

As a consequence of the review there was a shake-up of the association and new management was installed.⁴² The new management encouraged a more externally focused orientation. One of the themes for the 1993 annual general meeting in Ottawa was global challenges including a key presentation on the Asia Pacific region.

VI. 'Asia Pacific: Threat or Opportunity'

At the 1993 annual meeting of the Canadian Life and Health Insurance Association, Braxton Associates made a presentation on the topic 'Asia Pacific: Threat or Opportunity'.

Asia Pacific presented far more opportunities than threats for the 1990s and beyond, because it had:

1. the largest life insurance market in the world, larger than the Americas, larger than Europe;
2. the fastest growing regional economy, faster than North America, faster than Europe;
3. incredible growth in the life insurance business; much greater emphasis on life insurance than other parts of the world – three of the top four life markets were in Asia – Japan, South Korea, and Taiwan;
4. deregulating markets in certain countries.

⁴² CLHIA recruited Mark Daniels as CEO. Daniels was a John Hopkins PhD, who had taught at McGill and Brown Universities and had served in a variety of steadily more senior positions in the government of Canada.

The presentation contended that the major opportunities lay in Japan but there were also opportunities in South Korea, Australia, Taiwan, Hong Kong and Singapore.

In looking at Asia Pacific the point was made to the audience that Asia was Canada's Near Western neighbour, not Canada's Far East. The legacy of the British imperial phrase 'Far East' has survived long past its due date.⁴³

Methodology and Interim Conclusions

1. A starting point to thinking about Asia Pacific was in terms of GNP – GNP being a surrogate for market purchasing power.⁴⁴ Using 1990 data there were five countries with a GNP in excess of US\$230 billion – Japan, China, India, Australia and South Korea.⁴⁵
2. Next it was necessary to look at GNP per capita. While size is important for consumer products such as blue jeans and coca cola, it was important to look at GNP per capita as a surrogate for purchasing power for sophisticated products like life insurance. On that basis, while Japan, Australia and South Korea were still worth looking at, China and India were not, but Singapore, Hong Kong and Taiwan presented interesting possibilities.

43 Part of the reason for this is that while the distance between Vancouver and Tokyo is not much greater than the distance between Toronto and London. However the distance between Vancouver and Toronto is 3,400 kilometres and Toronto, where the life insurance industry is centered is much closer to London than to Tokyo. The distance from Toronto to London is only 5,700 kilometers versus 19,200 to Tokyo.

44 The data used at the time of the presentation is much different than the material developed by Angus Madison for the OECD 'The World Economy: Historical Statistics'.

45 About one half the size of Canadian GNP.

3. From there it was necessary to determine the fastest growing economies. In the 1990s 9 of the 10 fastest growing economies,⁴⁶ in excess of \$40 billion GNP, were in Asia Pacific, the five fastest being South Korea, China, Thailand, Hong Kong and Singapore. Those nine economies had a collective GNP of \$1.3 trillion and a weighted growth rate of 7.9 per cent in contrast to Canada's GNP of \$543 billion and a growth rate of 3.3 per cent. At that time Japan represented one quarter of the \$1.3 trillion and while its growth rate had slowed it still was growing at a rate of 4.1 per cent, before the dramatic slowdown of the last decade of the 1990s.

In summary, what was evident was that Japan and South Korea had size, wealth and growth. Australia had size and wealth but not growth. Singapore, Hong Kong and Taiwan were wealthy and growing rapidly but did not have size. China and India were huge and growing rapidly but had very low GDP per capita. While Malaysia, Indonesia and Thailand were all small and poor, they were growing rapidly.

While it is important to have the economic picture it was even more important to know:

1. do the people in a particular country buy life insurance? and
2. if they do buy life insurance, does the government of that country permit foreign companies to sell life insurance there, i.e. what is the reaction of host economies to the presence of foreign financial institutions?

In order to answer the first question it was necessary to look at:

1. the size of the life insurance market;
2. the degree of insurance density, i.e. per capita sales; and

⁴⁶ World Bank Atlas, 1991.

3. finally, the level of insurance penetration, i.e. sales as a per cent of GNP.

In 1990, Asia-Pacific was the largest life insurance market in the world, not only bigger than Europe, but also bigger than North and South America combined! Perhaps more importantly, its insurance market was still under-developed.

Moving from a regional analysis to a country by country analysis, 89 per cent of the world's life insurance was sold in ten countries. Of the ten countries, three were in Asia-Pacific:

- Japan;
- South Korea, which had a bigger market than the old Soviet Union;
- and
- Australia – nearly as big as the Netherlands.

Beyond the 'big three' in Asia-Pacific, the size of the life insurance markets dropped off dramatically.

The biggest by far was Taiwan followed by India and New Zealand, all significantly bigger than the remaining seven. The next five were about the same size and included the PRC, at that time no bigger than Hong Kong, Thailand, Singapore and Malaysia.

Sigma Re defined insurance density as premium income per capita in US dollars. On this basis, the biggest buyers of life insurance in the world were the Japanese who bought 44 per cent more than the British and twice as much as Americans. Australians and South Koreans too were big buyers, although not in the same league as the Japanese. After that per capita sales fell off dramatically with New Zealand, Singapore and Taiwan buying half of what Koreans bought, Hong Kong one quarter. After that only tiny amounts were sold.

Insurance penetration was defined as the ratio of premium income to GDP. The story was similar to density except that South Korea had by far the highest penetration in the world, largely because of tax incentives which encouraged savings and underdeveloped financial markets. South Korea was followed by Japan and Great Britain. Australia was similar to the U.S. and greater than Canada. In terms of penetration after the big three, Taiwan was in a league of its own, followed by New Zealand and Singapore.

In looking at per capita sales one might conclude that the focus should be on Japan, Australia, South Korea, New Zealand, Singapore, Taiwan and Hong Kong because people in the other countries don't buy much insurance.

However the Bata Shoe Company provided a lesson in not being mesmerised by current patterns. After the Second World War all shoe manufacturers except Bata ignored the under-developed world because people didn't buy shoes. Bata looked at the same set of facts as everybody else, and came to a very different conclusion. They made a fortune making and selling shoes to people who had never bought shoes before.

Correlating the macro economic data and the insurance data led to similar conclusions. The main market was Japan! It had to be recognised that a special relationship with Japan was difficult but was also essential. An Asia-Pacific strategy had to begin with Japan.

Beyond Japan, South Korea was a bigger insurance market than Australia. After South Korea and Australia the major market was Taiwan, followed by Hong Kong and Singapore in terms of per capita sales. While the Hong Kong market was larger than Singapore's, Singapore had much higher per capita sales than Hong Kong.

Then the question had to be posed 'Will host economies accept foreign life insurance companies?' With the knowledge of where the markets were the next question was can a Canadian insurance legally enter the market? The answer was, at best, a qualified 'yes' in: Japan, South Korea, Australia,

Taiwan, New Zealand, Hong Kong, Singapore, Philippines, and Indonesia. The answer was 'no' in: India, Malaysia, PR China and Thailand

Of the Asian countries only Indonesia had introduced initial steps towards deregulation. Japan was planning to do so. There had been greater opening up in Korea and Taiwan. Therefore, there would be difficulties in the adjustment period, but there were opportunities.

Country Analysis

There were three key points about the huge Japanese market:

1. Japan and the U.S. alternated as the largest life insurance market in the world. 1990 premium income was US \$203 billion or 29 per cent of the world share.
2. The Japanese were the largest per capita consumers of life insurance in the world, right up there with the Swiss.
3. While Japan was doing incredibly well in selling manufactured product, North Americans were much better than the Japanese at selling in the service sector.

In terms of future growth prospects Fortune magazine was predicting that the Japanese economy would surpass that of the United States in 2011. It also asserted that this would occur whether it was 2006, 2011 or 2016; it will happen! Japan was a big, rich growing market that bought a lot of life insurance. The following words of caution were offered. In the case of Japan there had to be an understanding of the country, the people and the distribution system. In addition, there had to be a long term commitment.

At that time the Ministry of Finance had begun the process of reforming the Japanese financial services industry – including permitting life and non-life companies to enter each other's businesses. The key objective of regulatory reform was to 'establish a level playing field' in light of US

pressure. The reform proposals were designed to relax barriers to entry. Formerly, the focus was to emphasise soundness and stability by restricting competition and keeping prices high and choice low. The new focus was on solvency, efficiency and fairness.

Proposals for reform of the insurance sector were tabled in June 1992 and entitled 'New Directions for the Insurance Industry'. In July 1993 guidelines were to be announced out of HasaKon, the law reform committee. New legislation was targeted for 1996.

Going forward government legislation would not be the main barrier to entry because reform would occur. The major barrier to entry was the Keiretsu structure, a set of business companies with interlocking business relationships and ownership structure. The Keiretsu structure and the distribution system would be the main barrier to entry.

Two US insurance companies, Prudential and to a lesser degree AFLAC, had been successful because of their distribution strategies. Prudential thought a product strategy was impossible. Rather, they developed an agency success formula which included full time, highly educated, male agents, who sold on the basis of client needs rather than personal favours.

AFLAC offered a unique product – cancer insurance. They were assisted in gaining entry into the Japanese market when Jimmy Carter was President of the United States and AFLAC were a Georgia-based company.

In going forward three options for entry were recommended:

1. joint venture with capital investment;
2. buy an existing company;
3. establish branches.

Reform would occur, in spite of 75 per cent opposition of large companies and 100 per cent opposition of medium and small companies, because the international community was pushing for it through GATT and the Japanese consumer wanted it; they wanted better prices, international networks, and specific customer products.

However, a Wharton educated Japanese managing partner insisted that pressure must come from the US just as it had for 140 years ever since Admiral Perry arrived on his 'black ship'.⁴⁷

South Korea was ranked the sixth largest life insurance market in the world – larger than Australia, larger than the former Soviet Union with 1990 premium income of \$22.4 billion or three per cent of the world's share. More importantly, it had the highest life insurance penetration ratio in the world at 9.45 in 1991. This was a consequence of a favourable tax structure, resulting in large consumption of life insurance as a savings instrument. And tastes were changing towards protection oriented products so that demand should remain stable.

In the 1980s South Korea had experienced an average real growth rate of life business of 31 per cent, up from 25 per cent in the preceding decade. Near term, the next five years, projections for real GDP growth rate was predicted to be 7.3 per cent.⁴⁸

The South Korean market had begun to open up to foreign participation in 1986 as a result of US pressure. However, it was still very restrictive in terms of granting licenses and pricing and the market share of foreign life insurers was only three per cent. However, there was some trend towards liberalisation and internationalism as the country tried to adhere to new GATT rulings. But foreign investors were leaving because of obstructive regulations.

In South Korea the Chaebols – huge business groups owned by individuals without banks at the centre – tended to segment the economy by industry sector rather than integrating the economy as with the Keiretsu in Japan.

47 Braxton was the strategic consulting division of Deloitte, Touche, Tohmastu (DTTI). DTTI was the only major professional services firm which had a Japanese name included in its international name. The Managing Partner at the time was Tomita San, founder of Thomatsu Awoki. Tomita named the Japanese firm after two prominent Japanese Admirals.

48 Life insurance sales normally exceed growth in GDP.

Taiwan was the fourth largest market in Asia-Pacific, sixteenth in the world, similar to Sweden and Spain. Continued economic growth, access to neighbours, and a wealthy population made Taiwan one of the most attractive life insurance markets in the world. As was the case in South Korea, Taiwan began to open its market to foreign life insurers in 1986 under US pressure but the foreign market share was still small. However, unlike South Korea, admission procedures appeared to be relaxing. Further liberalisation was anticipated as part of their effort to adhere to recent GATT rulings. The foreign equity participation cap was raised from 30 per cent to 49 per cent in 1992.

In the early 1990s Hong Kong had an \$800 million US market equal in size to the People's Republic of China. There was strong domestic demand for life insurance services as demonstrated by rapid growth in per capita sales. It was anticipated that the growth momentum would continue because of a heightened concern for retirement; and because the market was far from saturated.

At the time life insurers' profits (average rate of return) were very high. The market was very concentrated – the top 19 companies owned 97 per cent of all sales – Canadian-based Manufacturers was one of the three major companies. In addition, there was a distinct possibility that a compulsory pension scheme would be implemented. Those that had a well-developed distribution and sales network would be at a clear advantage. For Canadian firms there was the additional factor of a special relationship. Canada had received more immigrants from Hong Kong than the US, UK and Australia combined.

Singapore was more life insurance oriented than Hong Kong with a US \$600 million market and high per capita sales, equal to Taiwan. The life insurance market was growing rapidly. Fifty three per cent of the population was estimated to have some form of private life insurance compared to only 16 per cent a decade earlier. This may have been related

to disincentives for having more than two children.⁴⁹ Singapore was also unusual in that it had a remarkably high persistency rate – 89 per cent of policies remained in force after two years.

The market had seen some consolidation. The market leaders were profitable. Few new licenses were issued. About three quarters of insurance companies were in foreign hands as branches or subsidiaries. And foreign life insurers had 47 per cent of the market. A real GDP growth rate 6.4 per cent was anticipated as well as significant growth in the population because of migration from Hong Kong.

Even in the early 1990s everyone was talking about China, while no one was talking about India. They were both essential to global and regional agendas. While both were long shots in the early 1990s, it was important to remember three things:

1. The Indian life insurance market was twice the size of the Chinese market;
2. India had the world's largest middle class – up to 300 million; and
3. India was an English speaking country.

The Bottom Line

After examining all of the data the conclusion was simple. Asia Pacific represented a world of opportunity. There were not only large and growing economies but there were also large and growing insurance markets. More specifically, countries such as Japan, South Korea and Taiwan offered particular opportunities. And Canada was geographically a Pacific nation; Asia Pacific was the Near West, not the Far East.⁵⁰

⁴⁹ There was no publicly funded education if there were more than two children.

⁵⁰ By the early 1990s, Canada, as a nation, shipped more to and from Asia-Pacific than to and from Europe.

VII. Consolidation, Demutualisation and Asia Pacific

The speed of change which began with the ‘Little Bang’ accelerated in the 1990s and continued on into the twenty-first century. There were dramatic changes in legislation [demutualisation], industry consolidation and a return to a more globally oriented life insurance industry with a keen appreciation of the Asia Pacific region.

Public Policy Affecting Life Insurance

As the 1990s progressed some of the large insurance companies wanted to move away from mutualisation, a policy of the 1950s. Their reasoning was that there needed to be consolidation within the industry in order to gain greater economies of scale to deal with the large costs associated with the industry’s technological requirements.⁵¹ The government first indicated its receptivity to demutualisation in its June 1996 consultation paper on the 1997 Review of Financial Sector Legislation where it emphasised the government’s desire ‘to enhance access to capital.’⁵²

OSFI’s Regulatory and Supervisory Practices Division began working on the development of a new supervisory framework in response to the legislation. The Framework, which outlined a comprehensive, risk-based methodology for the supervision of federally regulated financial institutions in all industries, was approved for implementation and put into practice in 1999. The Act specifically outlined how large and federally regulated mutual life insurance companies could demutualise. A clear

51 Not all companies believed that demutualization was required. Prior to demutualization there were newspaper accounts that Sun Life and Canada Life were in discussion about merging but this was in the late 1990s when the government of Canada was blocking the mergers of some of Canada’s big banks so the timing was not propitious.

52 1997 Review of Financial Sector Legislation (Government of Canada, 1996 Consultation Paper on Financial Reform), p. 10.

purpose of the framework was to more clearly identify the government's role in insurance industry oversight.⁵³

As Darroch and Kipping have noted demutualisation would facilitate the consolidation and, ultimately, rationalisation of the life insurance industry. It would also contribute to accelerating the industry's renewed global growth with access to capital markets, which would facilitate major international acquisitions.⁵⁴

The Canadian Life Insurance Industry

The period 1993 to 2013 has seen more dramatic change in the Canadian life insurance industry than in any other period of history. First, there was the diversification into other lines of business soon after the 'Little Bang' of 1987 and the subsequent change in names to include the word 'financial'. Then there was demutualisation as a consequence of the 1999 legislation. Next there was the consolidation of the industry and the emergence of three major Canadian life insurance companies in the early part of the twenty-first century, two of whom, Manufacturers and Sun, had an active interest in the Asia Pacific region.

The consolidation process began in the mid-1990s when Manulife, still a mutual company, acquired North American Life,⁵⁵ a major Canadian insurer. Next, Power Corporation controlled Great West Life of Winnipeg, and acquired the London Insurance Group with a bid of \$2.9 billion.⁵⁶

Once legislation passed regarding demutualisation the process began. Manulife, the second largest Canadian insurer, Clarica (formerly Mutual Life), the sixth largest and Canada Life, the oldest and fifth largest became

53 OSFI on line history – 1 Feb. 2013.

54 Borscheid, p. 268.

55 Which had earlier acquired Winnipeg based Monarch Life.

56 Great-West Lfeco Inc., The Financial Post Data Group, 15 July 2002. This temporarily made Great West Life the second largest Canadian insurer for the first time.

public companies, with a combined market capitalisation of \$14.4 billion. Sun Life, the industry giant and much smaller La Vie Industrielle soon followed suit and the total market cap of the five demutualised companies amounted to \$24 billion.

After demutualisation the pace of consolidation quickened. In 2002 Sun Life, Canada's largest insurer for nearly a century got a whole lot bigger when it merged with Clarica (formerly Mutual Life), Canada's fifth largest insurer. The next year Great West Life acquired Canada Life for \$4.7 billion, making Great West Canada's second largest insurer.

However, that same year Manulife Financial Corporation and John Hancock Financial Services Inc. (including its Canadian subsidiary Maritime Life) of Boston announced a tax-free stock for the stock merger of the companies, worth \$15 billion. Completed in 2004 the merger created the largest life insurer in Canada, the second largest in North America, and the fifth largest in the world.

As a consequence of all of this activity, Canada now has only three major life insurance companies – Manulife Financial, Great West Lifeco and Sun Life Financial,⁵⁷ all with significant international presence in more than 20 countries and territories around the world; with nearly half of their worldwide premiums generated abroad.⁵⁸ Ironically, this is not dissimilar to the situation at the beginning of the twentieth century, except that the companies are much larger, more global and offer many more product lines (see Table 1).

Asia Pacific

57 Manulife is by far the largest of the three and ranks twelfth in the world while Great West ranks thirtieth and Sun Life thirty-second.

58 While the 'Little Bang' and demutualization mark major changes in the Canadian life insurance scene, perhaps the biggest change in the industry was the emergence of Montreal-based Power Corporation, controlled by the Desmarais family. Its key holdings are Great West Life Assurance which acquired London Life in 1997 and added Canada Life in 2003, as well as Investors Group and Mackenzie Financial, two of Canada's largest mutual fund companies.

1900		2011	
Assets – Canadian \$ thousands		Assets US \$ billions	
Company	\$	Company	\$
Canada Life	30,329	Manulife	452,243
Sun Life	21,309	Great West Lifeco	233,674
Confederation Life	11,100	Sun Life Financial	213,375

Twenty years ago the presentation to CLHIA correctly forecast that Asia Pacific presented a world of opportunity with large and growing economies as well as large and growing insurance markets. The Report also identified Japan, South Korea and Taiwan as particular opportunities as well as India as a better opportunity than China, among the long shots.

Twenty years later it is still obvious that Asia Pacific presents a world of opportunity with Japan still the principal market but with Taiwan becoming more attractive than South Korea and the city states of Hong Kong and Singapore even more important than they were. With the opening of the really big markets there would appear to be great opportunities in China, followed by India and Malaysia, followed by Indonesia.

For Canadian insurers the past 20 years have been periods of Asian activity for two of the three major players – Sun Life and Manufacturers.⁵⁹

Sun Life has an Asian Pacific legacy dating back to the nineteenth century, although their only continuous operations have been in Hong Kong and the Philippines, where they are the number one life insurer in the country based on premium income. In 1995 they entered the Indonesian market and in 2002 the Chinese market. They are also now in India and have just entered the Vietnamese and Malaysian markets. In most countries they have a joint venture. All told they have nearly 1,800 employees or twelve per cent of their global work force and over 140,000

⁵⁹ Great West Lifeco focuses on North America and to certain parts of Europe, the United Kingdom, Ireland and Germany. In February 2013 they purchased Irish Life.

advisors.⁶⁰ They also have investment and marketing service offices in Tokyo, Taipei and Singapore.

In 1994 Manufacturer's Life found a new CEO in the person of Dominic D'Alessandro, who they hoped would change their mutual insurance culture.⁶¹

Shortly after his appointment he received a consulting report that saw Asia Pacific having 'the strongest prospects for overall market growth and profitability.' The report praised Hong Kong, which was responsible for 78 per cent of the company's premiums in the region, but observed that 'efforts to establish beachheads in Korea, Taiwan and Singapore had made little progress.'⁶²

In 1992 Manulife became the first Canadian insurer to open a representative office in China. Four years later Manulife entered into a joint venture with Sinochem, a Chinese conglomerate. And in November 1996 Manulife-Sinochem's joint venture opened their first office in Shanghai. Six years later, in 2002, they received their second license in Guangzhou. In 2012 they were licensed in 35 cities in China with 900 employees. Their goal is to be in 100 cities by 2015. Manulife is also in Indonesia but have not found their experience there to be as positive as in China. However, they now have one million policy holders and a 25 per cent market share.⁶³

'As the twentieth century came to an end, Manulife was established and doing business in nine Asian countries and territories – but not in Japan.' By the end of that year they had signed a deal with a consortium to buy Daihyaku Mutual with 1.4 million customers, \$2 billion in premiums, \$17 billion in assets⁶⁴ and 2.1 per cent of one of the two richest insurance

60 Sun Life web site – 1 Feb. 2013.

61 D'Alessandro had a banking background having held senior positions at the Royal Bank of Canada, Canada's largest bank and as CEO of Quebec based Laurentian Bank.

62 McQueen, pp. 76,77.

63 McQueen, pp. 107–117.

64 Manulife's total assets before the deal were \$60 billion.

markets in the world with 450 offices and 6,000 agents.⁶⁵ By 2008 Manulife were the 11th largest insurer in Japan in premium income and the fourth largest foreign insurer in the country.⁶⁶

As has been noted, Manulife acquired John Hancock in 2004. With that acquisition they entered new markets in Malaysia and Thailand and added business in Singapore, Indonesia, and the Philippines.⁶⁷ Unlike Sun Life Manulife has stayed away from India because foreign companies can only own 26 per cent of an Indian company. In spite of not being in India, the 'Asia and Japan divisions now account for one-quarter of all earnings and is the company's fastest growing region.'⁶⁸

VIII. Conclusion

The indigenous Canadian life insurance industry dates back to the 1840s, two decades before Canada came into existence as a Confederation of British Colonies in North America. Since that time the country and the industry have enjoyed remarkable, if inconsistent prosperity.

Late in the nineteenth century two of the newly established life insurance companies, Sun and Manufacturers, decided to look for opportunities beyond North America and the United Kingdom and found opportunities in Asia Pacific.

While the late nineteenth and early twentieth centuries were periods of looking outwards, opportunities in North America plus the devastation of the Great Depression caused the industry to look inwards. In the late 1950s the industry sought government protection from American predators by way of mutualisation, an ironic turn of events given that Canada was one

65 McQueen, p. 118.

66 Borscheid, p. 519.

67 McQueen, p. 177.

68 McQueen, p. 119.

of the most welcoming jurisdictions in the world at the time for non-financial foreign investment.

With mutualisation came a certain somnolence and reduction in international activities. But all that changed with the 'Little Bang' of 1987, which permitted life insurance companies to get into other lines of financial services but also permitted the big Canadian banks to get into life insurance.

Earl Orser, CEO of London Life and Chairman of CLHIA, was alert to the threats and opportunities presented by this sea change and requested an overhaul of CLHIA. A new CEO was hired, who shared Earl's concerns. The Industry Association set about positioning its member firms for the future, little knowing that the Little Bang would be shortly followed by demutualisation and consolidation. The Association commissioned a report in 1993 on Asia Pacific entitled 'Threat or Opportunity'. The report proved prescient in that it found far more opportunity than threat in Asia Pacific for Canadian life insurance companies. Subsequent to the report there was major legislative change in Canada in the form of demutualisation, followed by industry consolidation.

Today, two of the three surviving large Canadian insurers are important players in the dynamic Asian Pacific life market and are committed to becoming even more important.

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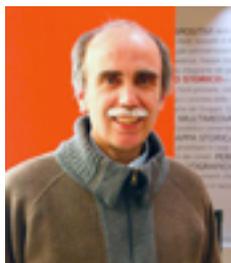
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Joe Martin is the director of Canadian business history at the *Rotman School of Management*, an adjunct professor, executive in residence and author of *Relentless Change, A Case Book for the Study of Canadian Business History*. He began his career as investment analyst with *Monarch Life Assurance Company*. From there he joined the staff of the Honourable Duff Roblin, premier of the province of Manitoba. Subsequently, Martin became management consultant with what is now known as *Deloitte Consulting*. He rose through the ranks to become partner in charge of the Canadian practice and he also served as chair of the global consulting committee. In 1996 Martin joined the faculty at the *Rotman School of Management*. He attended the *Harvard Business School* advanced management program, was made a fellow of the *Institute of Management Consultants of Ontario*, is a past president of the *Canadian Association of Management Consultants* and received an honorary doctor of laws from the *University of Winnipeg*, his alma mater. In 2012, Martin received the Queen’s Diamond Jubilee Medal.

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