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Central Banking in Central and Eastern Europe
Lessons from the Interwar Years' Experience 1/

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Abstract

This paper examines the philosophies which inspired the institution of central banking in Central and Eastern Europe in the interwar years. Influenced by the Financial Section of the League of Nations, the new central banks adopted laws which prohibited or severely restricted the financing of government fiscal debt. They were encouraged to centralize their payments systems and manage exchange rates to keep control of the money supply and achieve monetary stability. Before long they were forced to adopt further provisions in the area of banking supervision to regulate commercial banks. This paper considers the particular cases of Czechoslovakia, Hungary and Poland.

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Contents

Summary

A number of central banks in Central and Eastern Europe were established in the 1920s with the primary aim of creating monetary stability in the new order following the First World War. This paper examines the philosophies behind the institution of these central banks. It argues that their interwar experience may prove relevant to current institution-building and policymaking efforts following the imposition and subsequent demise of the socialist economic order in these countries.

During the war, many Central and Eastern European countries used highly inflationary practices, such as printing money and issuing short-term treasury bills, to finance government fiscal debt. The international financial conference held in Brussels in 1920 sought to curb such state-induced inflation by establishing politically independent central banks. This paper reviews the main features of the central banking laws adopted in Central and Eastern European countries in the 1920s. It notes that, in general, the views of the Financial Section of the League of Nations, dominated by the Bank of England, were incorporated into these laws. As the United States was not a member of the League of Nations, its views, shaped by a very different central banking tradition, were initially ignored. Under the direction of the League of Nations, the new central banks in Central and Eastern Europe were encouraged to centralize the payments function and manage exchange rates, in order to keep control of the money supply and achieve monetary stability. The importance of banking supervision, a policy advocated by the U.S. Federal Reserve system, was not fully appreciated until the following decade, by which time most central banks in Central and Eastern Europe had been forced to impose rules of behavior on commercial banks. In this regard, the particular experiences of Czechoslovakia, Hungary, and Poland are examined.

I. Introduction

The development of central banks to the status, functions, and role they presently enjoy, fulfil, and play was long and not exactly linear. Central banks found their way to their present position by complex historical development in all the countries where banks of issue were founded in the centuries preceding the present one. There is no need to go over that subject, as it has been covered by many excellent works (Conant (1969), Goodhart (1985), Smith (1936), and Giannini, (1994)).

There was a group of central banks, however, which did not follow the developmental route just mentioned. They were, we may say, the first modern central banks, as they began their existence after the First World War in countries that had achieved their independence as a result of the outcome of the war. By the flukes of world history, they are also the central banks that have had the experience of being radically transformed two more times in the intervening decades, after the imposition of the socialist economic order in the 1940s, and after its demise, in the late 1980s and early 1990s.

It so happens that several of the preoccupations, which were the source of the particular form central banking laws took in the 1920s when they were passed by national parliaments, are very similar to those which have inspired the central banking laws the same countries have adopted in the 1990s. Their interwar experience, therefore, may prove of some relevance to present institution-building and policy-making efforts, even if other features of interwar economics and politics are very different from those of today.

This paper is organized as follows: a first section reviews the main features of the central banking laws adopted in the Central and Eastern European countries in the 1920s. A second section deals with the commercial banking scene unfolding in the same period in those countries.

A third section will integrate the first with the second, and examine in some detail whether a certain difference in the philosophies, which inspired the construction of banking and central banking in those countries, may bear some responsibility for the serious troubles in which the same countries found themselves in the following decade, as a result of the international financial crisis which began in 1929 and engulfed the whole world in the following years.

II. Central Bank Construction in Central and Eastern Europe in the 1920s

The dissolution of the Austro-Hungarian Empire posed obvious problems of monetary and banking reconstruction along the new national lines sketched out by the Peace treaties. From the purely economic efficiency point of view, banking and central banking had no need to be reconstructed following the new borders. And trade did not have to find new outlets. The whole economic structure of the former empire could have been maintained, had it been found suitable by the new national elites. But very few people in the new states seemed at all inclined to reproduce the old economic order with only marginal changes. Most people wanted to redraw the economic map of their states along the new political borders, even if there was a cost in terms of economic efficiency. It was only Austria that tried to maintain pre-war influence in the economic and financial spheres in the Danubian area. 1/ Monetary reconstruction along national lines was thus deemed indispensable and it followed different roads in the different successor countries. In some, the League of Nations took responsibility for monetary and financial reconstruction. In others the national elites were able to build up financial institutions without recourse to the League or to other advisers. Still others took advice from European and American experts. All monetary and financial reconstruction, however, can be safely said to have been conducted in the spirit (guiding principles) of the Brussels conference. The gist of the Brussels recommendations was that inflationary finance had to stop and the printing press had to be abandoned as an instrument of government finance. Countries that did not have a central bank should equip themselves with one, and they had to ensure that central banks were independent from political influence. 2/

In the war years most countries had left the metallic standard to which their currencies had been anchored. What England and the United States, the countries which had the greatest influence on the Brussels recommendations, most wanted to avoid was a long period of monetary turbulence, in which the exchange rates of their competitors would fluctuate downwards, thus endangering the penetration of American and British exports. The United States, in particular, was obsessed with the nightmare of not knowing what to do with the increased agricultural produce its farmers had learned to grow to satisfy world demand in war years. Its structural trade surplus was

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1/ On the dissolution of the Hapsburgh imperial economy, see Garber and Spencer (1992).

2/ On financial reconstruction after the first world war, see Sayers (1976), de Cecco (1993), Santaella (1993). The International Financial Conference in Brussels was called by the Council of the League of Nations from September 24 to October 8,1920. Its main purpose was to submit to the Supreme Council of the League a program of financial reconstruction for Europe. For the proceedings and final report see International Financial Conference, Proceedings of the Conference, three Volumes. Brussels and London, 1920. The resolutions of the Commissions on Money and Exchanges are published as Appendix 9 of Sayers, op. cit., vol. II.

to be maintained in the post-war period, as it was reckoned that domestic demand would not be able to replace foreign demand to maintain U.S. incomes at the level they had reached in war years (Costigliola (1973)).

This meant that European exchanges had to return to a state of quiet, and currencies had to be managed around newly found parities by central banks more than to anything else devoted to monetary stability. In the course of the war, it had become apparent that the Central Empires, and in particular Germany, had financed the war by the printing press, not being able to do it by taxation, while most other countries had used government debt for the same purpose, often resorting to massive issue of short-term treasury bills (Bresciani-Turroni (1937), Sayers (1976)). Monetary policy in both victor and vanquished countries threatened to be swamped by an avalanche of fiat money and also by massive conversions of treasury bills (TBs), as commercial banks drew down their TB holdings in favor of peacetime loans to industry and commerce. Central banks' control of interest rates was therefore greatly endangered. In addition, Parliaments were no more to be relied upon as watchdogs of spendthrift governments. Universal suffrage having come into fashion in most countries, this meant that Parliaments were no longer the preserve of the moneyed classes. The representatives of workers and peasants were also there, and they had no great interest in keeping government expenditure down, as it meant jobs at a time when re-conversion of national industry and agriculture threatened the high employment levels reached in every country during the war (Holtfrerich, de Cecco, in Toniolo (1988)).

All these features of the new political economy militated in favor of constituting a new bulwark against deficit financing, under the form of independent central banks, called to manage exchange rates with monetary stability firm in their minds as a top priority. At least for the Bank of England, which set itself in the forefront of European monetary reconstruction under the guidance of its capable and obstinate governor, Montagu Norman, central bank construction in Central and Eastern Europe was also meant to thwart any attempt to use monetary tools to endanger the achievement of peace and disarmament in Europe (de Cecco (1993)). Between 1920 and 1925, therefore, monetary reconstruction took place in all the countries of the former Austro-Hungarian Empire according to the Brussels principles of central bank independence and fiscal austerity. As we shall see in what follows, these principles were so overwhelming in their importance for those who were the overseers of central banks' construction or reconstruction, that central bank laws were completely dominated by them, to the detriment, for instance, of a very important other aspect of central banking, that of banking supervision, which was often partially or completely overlooked, or at least consigned to the seldom attentive care of government departments, like the Finance Ministry.

In a recent paper on central bank independence and central bank functions, Swinburne and Castello-Branco (1991) have spelled out and analyzed a taxonomy of central bank functions. We shall take it as guidance and subject Central and Eastern European banking laws of the 1920s to scrutiny in order to obtain information on the items in the Swinburne and Castello Branco list. Before doing that, however, it is useful to recall that in 1921 Montagu Norman had sketched an extremely interesting list of the main features a modern central bank ought to possess. It was complemented by additions made by Benjamin Strong. Rather than summarize it, it is better to quote it in full, as it was extremely influential in the drawing up of new central bank laws, and in general on the development of central bank philosophy in following decades (Sayers (1976), Volume III, pages 76-77).

a. A central bank should not compete with other banks for general business;

b. A central bank should not take monies at interest on its own account nor accept bills of exchange;

c. A central bank should have no branch outside its own country;

d. A central bank should not engage in a general exchange business on its own account with another country;

e. A central bank should be independent but should do all its own government's business--directly or indirectly--including gold and currency;

f. A central bank should be the bank of all other banks in its own country and should assist them to develop their business and economic resources;

g. A central bank should protect its own traders from the rapacity of other banks in its own country;

h. A central bank may have an agency in another country;

i. That agency (if not itself a central bank) should do all its banking and all kindred business with the central bank of the other country;

j. And should receive the most favored treatment and information from the central bank of the other country;

k. And should do the banking and kindred business of its principal government in the other country.

To these, three more of particular importance in the Federal Reserve System were added at the suggestion of Mr. Strong, Governor of the Federal Reserve Bank of New York:

l. A central bank should act as the settling agent for clearing house balances arising between the banks of its own country, and to the widest extent practicable;

m. A central bank should handle domestic collections for its members and so regulate the domestic exchanges; and

n. A central bank should have power to examine banks which come to the central bank for credit and assistance.

It is fascinating to compare Norman's items with those added by Strong. The differences that exist even today between the U.S. and U.K. monetary and banking systems come out forcefully in those two short lists. Strong underlines the importance of bank examination, i.e., prudential regulation and of centralization of clearing and payments at the central bank. Those two functions were of paramount importance in a diffuse and centrifugal financial system like the one the U.S. had and still has. Montagu Norman underlined what was most important for him: that a central bank should not engage in commercial bank business; 1/ that a central bank ought to be politically independent, while fulfilling the role of government's sole bank; that a central bank ought to be a neutral agent, protecting traders from the commercial bankers' rapacity. Strong certainly could not accept the latter easily, as the Federal Reserve was a bankers' bank by statute. But Strong did not have the equivalent of the city of London to look after. Unlike the Boards of the Federal Reserve Banks, the Court of Directors of the Bank of England had no deposit bankers among its members. It was composed of city men, the traders who Norman wanted to protect from the rapacity of bankers. They were essential to the well functioning of the city of London, as they kept the commodity exchanges functioning, on which London's continuation as a world financial center depended.

How did the Brussels resolutions and Norman and Strong's commandments translate into Central and Eastern European central bank laws? Not surprisingly, it seems that Norman's views were more readily incorporated. He was nearer to the scene and, in the absence of the United States from the League of Nations, his bank and the British Treasury shared among themselves the privilege of controlling the actions of the League's Financial Section. As we said already, it was the Financial Section which was in charge of financial reorganization in the vanquished countries. But even where the reach of the League did not extend directly, Norman's commandments penetrated, as Norman was not the only one to be worried about the political independence of central banks, especially as far as setting legal limits to government financing was concerned. It comes therefore as no surprise to find that the principle of political independence was firmly asserted in most of Central and Eastern European central bank laws promulgated in the 1920s. Starting with the Reichsbank Law of 1924, where the principle is asserted in the first article of the Law establishing the bank, it can be found in all of the central bank laws of countries where financial

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1/ The Bank of England had been doing that, and alienating the joint stock banks, until the eve of the First World War. Even under Norman's stewardship, it remained involved in a commercial bank in Czechoslovakia (Teichova (1974)).

reconstruction was assisted by the League of Nations (Kisch and Elkin (1928)).

It is certainly the case that both Norman and Strong saw independence more as a means to resist the fiscal diktats of the government, than as a means to achieve price stability. First of all, they thought that price stability was to be assured by adherence to the gold standard (Strong) or gold exchange standard (Norman). Second, they thought it impolitic to assert that a central bank had any means to influence the price level. In Strong's case, he publicly denied such an ability, and in Norman's case, there is ample evidence that he, too, shirked from such a responsibility (Chandler (1958)). The reason for this denial of one of the functions most frequently assigned to the modern central banker is that the interwar period was a time when the pressure on central bankers was to act to make prices rise, as their main tendency was to fall. Accepting a responsibility for price stability would have meant an obligation to increase the money supply to counteract price falls, and this neither Norman nor Strong was prepared to accept. They wanted to keep a maximum of discretional power in this field.

Monetary stability, however, comes high among the responsibilities that central bank laws of the 1920s assign to the central bank. And the insertion of the political independence clause is explained by the desire to deflate freely, if need be. This in turn shows that Central and Eastern European legislators, when drawing up central bank laws, were concerned about endemic inflationary conditions, rather than the opposite, as was the case with the Anglo-American central bankers who had to deal with public opinion interest groups and Parliaments which worried constantly about deflation and unemployment (Eichengreen (1992)).

How to assure central bank political independence is a matter that exercised the ingenuity of legislators in the 1920s. The League of Nations Financial Section was of the firm opinion that the juridical form that central banks were given by law made an important difference, and they expressed themselves in favor of central banks constituted as private joint stock companies. Accordingly, the laws passed under their supervision duly established central banks as private joint stock companies, as the Bank of England was. It was also thought advisable that shares be spread among the largest possible number of holders, both at home and abroad, even by going to the length of fixing low nominal values for them or by allowing them to be split into fractions. This the League managed to impose on the Reichsbank Law, and to recommend to other countries. At the same time, the League recommended that the number of shares held by state institutions be kept at a minimum, and that banks that were reconstituted under its auspices, and where state capital was present, might act to get rid of this blemish in the future. This recommendation was made to Estonia and Bulgaria, both of which asked for League help (Kisch and Elkin (1928) and Ulrich (1931)).

It is, however, very interesting to note at this juncture that there also was a "Nordic model of central banking" being followed by central banks newly created in the region. This was the model of the Swedish Riksbank, a state bank and the oldest central bank, which was adopted by neighboring states like Finland and Latvia, in addition, of course, to Soviet Russia, which had other more ideological reasons for doing so.

A country which passed central bank legislation without recourse to the League, like Czechoslovakia or Poland, established stronger links between the bank and the state. In the Czech case, one third of the shares of the central bank, constituted as a private joint stock company, were by law to be held by the state. Also in Poland, after a pledge to keep Bank Polski in private hands, a second share issue was completely taken up by the Government: the intention was to sell them to the public in a due course which never materialized (Kisch and Elkin (1928), Podolski (1973), and Meyer (1979)).

We have drawn up a synoptic table (Appendix. Table 1) of how bank laws dealt with prohibition or limitation of central bank financing of the public sector. The various national recipes devised to satisfy this need are very different from one another. In some countries, there are absolute prohibitions to extend direct or indirect credit to the State, while in other countries there are specifications of the way in which such financing has to take place, and the maximum extent to which it is permitted. The most elaborate regulation of bank credit to the State is to be found in the Bulgarian and Romanian Central Bank laws. Although only one of these countries stabilized under League supervision, the blunt prohibition of Bank credit to the State, which is found in the laws establishing the central bank in Hungary, Czechoslovakia, and Poland, could obviously not be applied to two as seriously underdeveloped countries as the former two were at the time. It was thus decided to institutionalize bank credit to the State, but to fix very precise limits to its timing and maximum extent.

The prohibition to extend indirect credit to the public sector was, as we remarked, almost general. This was even made specific in some instances, as in the case of the Czech Central Bank law (and of the 1924 Reichsbank law), which expressly prohibited to the central bank the purchase of public bonds for its own account. It was generally felt at the time that the prohibition, even if not specific, did prevent central banks from performing open market operations. Open market operations and credit rationing had been used by the Reichsbank to make its will felt on the banking system, much more than discount rate policy. The latter policy choice had been dictated by circumstances to most other central banks which did not have a developed money market to rely upon.

Another way of keeping political influence at bay consisted in giving the central bank a monopoly of issue for a good number of years. Here it is interesting to note that only the Reichsbank was given a really long monopoly (50 years). Other banks created or transformed in the period were given monopoly of issue for periods ranging between fifteen and twenty five years. Only the National Bank of Romania was given thirty two years.

When it came to the appointment of the administrative organs of the Bank, however, the British tradition had to yield to continental etatism. In most cases the Governor and Deputy Governor were appointed directly by the Prime Minister, or by the President of the Republic or by the King, as the case might be, or by the shareholders' general meeting, subject to approval by organs of the state. In the cases in which foreign intervention was needed to found the bank, foreign shareholders were represented on the bank's Board. This was the case in Germany, Austria, Hungary, and Estonia. To mark the difference from these cases, both the Czech and Polish central bank laws established nationality clauses for shareholders and administrative officers of the central bank. The Czech law gave foreigners the chance of being shareholders, and reserved for them one place on the board. This was not much, if we consider that the bank's capital was expressed in U.S. dollars.

Central bank independence in its purest form was therefore inserted into the central bank laws only in those countries whose financial reconstruction took place under the supervision of the League. This fact has prompted an interpretation, according to which it was meant to be a limitation of monetary sovereignty for countries which needed foreign help to get back on their feet (Goodman (1992), Giannini (1994)). Severing the link between the central bank and the state was seen as the only way to prevent inflationary financing of state expenditures, especially in the case of countries which might use inflation to finance rearmament. Limitation of monetary sovereignty was further reinforced by the presence of foreigners on the central bank's Board. This was in line with the spirit of the League's reconstruction programs, which resembled more closely pre-war foreign financial intervention in states which had defaulted on their international debts than the assistance programs extended by international financial organizations like the IMF and the World Bank after the Second World War. League programs included the attachment of particular tax revenues to service international debt and the penetration of national bureaucracies by foreign experts with direct operational tasks and responsibilities. 1/

In the central bank laws which were passed in the 1920s, however, the diminution of sovereignty which was explicitly spelt out in the 1924 Reichsbank Law is seldom present. There was, historically, a problem with complete autonomy from state power which central bank legislators had to

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1/ That central bank autonomy was inserted to severely limit the monetary sovereignty of a government is further proved by the fact that it was reiterated in the statute of the Bank Deutscher Länder, the federal central bank set up by the Allies in the areas they occupied in Germany after the Second World War. After having made sure that no ties existed between the new bank and the German political body, the Allies also dictated that the new bank remain subject to the Allied banking commission (Goodman (1992)).

face. If they asserted that the central bank had nothing to do with the State, the fear could assail the public at home and abroad that the State did not stand by the central bank, that it did not guarantee it. This fear had to be dispelled to give enough authority to the central bank's note issue, and somewhere in the law mention had to be made of State involvement in the bank. Typically, the new laws passed in the 1920s underlined state involvement by making the bank's managers and administrators state appointees.

In addition, all central bank laws contained provisions about "State Commissioners" whose function it was to supervise the central bank and watch that it abided by the law. Not even the central bank laws of the League-assisted countries managed to escape this restriction. And almost all contained provisions for an arbitration procedure in case the State commissioner found fault with the legality of central bank activities. In that case, the laws mandated that the deliberations of the central bank to which the State Commissioner took exception be blocked for a short period, while the arbitration procedure was instituted.

The soundness of the currency to which the central bank had the monopoly of issuing, however, required that the state, in passing the law, pledged to avoid abusing the bank for fiscal purposes. 1/ This was typically done, as we saw above, by more or less strict rules about state financing. To reinforce the pledge, moreover, several among the central bank laws we are referring to contained detailed undertakings to link the currency to either gold or one or more convertible currencies at a fixed rate. None among the laws considered here went to the extreme of making inelastic provisions for currency issue. All of them contained provisions to make currency issue elastic, as it was then said, usually by fixing a steeply progressive tax or fine on overissue.

It is also extremely interesting to compare the reasons given, very often but not always in the first articles of the laws, for establishing the bank. The laws of countries that stabilized their currency under League supervision contain, among the main purposes of the bank, the maintenance of the gold value of the notes issued by the bank. In the accompanying synoptic table, this clause appears in the laws of Hungary, Bulgaria, and Estonia. It does not, however, receive the same pride of place in the other laws, although the pledge to adhere to the gold exchange standard is contained in most of them. It is interesting to note that the same strong gold standard clause is contained in the laws of the other countries which stabilized under League supervision (Austria, Greece, and Dantzig).

In all countries, however, the pledge to fixed exchange rates is tempered by a clause which gives the State powers to suspend convertibility of the central bank notes for grave reasons. Commitment is therefore not

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1/ Abuse is the term used by Maxwell Fry in a recent paper on fiscal relations between the state and the central bank (Fry (1993)).

absolute, and the ultimate power to fix the exchange rate firmly stays with the Government, which remains the ultimate guarantor of the central bank's solvency.

Thus the central bank laws of the 1920s demonstrate the earnest effort of the national elites to re-establish fixed exchange rates, but did not exclude the possibility that the effort might fail, whatever might be the reasons.

Among the functions the 1920s laws assign to central banks, the articles containing the general purposes never fail to mention the organization of the national payments system. This is foreseen as mainly done by centralizing state monetary transactions in the central bank and by the central bank's organization of clearing arrangements for the banks operating in the country. Very often there is also a provision for the central bank to centralize all foreign exchange transactions.

Those functions, moreover, are not everywhere equally explicit. More than once subtle nuances are made to underline, for instance, that the central bank may not be the sole treasurer of the State. This was the case in Hungary, where one very large private bank had traditionally exercised semi-monopoly powers on state banking and payments, and was also the case in Czechoslovakia. In the less developed countries, on the other hand, the law clearly assigns to the central bank the role of development bank, in addition to its more traditional functions. This is the case, for instance, in Latvia and Lithuania, where it was obviously expected that private banks large enough to take care of the development function were not easy to come by.

The main reason why central bank laws, especially those sponsored by the League, insisted on centralization of state short-term funds at the central bank is that in scarcely developed money markets like those of the Central and Eastern European countries, State short-term transactions replaced to a large extent the commercial transactions which characterized the developed money markets. It was extremely important that the central bank get some hold on them, at least by insisting that they pass necessarily through it, in order to make its interest rates effective, or to exercise some sort of credit rationing to the banks. In several of the Danubian countries, young central banks came to coexist with old and powerful commercial banks, and it was imperative that they find some way of exerting leverage on them. Compulsory balances to be held at the central bank could of course be imposed by law, following the example of the Federal Reserve Act. But European practice went against it, and the measure had to wait a few decades before becoming widespread on the Old Continent as well. None of the central bank laws of the 1920s mandated compulsory reserve requirements.

A further difficulty was represented by the Post Office operating as a payments network in most of the countries considered. This was a tradition of the Austro-Hungarian Empire, which the new countries inherited. The Post

Office Giro and Payments system was not necessarily connected to the central bank's payments network. Post Offices were state agencies and referred to one particular ministry.

With the severe limitations imposed on open market operations for reasons of fiscal discipline, precious little was left to the central banks to impose its monetary policy on the banking system and, through it, to the economy. Skilful use of centralized government cash transactions, when commercial banks had no previous claim on that, was one way. But it is clear that the central bank laws of the 1920s were intended first of all as stabilization laws, intended to break inflations of the money supply induced by government deficit monetization and to rely on the gold exchange standard as the main monetary policy rule. The fact that central bank laws left little space to active monetary policy was considered a merit of those laws, rather than a defect. They were all anti-inflation laws more than anything else, and the inflation theory which stood at their core saw unbalanced state budgets and their monetary financing as the main source of inflation.

The absolute majority of the central bank laws of the 1920s mentioned the control of credit among the central bank general purposes. This function was more elaborately specified in the other articles, where the operations of the central bank were detailed. Again, the majority of central bank laws established the central bank as a bankers' bank, discounting or rediscounting commercial bills which contained two, or preferably three, signatures. One exception was the Bank of Latvia, which the law authorized "to open credits and make short term loans against promissory notes bearing one signature only" if it accepted as additional security mortgages, agricultural and industrial products, other values (Article 24).

The bankers' bank feature was reiterated in the ever-present undertaking to restrict activities to short term bills and advances, and in particular to abstain from giving interest on current account deposits. Often, as in the case of Czechoslovakia, the central bank was prevented from engaging in commercial and industrial enterprises. Latvia was again the odd man out, allowing its central bank to "assist commerce industry and agriculture by granting short term credits." Most laws dictated that the central bank may not buy its own shares and those of other companies, except in the business of note-printing and coin minting.

The Romanian central bank law contained articles (22 and 23) which, like the Federal Reserve Act, clearly specified that the bank could deal only in "real" bills and should not deal in "finance" bills. Most laws dictated that the central bank's discount and advance activities be conducted at rates above the official discount rate, often specifying the minimum differential. All laws reserved the right for the central bank to fix its own discount rate, and required it to make public all changes in it.

III. Prudential Regulation of the Banking System

Goodhart and Shoenmaker (1993) have recently reckoned that the number of central banks involved in the prudential supervision and regulation of banks is equal to the number of those which do not perform this role. In the 1920s an equivalent enquiry would have yielded an even stronger result. The number of central banks involved in supervision and regulation was very small. It would have taken the wave of banking reforms of the 1930s to tilt somewhat the balance in favor of central banks' involvement in supervision.

It is not surprising, therefore, that the central bank laws of the Central and Eastern European countries passed in the 1920s made such scant reference to bank supervision. As we said above, credit control is often mentioned in the laws as a prerogative of the central bank, but it has probably more to do with the central bank's macro-function of influencing total credit levels. In the case of Czechoslovakia, the law attributes to the central bank the role of invigilating over the credits conceded by banks, with the aim of deterring enterprising borrowers from tapping different sources of bank credit by exploiting the scarcity of information of individual banks about the loans given individual borrowers by the entire banking system. This activity of the Czech central bank allowed it to specifically request information from banks on existing credits. With this exception, however, little or no supervisory activity was conferred by Central and Eastern European central bank laws on central banks. Nor was the situation changed by intervening banking and financial laws until the early- and mid- nineteen thirties. Moreover, they tended to give overall powers to government departments, like the Ministry of Finance, and to consider central banks as executive arms of the Ministry.

Banking regulation, we are told by the authoritative Commercial Banking Legislation and Control, which the London Institute of Bankers published in the late thirties (Allen, Cope, Dark, and Witheridge (1938)), tends to follow the most important innovations that occur in the banking and monetary field. First of all the payment system was organized as a metallic currency system, and legislation appeared to regulate the orderly issuance of coin. Second, banks started to issue notes, and again legislation was passed to regulate that activity, often conferring the monopoly of note issue on one particular bank. Finally, banks began to give loans by accepting deposits, and regulation appeared to control this latest activity.

Deposit banking, however, became widespread in England much earlier than it did in the rest of Europe. On the continent, commercial banks became involved, very early on, in fostering industrial enterprise by acquiring and holding shares in industrial companies. Deposit banking and the use of checks remained, for quite a long time, a British peculiarity that led to a particular form of payments network. What characterized continental banking since the first half of the XIXth century was the rise of universal banks.

Universal banks were created in the more developed countries much earlier than central banks for the obvious reason that universal banks did not have to correspond with units of political sovereignty. In the territories which achieved independence after the First World War, therefore, universal banks had often thrived for quite a long time, creating an intricate web of relations with the main industrial and commercial establishments of the same territories.

Political independence meant monetary sovereignty expressed as the monopoly of note issue. It would have not been necessary for the State to go to the length of creating a brand new central bank. It might have conferred the monopoly of note issue on one of the existing banks. But universal banks on the Continent were traditionally not in the business of note issue. And in the Austro-Hungarian and Russian Empires, of which the new countries had been a part, banks of issue had not been universal banks but separate institutions that were either partially or totally dominated by the state.

It came therefore as a natural consequence of political sovereignty that each new country should have a new central bank. Montagu Norman and the League of Nations' only worry was to make sure that the central banks would perform their role of monetary controllers, free from all political and particular influence in the new countries, in order to constitute a permanent bulwark against inflation. They were not interested in the regulatory micro-functions of the central bank. Its relations with the commercial banks had to be like those they would entertain with the government: centralization of the payments function in order to keep control over the money supply. Supervision and regulation of commercial banks was not a function that the Bank of England, the Bank of France, and the Reichsbank ever had anything to do with before the war. From none of these elder brothers thus came any example to follow for the new central banks founded in the 1920s.

On the other side of the Atlantic, however, the Federal Reserve Act had established a peculiar federal central bank which was expressly given the task of supervising and regulating the commercial banks, albeit not exclusively, as well as conferring upon it even the powers, unheard of in Europe, to carry out on site inspections of bank premises and careful examination of bank books.

In addition to the central banking commandments that were written by Norman, Strong had appended a few articles underlining the importance of the supervisory (he called it "bank examination") function. In the new countries of Central and Eastern Europe, the governing class felt the need to provide for banking supervision with a greater affinity towards the other countries of Europe than to the United States.

However, it was often a not very keenly felt need. Regulation and control of commercial banks were accordingly provided for, but it was executed in the half absent-minded way which had also characterized the same activity in other countries of Europe until the financial crisis of 1931.

If we restrict our attention to the better documented cases among the countries we are considering here and analyze the regulation and supervision standards and policies of Czechoslovakia, Hungary, and Poland, we find striking differences in this field among countries which had all been members of the Austro-Hungarian Empire. All of these countries had a homogeneous banking and monetary tradition, with the exception of Poland, which was the result of a re-unification of parts which had belonged to different countries. 1/

That notwithstanding, Bohemia and Moravia had been subjected to Austrian banking laws, which required the case by case licensing of banks, while in Hungary and Poland no licensing was required. Considerable bank concentration had been thus fostered in what became Czechoslovakia, while something quite similar to free banking had occurred in what became Poland and Hungary. The three countries were different also from the point of view of their economic structure; Poland and Hungary were still based on large export agriculture and scant industry, while a remarkable industrialization process had been fostered in Czechoslovakia in the last decades before the war. What the three countries had in common was the presence of universal banks, which had followed the Austrian and German example and promoted the growth of industry by rolled-over current account loans and by the acquisition of shares. To a much lesser extent than their equivalent in Austria and Germany, those banks had been able to rely on disposal of shares to the general public through the Stock exchange, and had ended up, especially in Poland and Hungary, being more like holding companies of industrial and commercial firms than real universal banks. Moreover, while the Czech large banks could rely on a network of savings and cooperative banks which provided them with real savings, the Hungarian and Polish large banks had to rely on foreign financial resources to conduct their industrial promotion business. And in Hungary, as we already noted, large banks were surrounded by what resembled wildcat banks of the US West, undercapitalized and overstaffed, and certainly not to be relied upon as a steady source of interbank deposits.

Immediately after the war, Czechoslovakia was much more able to get itself organized and exploit the early post-war boom than the other two countries were. Its problems, of course, were much less difficult, but the administrative apparatus which it was able to put in place to organize and regulate its financial system was quite impressive. Local banks had managed to avoid getting stuck with Austrian government bonds, which lost most of

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1/ The best available information on the banking systems and on banking regulation in these three countries during the inter-war years is provided by the Civil Affairs Handbooks which the Federal Reserve compiled for the U.S. Army for each of them in 1945. See United States Army Service Forces (1945). I have made liberal use of it in what follows .

their value, and the Czech government was able to proceed to the stamping of Austrian National Bank banknotes with great speed, and thus avoided being loaded with an excessive share of them. Czech industry was well placed to sell abroad, and did so to a remarkable extent. The very virtuousness of the Czech performance, however, was the cause of acute financial problems. Foreign capital flocked to Czechoslovakia, which seemed to have such good economic prospects, and induced the Czech currency to revalue. The inflow, and the revaluation, became acute after the Communist and Socialist Parties split in 1921 and a national coalition government was formed. The return to moderate politics, by enticing speculative funds from abroad, put Czech industry at a distinct competitive disadvantage, as the exchange rate rose; a serious export slump followed. The large banks which had lent to industry and owned industrial shares found themselves in serious difficulty. The year 1922 saw the most acute part of the crisis as a trade deficit opened up because of revaluation, and wholesale prices fell by 50 percent over the previous year. Central bank credit and circulation of money decreased each by 2,000 million Crowns as unemployment rose and bankruptcies followed. For the banks, the crisis reached its peak in 1923 when two small banks collapsed, and a general run started on most other small banks, which had benefitted from the previous financial euphoria. The Government then stepped in and assisted banks with public funds, but in spite of this, by 1926 current account deposits at all banks had decreased by 30 percent compared to 1922.

The interesting feature of the crisis' aftermath is that the Czech Government was induced to review legislation on banking, and on October 10, 1924 the so called Bank Laws were promulgated in order to protect depositors of money and securities. They were among the very first of such laws to be passed in Europe, and preceded other countries' similar measures by several years. (But then the Czechs were used to virtue: they managed to keep the exchange rate more or less fixed from 1923 to 1934). Only specially licensed banks were to be allowed to collect savings deposits, and those which did were subjected to supervision and regular audit by government authorities or banking associations. Since most banks asked for, and were granted, the special license to collect saving deposits, virtually the whole banking system was subjected to the new regulations.

Thus Czech banks, in order to operate, needed two licenses: one to act as banks, the other to collect savings deposits. Moreover, the statutes of credit institutions were subject to Government approval, many credit institutions were under direct government supervision as they had needed assistance, and each bank was permanently assigned a government commissioner representing the Ministry of Finance, with full powers of inspection. The Bank Laws also imposed heavy penalties if the law was infringed, especially if losses resulted. Serious cases were punished by imprisonment. If banks experienced grave losses, the law empowered the Government to liquidate them. If compulsory bank audits were skirted, or if the auditors' recommendations were not followed promptly, serious punishment could ensue. The 1924 Law also mandated that securities held in trust by a bank had to be kept in a separate account and not mixed with those owned by the bank.

One of the most interesting features of the 1924 Laws was the creation of the Special and General Funds. The Special Fund for the Alleviation of Postwar Losses had the aim of meeting part of the losses which banks and savings cooperatives had suffered during the economic crisis in the period of deflation. Bonds were issued by the Fund for an amount of Kc 1,640 million that were guaranteed by the State, and they were distributed to institutions which had experienced the gravest losses. Interest and repayment were covered by contributions from all financial institutions and the State. Credit institutions contributed a percentage of their dividends, while savings banks paid 10 percent of their profits. All credit institutions had to purchase the bonds issued by the Fund in proportion to their deposits.

The General Fund for Financial Institutions was also established by the 1924 Laws. It sought to increase the safety of deposits by making loans to members which had experienced losses to an extent threatening their existence and the interests of depositors. The fund was divided into three sub-funds according to types of credit institutions. Membership was compulsory and contributions were set as a percentage of interest paid to depositors. If the Fund needed to pay out more than its resources, it could issue bonds at 4 percent and with a life of 40 years, guaranteed by the State. Members of the Fund were obliged to buy those bonds with 1/4 of 1 percent of deposits.

No measures of equivalent rigor were passed in either Poland or Hungary. In Hungary, as we have noted, no special license was required to start a bank. Banks were subject to the general rules of the Commercial Code, and they could be started with a minute capital. No supervision was exercised on them until 1916, when an institution called the Central Corporation of Banking Companies was formed. It was a peculiar organization, put in place by the Government which appointed its top bureaucracy, but administered also by the banks. It received some powers to inspect banks and supervise them, although the State's primary goal for its creation had been to group banks together to better organize them, so that they could finance the war needs of the state itself. Real supervisory activity, however, had to wait until the 1931 crisis, when banks got into serious difficulties especially because of the withdrawal of foreign deposits and the banks had to be rescued by the Government.

The same laxity seems to have marked the early years of Polish financial life. As in Hungary, a veritable boom in banking activity accompanied violent inflation, and as in Hungary, stabilization efforts induced extensive bank difficulties, since they found it difficult to adjust to the deflationary environment. In 1919 there were 34 commercial banks. In 1924 they had become 87 (the peak), and in 1929 they had decreased to 63. 1/ This was the effect of deflation, but also of a law which, in 1924, accompanied the first stabilization experiment and the introduction of the Zloty currency. It subjected banks to licensing, fixed minimum limits for capital, required balance sheets to be drawn up in gold values, instituted a system of Government supervision, and asked the banks to submit monthly or quarterly returns, annual balance sheets and profit and loss accounts (League of Nations (1933)).

Although the first stabilization effort was inconclusive, especially because of the dreadful crop failure of 1925 and the ensuing depreciation of the Zloty, the business climate never regained the hectic tone of the inflationary period. Some order was brought to the Polish banking system by the new regulatory framework, but the new regulatory and monetary regime coincided with a prolonged "stabilization crisis." Visiting the country with his mission of American experts in 1926, Professor Edwin Kemmerer remarked in the mission's written report (Republic of Poland (1926)): "With the exception of a number of the banks in which foreign capital is interested and of a few strictly Polish banks, the joint-stock banks generally are now in a nonliquid condition. The investment in real estate and shares of private corporations is heavy. The collateral loans are largely secured by shares, debentures, and mortgages which are not at present saleable except at prices involving heavy sacrifices; the loans advances and discounts are mainly of a type which will have to be carried until the borrowers are in a position to refinance through the sale of stocks or mortgage debentures. In such cases, the banks though nominally only creditors, are actually for all practical purposes partners in the business enterprises in which they hold securities and investments or as collateral for loans. Much of the time of the bank officials is taken up in managing the properties of the bank and those pledged as collateral to loans." It might be of interest to note that Poland had experienced a veritable asset boom in the early twenties which had, in particular, concerned real estate, where banks had made extremely large investments. The Kemmerer report noted that bankers--post factum--had rationalized their behavior by complaining that foreign exchange restrictions had prevented them from diversifying their investments.

The report came out strongly in favor of a banking reorganization which favored mergers and greater concentration. "In all countries of Europe, it wrote, the principal credit needs are supplied by a few, well managed joint-stock institutions which, through well organized branch systems, serve the different sections of their respective countries. These banks finance

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1/ These figures come from a table contained in the League of Nations Memorandum on Commercial banks, 1913-29. The text of the same document, however, tells that "between the end of 1920 and the end of 1923, the number of banks having their head offices in Poland increased from 28 to 111, and the number of bank branches from 208 to 605... By the end of 1927, the number of domestic joint-stock banks recorded in the official statistical yearbook had dropped to 56.

industry, commerce and agriculture. They take care of the small tradesmen as well as of the large concerns. In Poland, there are three fair sized joint-stock banks but there are no large ones. The financing of the current transactions of the large business enterprises and of agricultural concerns is done principally by the Bank of Poland which, due to the unsettled economic conditions in the country and to the small size of capital of the joint-stock banks and their impaired condition, is forced to deal on a large scale directly with business concerns."

If large banks were encouraged to rise (noted the report), the Bank of Poland and the Government would be relieved of their short-term financing activities, and could devote their time to more curricular activities, such as the supervision and regulation of the banking system. In particular, the arch-etatist creation of the Polish government, the National Economic Bank (NEB) and the State Agrarian Bank (SAB), which overpowered all other banks in Poland by the scope and scale of their operations, would be, the report hoped, reduced by the rise of large private joint-stock banks. Kemmerer and his colleagues believed "that the participation of the government in the banking business as a permanent policy is unwise." They were, however, prepared to admit that the NEB and the SAB had for the immediate future no credible replacement, as they performed functions that other banks were unable to perform for lack of adequate resources. They hoped that the two banks would be merged and would leave the field of deposit and short-term banking, becoming more specialized long-term banks and less universal banks.

The all-American Kemmerer Commission expressed very strong views on how the Polish system of banking supervision ought to be reorganized. They suggested a system reminiscent of that prevailing in the U.S. before 1913: bank inspection carried out directly by the government. Accordingly, they opposed the Private Revision Society to be formed by the Polish Bankers Association foreseen by the Banking Law of 1924 (after Austrian and German practice, and with similarities to the Hungarian Central Corporation of Banking Companies).

"Some bankers in Poland, the report noted, strongly object to banking inspection by government inspectors as an infringement on their rights, and as a handicap to their initiative. They claim that it is a system peculiar to America and contrary to European practice." But, the report went on, banking in Europe is concentrated in large institutions which have grown over a very long period, and have extremely skilled personnel and very large capital resources at their disposal. "If similar conditions existed in Poland there would be more force in the argument against government inspection... But Poland is a politically new country which is building up a new banking and credit structure. It has comparatively few well managed banks and the liquid resources of these banks are small. It has many weak banks with small capitals. The officers of the latter have still to acquire the experience and judgment necessary for good management."

Therefore, bank supervision should be a function directly assumed by the Ministry of Finance, by the creation of a Bank Commissioner appointed by the Minister of Finance with the approval of the Council of Ministers for a fixed term, e.g., five years, and to be given a special section in the Ministry. The Kemmerer report proposed that the Commissioner should have at his disposal a large force of Inspectors, and that he should inspect not only all banks, but also the Bank of Poland, the National Economic Bank, the Central Cash Office, and the Agrarian Cooperative Societies. He and his inspectors should have the powers of making thorough on site inspections, as supervisory authorities did in the U.S.. The report insisted, of course, on the need for the Commissioner to be a man of integrity and distinction, solely dedicated to his job, and that he be given absolute independence in his functions.

In addition, the Kemmerer report advised that the Banking Law be amended to include articles mandating that joint-stock banks should keep a minimum cash reserve of 15 percent against demand deposits and of 5 percent against time deposits for banks operating in Warsaw, and a smaller one for banks operating in the provinces.

Obviously, the Kemmerer mission recognized similarities in the U.S. and Polish financial structure. They underlined the need to find appropriate solutions for a structure which was in the process of being built at a fast rate, and which could therefore not rely on the patrimony of loyalties and affinities and homogeneity, as was the case for structures built over many centuries. In new countries, like the U.S. and Poland, the hand of the Government had to be heavier and more direct. Self control could not be granted to actors who were not yet used to repeated games, and could be tempted to adopt hit and run strategies. Proximity to old-established European financial systems made imitation of their ways almost irresistible, but in the opinion of the report, extremely dangerous for a new country.

We considered it appropriate to give financial structure and banking supervision and regulation in Bulgaria and Romania a separate treatment in this paper on account of the much less developed conditions in which these countries' economies were in the interwar period, even compared to the other Danubian countries. 1/ In both countries, the foundation of a State Bank preceded that of private banks and was undertaken not only to play the role of state financing and note issue, but also to perform purely commercial banking functions, which remained greatly underdeveloped until the end of the XIXth century. State banks, and later private banks, were as a consequence, involved in the active fostering of industry, agriculture and commerce by direct intervention in these fields, even more than elsewhere in the region. Not only did they lend, they also promoted companies by buying

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1/ Information on the banking systems of these countries is much less abundant and of lower quality. It comes, for those who do not read their respective national languages, mainly from the League of Nations Memorandum we have already quoted.

their shares, and traded directly in primary commodities and agricultural products. In both countries, therefore, the transformation of state banks into Western-style central banks, imposed by international action in the 1920s, created a financial dualism which probably reinforced, rather than alleviated, the harshness of the depression. However, after the great wave of foreign investments, this dualism that had involved Bulgaria and Romania, as it had almost all other European countries in the second half of the twenties, began to recede in 1929 and disappeared soon after. In both countries, some private banks had been started with the help of foreign capital. The universal nature of their operations rendered them extremely exposed to the breaking of the international boom, as their investments in industry became illiquid, and weighed heavily on their balance sheets. No serious banking regulation and supervision had been exercised in the 1920s or earlier, especially because the very existence of banks had been considered as positive, and their involvement with industry and commerce a virtue. An insufficient deposit base compared to the development of assets made the large banks dependent on foreign short-term deposits, which started being withdrawn at the close of the twenties. Contrary to what happened in the three more developed countries we dealt with earlier, the authorities (both central bank and government) did not exert a sufficiently vigorous action to counter the serious withdrawals of domestic deposits that the private joint stock banks experienced in the crisis years, which went to benefit banking institutions guaranteed by the state. As a result, failures of large banks occurred in Romania, while in Bulgaria the total number of large banks shrank dramatically, as stronger banks absorbed the weaker ones.

In both countries, as elsewhere, a determined effort would be made in the 1930s to regulate and supervise the banking system but, as elsewhere in Continental Europe, it would incline strongly towards state intervention.

IV. How did renewed Central Banks and Banking Systems work together: Lessons of the Interwar Central and Eastern European Experience

It is now time to integrate the first and second parts of this paper. We began by noting the strong international action, influenced especially by Britain and the United States, which in the 1920s fostered the transformation of state banks into independent central banks. Although the action of the League of Nations' Financial Section was vigorous and single minded, it had to come to terms with the common elements all the Danubian countries shared, both in commercial and central banking, as well as with the League's own financial philosophy. Although armchair advising is certainly much easier than field work, we must detect a marked absence, among the League's aims, of seeing central banks take up banking regulation and supervision in the Danubian countries. Furthermore, the League did not embark on a crusade to foster banking legislation to impose strict rules of behavior on commercial banks. Such rules did not exist in the countries from which most of the League's financial experts came. They would be introduced almost everywhere in Europe in the 1930s, with a few exceptions, as they were in the Danubian countries.

Among one countries we considered, the one in which extensive regulatory activity took place in the 1920s was Czechoslovakia, and there the League had no influence at all. It was all domestically thought out and enforced. Wherever the League's direct or indirect influence reached, it concentrated on the establishment of strong and independent central banks, detached from direct or indirect government financing, seriously intent on bringing about and sticking to a fixed exchange rates regime, and enjoying, as completely as possible, a monopoly over monetary policy.

This last feature was the most difficult to bring about in the countries we have examined. The State almost everywhere had much to do with the existing payments network, and showed little inclination to relinquish it to the central bank. In some cases the commercial banks were too strong, and in other cases they were too weak, to permit the evolution of monetary policy towards the classical form the League would have liked to see. The generalized prohibition to perform open market operations imposed on central banks meant that this role was performed by state agencies. Central banks could rely almost nowhere in the region on canonically organized money markets. There was a generalized dearth of good short-term self liquidating commercial bills. Commercial banks were mostly involved in what now goes under the name of relationship banking, lending to firms through continuously rolled over current accounts, sometimes taking finance bills as collateral.

As a consequence, central banks, could neither restrict credit through their discount rate, which was largely ineffective vis-à-vis the large banks, nor bring about the money supply they desired because they could not cooperate with large banks through the public debt market. Their actions became effective when it was too late, and essentially consisted of coming to the rescue of illiquid banks, as the Kemmerer report noted in the case of Poland.

The Federal Reserve Act contained most of the components which constitute modern central banking. They were aptly evoked in the few clauses Benjamin Strong appended to Montagu Norman's Commandments on central banking. But the influence of the Fed was extremely limited in Europe in the 1920s as far as central bank reconstruction was concerned. It was extremely great as far as the organization of stabilization operations was concerned, but there it stopped. European central banks were without exception built or rebuilt with British, French or pre-war German experience in mind. And, since it was the State's fiscal profligacy which was believed to be the root of monetary inflation, (even though it was regular British practice) open market operations were forbidden, even to the Reichsbank which had counted them as one of its more powerful instruments of monetary policy before the war. No prestigious European central bank used compulsory reserve requirements, another American innovation. They were remarkably appropriate to monetary systems where central banks could not rely on age-old authority with the banking system, where there were large commercial banks and where political and ethnic factiousness permeated the banking system and increased its heterogeneity. 1/ But they had to wait a long time until they would be used in Europe.

Monetary reconstruction in the 1920s, therefore, seems to have been shooting at yesterday's enemy--state-induced inflation--with yesterday's arms and ammunition. This single-minded concentration prevented the reincarnation of that ghost even after runaway inflation had destroyed war-time monetary overhangs. But the new enemies, commercial banking-induced asset inflation and financial fragility, were largely ignored by the League and by international opinion until they hit Europe with incredible violence at the end of the decade.

In the countries this paper has focused upon, therefore, the League and international action inspired by Great Britain and the United States managed to bring about independent central banks for some years. But these politically autonomous institutions swam in a sea of state intervention, even in countries like Czechoslovakia and Hungary where strong factions existed that favored the development of private enterprise, but which at the same time did not want to renounce state subsidies of all kinds, including those obtained through financial repression.

By not putting greater emphasis on the need for strict prudential supervision as a necessary requisite for the permanence of autonomous central banks, the League and its supporters made sure that the latter would lose that feature once overextended financial structures collapsed and central banks were unable to remain aloof. The new financial reconstruction that occurred in most countries of Europe in the 1930s, in particular in the Danubian countries we have examined here, gave central banks operational pride of place in financial regulation, but firmly integrated them into the apparatus of generalized state control (Zahn (1937), Allen et al., (1938)).

1/ In Czechoslovakia, for instance, the Zivnostenka bank was the expression of Nationalist urban bourgeoisie. It was a large universal bank with extensive stakes in important industries. Sudeten Germans controlled the banks grouped around the German Agrarian Bank (KDD). The new Czech state did not show much generosity towards them, and may have discriminated against them. The Union Bank, BEBCA, and the Länderbank had strong foreign connections in Vienna and elsewhere. They were classified as dual nationality banks and prevalently managed and patronized by the Jewish Bourgeoisie. The Anglo-Bank and the Moravian Bank were also friendly to the Government. They were not well managed and received considerable help from the Government. (United States Army Service Forces, Civil Affairs Handbook, Vol. 5, Czechoslovakia, Washington, D.C., 1945)

Table 1. Credit to the State

Czechoslovakia	The Bank is the Government's banker. The Bank is not allowed to grant, directly or indirectly, any credit to the State except as specified in Article 135, which states that one half of the Bank's reserve fund must be invested in State Bonds; otherwise, the Bank is prohibited from acquiring State Bonds on its own account. (The State to own one third of the Bank's capital).
Hungary	The State or Local Authority must not avail itself, either directly or indirectly, of the Bank's resources, with the exception of foreign notes, gold, or foreign credits (Article 50). The State must not issue paper money. The Bank may execute commission transactions for the State, provided such transactions do not result in debit balance for the State (Article 51). Bank shall not enter into other transactions with the State which involve granting of loans or credit by Bank.
Poland	The Bank must not effect payments on account of Treasury free of charge. It may act on commission for the Treasury, provided that the indebtedness of the Government to the Bank is not thereby increased.
Romania	The Bank performs the services of State Treasury as well as of railway administration and other state organizations. In order to facilitate the meeting of public expenditure at the beginning of each financial year, the Bank is permitted to grant the Treasury temporary advances up to a maximum amount of two milliard Lei. These advances must be repaid in the course of the second half of each financial year, and may on no account be carried from one year to the next. Apart from that, the State may not obtain, either directly or indirectly, advances of any kind from the Bank. Provisionally, however, it could balance its accounts with Treasury Bonds.
Bulgaria	The Bank is the sole State treasurer. The Bank may discount for the temporary requirement of the State for expenditure authorized in the budget, treasury bills with a maturity of not more than three months, up to an amount of 400 million Levas, to be repaid not later than the end of the quarter following the end of the fiscal year (Article 35). The rate of discount to be 2 percent below bank rate, with a maximum of 7 percent. The Bank

shall not grant accommodation to the State or public authorities or enterprises, directly or indirectly, for which funds are not immediately available at the Bank, nor enter into contracts in the name of the Bank for their account (Article 65). The Bank will invest an amount not exceeding 20 percent of the paid up capital and reserves in State or State guaranteed bonds quoted on the Sofia Stock Exchange (Article 35). The Bank can discount, purchase, or sell treasury bills and grant advances for no more than 200 million Levas (Article 35).

Estonia

The Bank can make temporary allowances to the Government for expenditure authorized in the annual budget, provided that the advances outstanding at any time do not exceed one-sixth of the estimated revenue for the year and are repaid not later than the end of the quarter following the close of the fiscal year in which the advances were made (Article 51). The rate of interest to be agreed between the Bank and the Government. The Bank can invest an amount not exceeding the paid up capital of the Bank in securities of, or guaranteed by, the Estonian Government, with a maturity not exceeding five years. All shares of the Bank to be temporarily owned by the Government. A foreign adviser to be appointed by the League of Nations.

Lithuania

The Bank may not conduct any operations with the State that are not indicated in this Law (Article 17). The Bank may acquire public funds and other sate government securities to an amount not exceeding its capital.

Latvia

The capital of the Bank or sums deposited with it cannot be used to cover the expenditure of the State (Article 6).

Greece

All banking accounts and balances of the State and state undertakings to be kept at the Bank at no interest (Article 45). The Bank to be entrusted with the management of all internal state debt.

The Bank may make advances in drachmas to the Government for expenditures authorized in the annual budget, as approved by Parliament, provided that the whole of the advances outstanding shall not exceed 400 million drachmas, to be repaid at the end of the quarter following the close of the fiscal year (Article 55). Maximum one-tenth of state budget receipts voted by Parliament. No other advances possible. The Government appoints a Commissioner who attends Bank and Board meetings and Annual General meetings (Article 47). He has veto power over decisions he deems to be against the law. Veto suspends decisions, which are submitted to a commission of three arbiters appointed by the Bank, Government and Supreme Court. They decide within seven days.

Table 2. Purposes of the Bank

Bulgaria	The chief purpose of the Bank is to maintain the gold value of the notes (Article 2). For that purpose it is entrusted with the control of monetary circulation. It will also facilitate payment by transfer.
Czechoslovakia	The Bank is to be in charge of money circulation, and its due operation in the State; of the granting of credit to commerce, industry and agriculture, of the establishment of clearing houses, of the organization and centralization of State revenues and funds (Article 5). It is the duty of the Bank, in the interest of orderly banking, to ascertain the amount of commercial credits and control them (Article 33).
Hungary	Main function of the Bank is to prepare the way for the introduction of specie payments by forming a reserve of gold bullion and of claims payable in stable currencies, and to ensure continuance of specie payments, once introduced. Other functions are to regulate money circulation to facilitate compensation of payments and to take measures for the utilization of available capital subject to the provision of the Statutes (Article 11). Bank to provide by all means at its disposal for maintenance of stability of notes in terms of gold exchange.
Latvia	The objectives of the Bank are: to regulate the circulation of money; to assist commerce, industry and agriculture by granting short term credits; to facilitate payments at home and abroad; to carry out the operations of the Treasury (Article 2).
Lithuania	The Bank's functions are to regulate the circulation of money, to facilitate the payment of money in the country and abroad, to realize a strong currency system and to encourage the growth of agriculture, industry and commerce (Article 1).
Estonia	The first duty of the Bank is to ensure that the value of its gold notes remains stable. To this end it must exercise control, within the limits of its statutes, over monetary circulation and credit (Article 2).

Poland	The Bank is established in order to maintain the stability of the currency, to regulate money circulation and credit (Article 1).
Romania	The Bank is charged with maintaining the stability of the currency as well as providing for the monetary circulation and the control of credit. It has the exclusive right of issuing bank notes (Article 1).
Greece	The first duty of the Bank shall be to ensure that the gold value of its notes remains stable (Article 4). To this end it shall exercise control within the limits of its statutes over currency and credit in Greece.

Table 3. Restrictions on Foreigners

Bulgaria	No restrictions. Foreign adviser.
Czechoslovakia	The Board (Governor plus nine members) can elect a tenth member who need not be a native-born citizen of Czechoslovakia (Article 73). The Governor and members of the Board must be native born citizens of Czechoslovakia. The General Meeting of Shareholders can only be attended by Czechoslovak nationals.
Hungary	No restrictions.
Latvia	No mention of foreigners.
Lithuania	Foreigners may not own more than one third of the capital stock (Article 6). Only Lithuanian citizens can be members of the Board of Directors (Article 18). Foreigners may participate in the Advisory Board in proportion to the capital stock they own.
Poland	No restrictions.
Romania	The General Meeting consists of Romanian shareholders . The Governor must be of Romanian nationality. The Board of Directors must composed of Romanian nationals (Article 75).
Greece	Voting in the Annual General Meeting of Shareholders is restricted to Greek subjects.

Table 4. Central Bank Management

Bank	Title	Appointment Procedure	Length of Office
Estonia	President	By the Government	5 years renewable
Bulgaria	Governor Deputy Governor	By Royal Decree, proposed by Finance Minister	5 years renewable
Hungary	President	By Head of State, proposed by Finance Minister	Up to day of fifth General Meeting following appointment
Lithuania	Governor	By President of Republic, on recommendation of Cabinet. Dismissed by same procedure.	No term limit
Latvia	President Deputy President	By Cabinet on recommendation of Minister of Finance	3 years renewable same
Romania	Governor Deputy Governor	By Royal Decree, designated by Government	6 years renewable same
Czechoslovakia	Governor	By President of Republic. Dismissed by same on proposal of Government	5 years renewable
Poland	President Vice President	By President of Republic on recommendation of Council of Ministers. Removed by same procedure if fails his duties	5 years renewable
Greece	Governor	Elected by Annual General Meeting of Shareholders. Must receive the approval of Government	5 years renewable

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