



Working Papers in Economic History

September 2012

WP 12-07

Public borrowing in harsh times: The League of Nations Loans revisited

Yann Decorzant and Juan H. Flores

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Keywords: League Loans, Great Depression, capital markets, underwriting

JEL Classification: N20; N24; G01; G15.

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This paper reassesses the importance of the League of Nations loans of the 1920s. These long-term loans were an essential part of the League's strategy to restore the productive basis of countries in Central and Eastern Europe. Whereas the literature is not conclusive as to the final result of this experience, we argue that the League Loans were successful because they accomplished the task for which they were conceived—namely, to allow countries in financial distress to access capital markets. This success rested on the sustained efforts of the League of Nations to gather support from creditor countries' governments and financial intermediaries, as well as its efforts to develop plans for economic reform for borrowing countries. We provide quantitative and qualitative evidence to show that the League provided market access in a difficult and hostile environment, and did so by building its own reputation as an actor that provided a credible commitment to economic and institutional reforms. Through the success of the placement of the initial issues, the League became capable of influencing borrowing costs, even if they continued to be predominately determined by the secondary market and remained high as a result of the risk involved. Much of the confusion in the literature is explained by the fact that the League lacked its own capital, which impeded its ability to act as a lender of last resort once the great depression hit Europe.

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Introduction

Since the beginning of the current debt crises in some Southern European countries, economists and policymakers have been looking for prompt and forceful responses to restore confidence and avoid a continued spread of the crisis. Among the proposals being brought, economists have considered a more active and systematic role by the IMF as a direct lender of last resort and as a monitoring agent on fiscal programs aiming to restore the budget equilibrium of countries in financial distress.² Other, related proposals had already advanced the idea of IMF-supported bond issues, in which the international organization would act as a guarantor for countries perceived as risky, thereby accessing external funds at lower interest rates.

This paper looks at a previous experience in which an international crisis impeded access to international capital markets for countries in a deplorable financial situation. After WWI, countries in Central and Eastern Europe had to be reconstructed and the world economy suffered from a severe crisis. International trade had shrunk to minimum levels and international capital flows had completely dried up. International cooperation, which had smoothly restarted by 1919, both at official and informal levels, tried to overcome these difficulties through a number of channels, one of which was the creation of the Economic and Financial Organization of the League of Nations (EFO) in November 1920. Among the different functions pursued by this innovative body, a main issue concerned the reactivation of long-term credit for reconstruction and development purposes. Among the outcomes were loans contracted on behalf of Eastern and Central European countries, issued under the auspices of the League of Nations—a *premiere* in the history of finance.

The literature on these “League loans”, as they would later be known, remains skeptical about the success of the initiative. The most critical authors argue that most of these loans did not escape the destiny of most foreign loans issued during the 1920s, which was plain default. However, qualifying this attempt as a failure because it could not avoid the hostile environment of the 1930s overlooks several important elements related to the legacy of the experience. Historians and political scientists have advanced some of these elements. Probably the most important has been the recognition of the League loans as the first time in history where an international organization directly intervened and supported the world’s economic activity on a major scale. As the timing of this ex-post discussion informs us, the League loans episode was in vogue during the conceptual shaping of Bretton Woods Institutions after WWII. Indeed, many of the tasks which are embraced by the IMF today were already well known by its League of Nations predecessors, such as the production of economic information, advising on economic and financial matters and supporting short- and long-term credit by the promotion of international cooperation.

In this paper we argue that a major and yet underemphasized success of the League loans was their ability to provide countries that would have otherwise remained isolated access to financial markets. This was done without a pool of capital at the League’s disposal, and without any previous agreement with other creditors. In this sense, the League acted as a “money doctor” that provided a seal of approval to the loans it promoted. But contrary to any traditional money doctor, it pursued a set of functions beyond advising and providing medicine. It was a public and multinational entity, and this allowed it to have a larger scope for intervention and to overcome political obstacles. This was a novel and major item as national rivalries were a thriving fact in the 1920s, and governments were hostile to capital exports. Moreover, the League was also in charge of the monitoring of the reconstruction plans, the management of the proceeds from the loans, the normative that helped define the loans' terms and

² Eichengreen, “The IMF Must Be Empowered Now.”

even supplying a detailed procedure in the event of default. In other words, whereas the power of a traditional money doctor was to provide automatic or quasi-automatic access to external funds, with the League this was not the case. The League's main function (from which all other functions originate) was the procurement of support from creditor governments and underwriting banks for each of the loans it backed. If necessary, the League could interact with central banks in creditor countries, obtain further guarantees from borrowing governments and provide arbitration functions in case of disputes. But the success of a loan issue, and to some extent the costs for the funds, remained within the sphere of the market.

This subtlety has strong implications. To the extent that the League provided the technical and moral support to an economic program, this necessarily involved costs for a government in terms of loss of sovereignty and decision-making power. However, because the League did not itself lend nor actively participate in financial markets, the advantages of such a procedure were far from straightforward. One of the advantages, which has been advanced in the literature, concerns the credibility gained through the implication of the League in an economy's reform program (Santaella, 1993). A government's announcement of an economic policy would thereby avoid a problem of time inconsistency—whereby a government has an incentive to renege on an announced policy—by reaching a binding commitment through the involvement of an external agent. This was done through close monitoring and joint work with local authorities. An ex-post perspective on these programs demonstrates that they were successful in terms of macroeconomic achievements.

Nevertheless, this macroeconomic perspective misses some crucial aspects regarding the construction of the external agent's own credibility. The stabilization programs supported by the League could only succeed after a previous and essential phase that was related to the securing of financial resources - from private capital markets- most often *before* the program was set in place. The League was therefore responsible for securing necessary credibility in the eyes of investors and contemporary agents, and this was ex-ante a different and major issue. Moreover, from our narrative it seems clear that the first countries turning to the League for assistance did so because they had no other choice. Countries seeking financial support would have first tried to tap funds through the support of other governments' and banks' loans, mainly in the form of short-term credits. Because it was impossible or very difficult for them to issue a long-term loan in international financial markets, they were obliged to pass through the League. This was a joint decision between policymakers and central bankers from creditor countries that did not necessarily depend only on market factors.

The role of the League thus contrasts with the role played today by the IMF. Whereas the current literature debates the “catalyzing” role of the IMF in attracting capital flows to countries in financial distress, the League adopted this role as the most important aspect of its countries' support policies precisely due to its own lack of capital. Moreover, the channels identified in the literature through which the IMF may achieve this catalyzing role are diverse but hardly transposable to the League's case. A first channel is the change in the economic policy behavior adopted by one country, thereby providing access to IMF loans and facilitating access to private capital. A second channel considers the importance of the informational role of the IMF, as it would act as a delegated monitor.³ Finally, these channels are supposed to have a non-linear impact on borrowing countries. IMF-support would have no catalyzing effects for those countries in a highly illiquid or insolvent position because restoration to normal levels has a low probability. Vulnerable but rescuable countries have the most to gain, whereas well-behaved countries would obtain no benefit from IMF programs.

³ Tirole, *Financial Crises, Liquidity, and the International Monetary System*.

These empirical findings are in sharp contrast with the League loans. Precisely because an announcement of regime change was supposed to be accompanied by a long-term loan, tapping for financial funds often occurred before the economic policy regime actually took place. The credibility problem was therefore transferred to the League, which, as a new actor in the international scene, was expected to gain through the results it achieved. A further difficulty concerns the fact that countries seeking the League's support were those that were the most vulnerable, those to which private financiers would not lend or would do so only by imposing very high interest rates. The non-linearity prediction about IMF programs would therefore not apply to the League case. Finally, because the League of Nations did not lend nor was it in a position to provide an explicit guarantee to the loans issued under its administration, its support was only intended to foster the economic reform programs and improve the macroeconomic position of borrowing countries, which would then be able to gain access to financial markets on their own in the future.

It is therefore necessary to look at the precise conditions under which the League loans were issued. We describe how the borrowers' credibility problem was solved, and how countries in financial distress could finally access capital markets. We also compare this with other cases of borrowing countries that tapped for external resources for reconstruction or stabilization purposes without the Leagues' support. An obvious yet secondary issue is the measurement of the League's added value. We demonstrate through historical counterfactuals that the mere possibility of issuing a loan was already a huge gain for borrowing countries. Besides, the League prioritized a favorable pricing of the bonds it backed. This was achieved thanks to the success of the first loans that increased the bargaining power of the League in its negotiations with underwriting banks. In other words, while novelty and adverse market conditions reduced the possibility of bargaining borrowing terms for the first loans, the League succeeded in improving the borrowing terms of the last loans it supported. Finally, we differentiate (primary) market access terms with the evolution of secondary market prices, which were determined more by macroeconomic achievements than by the mere presence of the League's representatives in borrowing countries. As we shall demonstrate, the monitoring role of the League was an important part of the League's work. But it also had its own limitations as shown in subsequent periods, when a sudden and violent shock hit both lenders and borrowers (the effects of the great depression) and the League could not act as a lender of last resort.

This paper is organized as follows. In the first section we provide a literature review on the works dealing with the League loans. We then analyze the historical context and present the League loans as the outcome of several years of failed attempts of international cooperation to promote international trade and economic activity. In the third section we look at the functioning of the League loans, and present some empirical evidence on the conditions under which these loans were launched. In the fourth section we compare the League loans with other reconstruction loans and provide some counterfactual cases of countries that refused the League's conditions and remained excluded from financial markets. In the fifth section we provide a principal component analysis to test whether the League loans were different than the rest. We conclude in the last section.

Literature review

The League loans have been studied in different contexts and through different perspectives. The League itself published a number of studies providing a precise description of the proceedings and methods used and the successes achieved, while also recurrently signaling the mistakes and problems

encountered by the League and by governments receiving its support.⁴ Legal studies have looked at the novelties in terms of debt contracts, such as the inclusion of arbitration clauses and the problems related to currency clauses.⁵ These studies also looked at the experience of the League in dealing with defaults. Other studies analyzing international investment in the 1930s also looked at the League experience. For instance, the Royal Institute of International Affairs emphasized that countries receiving League loans would “have found it impossible to borrow abroad by any other method”.⁶ The study emphasized other positive elements such as the precedent setting of international financial cooperation or the general supervision successfully pursued by the League. This supervision was different from the traditional practice of having borrowers and lenders directly linked. The report also mentioned that all loans had been successfully placed in the markets. It concludes somewhat idealistically that the success of this experience was only possible due to the good faith of the League, the borrowers and the lenders.

After WWII, Myers’ seminal paper looked at the experience of the League loans at a time when Bretton Woods institutions were still under construction. It provided a detailed description of each loan and the policy recommendations on a case by case basis. Myers stressed the importance of the League as the organization embodying the cooperation efforts which led to the reconstruction of countries in Central and Eastern Europe. Interestingly, Myers accurately forecasted the challenges that the Bank for Reconstruction and Development would face. Discussing the relative success of the loans, Myers showed that they allowed countries to reestablish the productive basis of their economies, but qualifies her conclusions by acknowledging that most of the loans and the stabilization they permitted did not prevent the economic debacle of the 1930s.⁷

Borchard described the experience of League loans from a legal perspective in terms of bondholders' protection and control mechanisms, and acknowledged the work of the EFO as inspiring “investors with confidence”, though he also highlighted the fact that all the borrowers except Estonia defaulted on their loans.⁸ Piétri focused on the League of Nations' role in the reconstruction of Austria. She provided a detailed description of the diplomatic work of the League, and accorded the Austrian loan of 1923 (the first League loan) a prominent role in the opening of American financial markets to reconstruction loans for other European countries.⁹ However, Piétri argued that the macroeconomic stabilization that Austria achieved was unstable and unable to reduce both the persistent high unemployment rates and the country's large trade deficits. Therefore, the economy remained vulnerable to external shocks.¹⁰ Finally, Mouton revisited this experience taking into account the French perspective and the main results achieved at the Brussels' international conference, which paved the way for future international cooperation, with the League loans as one of the main outcomes.¹¹

⁴ Secretariat of the League of Nations, *Principles and Methods*; Tyler, *The League of Nations*.

⁵ See for instance: Borchard and Wynne, *State Insolvency and Foreign Bondholders* and Weidemaier, “Contracting for State Intervention.”

⁶ Royal Institute of International Affairs, *The Problem of International Investment*, 231.

⁷ Myers, “The League Loans”, 505.

⁸ Borchard, *State Insolvency and Foreign Bondholders*, 215.

⁹ Piétri, *La Société Des Nations*; Piétri, “L’oeuvre D’un Organisme Technique De La Société Des Nations: Le Comité Financier Et La Reconstruction De L’Autriche (1921-1926).” See also Marcus, “Credibility”.

¹⁰ Other authors describing the role of the League of Nations in the reconstruction of Europe include Silverman, *Reconstructing Europe After the Great War* or Kindleberger, *A Financial History*. The League loans are mentioned as part of this broader effort of international cooperation, though not really analyzed.

¹¹ Mouton, “Société Des Nations Et Reconstruction”; Mouton, *La Société Des Nations Et Les Intérêts De La France (1920-1924)*.

Eichengreen argued that after WWI, there were two main impediments to international lending.¹² On the one hand, the reparations problem led to a debt overhang for borrowing countries, impeding their access to new loans in international capital markets. On the other hand, the disruption of international trade impeded these countries' economic recovery. The League loans, as part of an effort by creditor countries to foster economic recovery, succeeded by having a catalytic impact on lending to Europe.¹³ Eichengreen's first analyses on the League loans were published at the time in the 1980s when American authorities were discussing the possibilities of giving financial market access to defaulting Latin American governments, and the findings suggested that these kinds of interventions could facilitate foreign investment to former defaulters.

Santaella tested the impact of the League loans in terms of macroeconomic performance and external enforcement. He gave theoretical and empirical evidence showing that the League provided the credibility necessary for borrowing countries to engage in macroeconomic reforms. For this author, countries subject to League of Nations' monitoring succeeded in introducing economic and institutional reforms. They all stabilized their currencies, established or reformed their central banks, and improved their fiscal balances. Echoing Eichengreen, Santaella also stated that the League served as an external agent which played a "catalytic role in mobilizing other credits".¹⁴

Emphasizing the role of the EFO as a potential ancestor of the IMF, Pauly outlined the role played by the financial committee's members in setting up the League loans used for the reconstruction schemes in Austria and Hungary.¹⁵ He described the intervention by the League as comparatively more "intrusive" than today's IMF financing programs.¹⁶ Schuker focused on the role of the League of Nations as a money doctor, who cooperated and occasionally competed with other money doctors of the period and described the conditionality applied to the League loans.¹⁷ He enumerated the first attempts by the League of Nations to promote international credit and trade, and described how these propositions failed one after the other. The author called this "the limitations of multilateralism".¹⁸ As the League was also unable to prevent capital flight and defaults in the 1930s, he considered the League reconstruction programs to be failures.

More recently, Fior revisited the League's role in the 1920s reconstruction of Europe, and argued that the League loans could be considered a success in different aspects.¹⁹ First, the author estimated that 42% of the total amount of loans issued for reconstruction purposes in the main financial centers of Europe and on Wall Street were supported by the League.²⁰ Second, the League of Nations developed a pioneer process of international cooperation, which was to be followed in other

¹² Eichengreen, "Til Debt Do Us Part"; Eichengreen, *Golden Fetters*.

¹³ Eichengreen, "Til Debt Do Us Part," 13.

¹⁴ Santaella, "Stabilization Programs," 590. As an IMF researcher, Santaella was looking for parallels to the role played by the IMF with regards to countries in distress in the early 1990s. This idea had already been advanced by Menzies, "Technical Assistance and the League of Nations", who compared the Economic Committee of the League of Nations with the GATT and the Financial Committee with the IMF and the World Bank.

¹⁵ Pauly, *The League of Nations*; Pauly, *Who Elected the Bankers ?*; Pauly, "International Financial Institutions"; Pauly, "The Institutional Legacy."

¹⁶ Pauly, "International Financial Institutions," 247.

¹⁷ Schuker, "The Competition."

¹⁸ *Ibid.*, 58.

¹⁹ Fior, *Institution Globale*.

²⁰ Fior recognizes that the League loans were focused on countries with lesser economic weight on the European scene. However, this reinforces his argument in two ways. First, this gives more significance to the total amount of League loans with regards to other reconstruction loans. Second, this gave capital market access to countries that would have otherwise been impeded their economic recovery. *Ibid.*, 290.

cases beyond the League such as the stabilization programs of Germany (1924), Belgium (1926), Italy (1927), Poland (1927) and Romania (1929).²¹ Beyersdorf has challenged the criticism advanced by some authors of the supposedly biased work of the League's financial experts as responding more to Anglo-American banking interests than to those of debtor countries, in particular Austria.²² Beyersdorf demonstrated that international cooperation was necessary for the success of international loans, and described how banks and policymakers in all creditor countries were consulted in order to organize Austria's reconstruction program by establishing economic orthodoxy.

Summing up, the literature remains inconclusive about the final balance of the League loans. Those looking at the glass half-full emphasize their catalytic impact by opening up financial markets to other European borrowers. Some scholars also present this experience as an example of international cooperation and as a model for the Bretton Woods institutions. Those who view the glass as half-empty question the final result in terms of macroeconomic stability and returns to investors, as most of these loans defaulted. We now aim to describe the context and manner through which the League loans were conceived. In a context of world economic distress and urgent financial needs, efforts for international cooperation failed systematically. The League loan experience thus emerged as the only far-reaching effort whose final impact deserves a definitive analysis of its successes and limitations.

Historical Background and League loans' origins

In 1919, Europe was still suffering from the wounds of the conflict. In addition to having to manage the consequent financial difficulties and physical destruction of the war, new challenges emerged with the integration of the newly created states of Central Europe. Among these challenges, a major issue concerned the integration of these new countries into the world economy by fostering international trade on the one hand and by creating access to capital markets on the other. Most of those countries had to build up their productive activities and set up stable monetary and fiscal systems, for which foreign investment was necessary.

A major impediment was the fact that conditions in the rest of Europe did not look much better. Inflation was a major problem in many economies, most notably in Germany. Ritschl and Straumann estimated the level of German prices in late 1919 and early 1920 at about ten times their levels in 1914.²³ Most European countries experienced a strong inflationary process inherited from war finance necessities, aggravated in many instances by tax systems that proved deficient in financing the unprecedented costs of the First World War, as well as new customs borders and a decline in international trade.²⁴ One of the most urgent cases was Austria, where the situation was even worse than in Germany, with rampant hyperinflation following immediately upon the war's end. At the other extreme, Bulgaria registered an inflation rate of "only" 21% between 1919 and 1920.²⁵ According to Kindleberger, Great Britain seemed at first to manage the transition period rather well, but the general situation among its main trading partners was a major concern for the exporting and financial

²¹ Ibid., 291.

²² Beyersdorf, "CREDIT OR CHAOS?". Some of the works quoted by Beyersdorf are Burk, "The Diplomacy of Finance"; Orde, *British Policy*; Berger, "The League of Nations."

²³ Ritschl and Straumann, "Business Cycles."

²⁴ Ibid., 163.

²⁵ These figures are from: Decorzant, *La Société Des Nations*, 164–165; based on data from Mitchell, *European Historical Statistics*, 738–739; 743–746; and Ferguson, "Keynes and the German Inflation."

sectors.²⁶ This same concern was shared among American bankers, who were already increasingly involved in European affairs before WWI.²⁷

It is therefore unsurprising that the first attempts to unblock this tragic situation originated from US banks in early 1919.²⁸ Among them, the first came from Frank Vanderlip, President of the National City Bank of New York, who put forward the idea of “the formation of a consortium of international banks, appointed and backed by the governments of the United States and of other nations which exported significant amounts to Europe”²⁹ to float an international loan to help European countries to get new credit. Vanderlip's proposition was very badly received by the French finance ministry, mainly due to its implications in terms of foreign government control through an international commission.³⁰ To this resistance was added that of the US government itself, which was reluctant to issue any new loan to European countries, thus causing its definitive dismissal. A second competing proposition was advanced by the bank J.P. Morgan (later characterized as the “Davison plan” by Artaud, Morgan's associate's name).³¹ Its plan involved issuing bonds to sustain a short-term credit program that would serve to finance European imports. The US government was expected to subscribe 10% of these bonds, something to which it immediately objected. Furthermore, the French Treasury also reacted against it, partially because no agreement could be reached regarding how the resulting exchange-rate risk of the plan would be, nor about who would take responsibility.

These first unsuccessful propositions did not hinder the emergence of other, related plans. As the economic situation deteriorated, a new initiative was advanced in the fall of 1919 through the president of the Dutch central bank, Gerard Vissering and the director of the Dutch bank Hope & Cie, Carel Eliza Ter Meulen, who convened two conferences of bankers in Amsterdam to discuss the situation. Eventually, the “group of Amsterdam” issued a Memorandum in which they listed the current economic problems and concluded by urging the eight countries to which they belonged to organize an international financial conference.³² This document was signed by more than 150 prominent personalities from the financial, academic and diplomatic spheres, sent to all concerned governments and published in January 1920 in some of the most important newspapers, such as the *London Times* and the *New York Times*. Consequently, in February, the League took charge of the rapid organization of an international conference, held in Brussels the 24th of September 1920.³³ For two weeks, almost 150 experts from finance ministries, central banks and private banks of 39 States tried to find solutions to the world's financial distresses.³⁴ Of the four commissions established at this conference, one was especially devoted to the international credit question.

The aim of this commission was to find solutions to cope with the lack of international credit, especially for Central and Eastern Europe. What the commission finally proposed was the creation within the League of an organ that would serve as guarantor for international credit borrowers whose access to the regular market was impossible because they came from countries that were financially

²⁶ Kindleberger, *A Financial History*.

²⁷ Burk, “The Diplomacy of Finance”; Horn, “A Private Bank at War.”

²⁸ Abrahams, “American Bankers,” 574–580; Artaud, *La Question Des Dettes*, 173–180.

²⁹ Abrahams, “American Bankers,” 574.

³⁰ Artaud, *La Question Des Dettes*, 173–174.

³¹ *Ibid.*, 175.

³² League of Nations Archives (LONA), R293, 10/2845/2845. Also at the Bank of England Archives, BOEA, C40/1034.

³³ Ter Meulen to Eric Drummond, 2nd March 1920. LONA, R293, 10/3253/2845.

³⁴ Conférence financière internationale, comptes rendus de la Conférence, Tome 1, Rapport de la Conférence, Bruxelles, Th. Dewarichet, imprimé pour la Société des Nations, 1920, LONA pp. 35-47.

unreliable. This organization was to be composed of bankers and businessmen that were to be selected and elected by the Council of the League.³⁵ This project was known as the “Ter Meulen scheme,” in reference to the Dutch banker who designed it.³⁶ It involved the participation of the League, private bankers and sovereign debtors. It was intended to support traders or manufacturers who wanted to obtain credits for import purposes. They had to apply to their government, which would then contact this new organ at the League. After having decided if the request was related to essential imports, the organ asked the borrowing State to present the guaranties it would provide to secure the credit requested.³⁷ Guarantees had to be linked to real income, such as tariffs’ revenues. Both parties would then agree on how the guaranties would be managed, and the State was then allowed to issue bonds denominated in gold. The bonds were used as collaterals and were given to the exporter. If the transaction took place normally and the importer paid the exporter, the bonds could be canceled. If the importer failed to fulfill the terms of the contract, the exporter could sell the bonds. The Ter Meulen scheme thus associated the private as well as the public sector in the setting up of the loan.

Eventually, this project altogether with other recommendations of the conference came to a call for the creation of a permanent body dedicated to economic and financial questions inside the League. Within a few weeks, this recommendation turned into concrete results as the first session of the Provisional Economic and Financial Commission (PEFC) of the League took place by November 1920.³⁸ From the very beginning, the question of the implementation of the Ter Meulen scheme was set in the agenda.³⁹ Moreover, in March 1921 an “Organizer of international credits”, Sir Drummond Fraser, was appointed by the League in London.⁴⁰ His role was to promote the Ter Meulen scheme among lending and borrowing countries. He advertised this new plan in countries that could benefit in Europe, mainly in the UK, as well as in the US, to try to foster the scheme.⁴¹ Nevertheless, Myers summarized the governments’ general refusal “on the grounds either that it would involve outside interference in their domestic affairs, or that it would classify them as ‘impoverished’ nations”.⁴²

In its last report to the Financial Committee of the League in February 1922, Drummond Fraser concluded that no further development of the scheme seemed possible at the time.⁴³ His official appointment terminated in March 1922 and he decided not to apply for a new term. A few months after the retirement of Drummond Fraser, the Organization of International Credit was transferred from London to Geneva.⁴⁴ Ultimately, no real accomplishment came from the Organization and the Ter Meulen scheme was never put into practice. However, Myers accurately observed that the League

³⁵ Ibid., p. 27.

³⁶ On the Ter Meulen scheme, see: Myers, “The League Loans,” 493–494; Abrahams, “American Bankers,” 582–583; Silverman, *Reconstructing Europe*, 283–287; Eichengreen, *Golden Fetters*, 156–157; Schuker, “The Competition,” 58–59; Fior, *Institution Globale*, 132–134; Decorzant, *La Société Des Nations*, 272–274.

³⁷ Conférence financière internationale, Annexe V, Commission des crédits internationaux, Bank of France archives (then: BFA), Conférence financière internationale de Bruxelles, 1060200109/33, p. 3.

³⁸ For more details on the PEFC and, then on the EFO see, among others: Hill, *The Economic and Financial*; Clavin, “‘Money Talks’”; Clavin and Wessel, “Another Golden Idol?”; Clavin and Wessel, “Transnationalism and the League”; Decorzant, *La Société Des Nations*.

³⁹ LONA, Comité Financier, P.V. et Documents, 1-3 Sessions, Nov. 20-Mars 21, V. 1349, p. 12.

⁴⁰ LONA, Box R352, 10/15621/12790.

⁴¹ LONA, Box R352, 10/15615/12790; LONA, Box R352, 10/12790/12790; LONA, Box R352, 10/12791/12790; LONA, Box R352, 10/12792/12790; LONA, Box R352, 10/19135/12790; “United States And Ter Meulen Bonds”, *The Times*, Tuesday, Nov 15, 1921; pg. 16; Issue 42878; col E.

⁴² Myers, “The League Loans,” 494.

⁴³ LONA, Box R 352, 10/19135/12790.

⁴⁴ “Letter from the DSG to Mr Le Neveu, 8 August 1922”, LONA, Box R 352, 10/22219/12790.

was regarded as the “proper authority to supervise international capital movements”.⁴⁵ In fact, even if no plan allowing private enterprises to get credit with the backing of the League would be created, in the following years the League would be asked to help to set up and to manage several credits plans for Eastern and Central European countries. The main problem those countries encountered was a lack of confidence from potential lenders.⁴⁶ From that perspective, the League appeared mainly to be an external support to gain credibility among creditors.

Marketing the League loans

The reconstruction efforts pursued by the League were shaped by the most urgent necessities and by constant diplomatic and strategic work that aimed to involve governments and private agents. To a large extent, the Austrian case served as a model for subsequent loans with reconstruction purposes - supported or not by the League. An ex-post analysis serves to identify the different phases of the procedure used. These phases were defined according to the precise conditions of the requesting country.⁴⁷ The tasks and responsibilities were shared among the different organs of the League (the Council, the Financial Committee and the Secretariat). In short, the Council – which was with the Assembly the main authority of the League - was the arm that was primarily responsible for all work done in the League. It was the organ which governments were obliged to address when they sought financial assistance from the League.⁴⁸ The Council would then dispatch the different tasks to different bodies, but it was the only organ that could make decisions and approve documents and reports. The Financial Committee would then be appointed by the Council to examine the requests and give its opinion, frequently with the support of the Secretariat’s Economic and Financial Section. In later stages, the Financial Committee would prepare reconstruction plans based on the preliminary reports on the economic and social needs of the country. Once an agreement was met between all parties, the resulting legal documents that represented the road map and the obligations to which the country would be bound had to be approved by the Council. Finally, the Council was also responsible for the appointment of trustees and all the League’s officials working on the financial schemes. During the whole process, it was also the organ that was in charge of settling major disputes.

The steps required to issue a League Loan can be summarized in four phases, which may overlap chronologically but are nonetheless illustrative of the manner though which the League loans were conceived. 1) A *diagnostic phase*, whose final outcome was a report published by the Council. It described the precise economic, financial and social conditions of the requesting country and identified the main needs to be addressed in the financial reconstruction scheme; 2) *The general agreement* phase, that concerned the preparation of all the necessary documents describing the road map for the reconstruction scheme (protocols, formal approval by the council and ratification by the public authorities of the country concerned). It also defined the terms, objectives and conditions to be met in applying for an external loan. 3) *The Loan planning phase*, which involved a joint effort to contact and obtain the support of creditor governments, central banks and underwriting banks of

⁴⁵ Myers, “The League Loans,” 494.

⁴⁶ An issue raised already since 1919. See Decorzant, *La Société Des Nations*, 196–208.

⁴⁷ The basis of this section comes from Tyler, *The League of Nations*.

⁴⁸ It was composed by representatives of France, Germany, Great Britain, Italy and Japan (permanent members), and nine other countries which were elected periodically by the Assembly.

different countries. The League also had to name the trustees and agree with the fiscal agents on the use of the proceeds; 4) *Market placement*.⁴⁹

1) *Diagnostic phase*: Deepening the money doctor metaphor, the first phase of the issuing mechanism of League loans was the diagnosis of the patient. The League's own narrative emphasizes that they would only intervene in countries willing to have it involved. This implied a number of informal contacts where a government would provide the League with the necessary information and proposals for the role of the League in a country's reconstruction plan. Once both parties agreed on some basic principles of cooperation, and when the Council received a formal request by the government, the League would begin an enquiry procedure. The Council of the League would then inform the Secretariat or the Financial Committee, who carried out the detailed work.⁵⁰ They formed commissions and named the agents who would be responsible for investigations and deliver a report on the precise problems and solutions to a country's financial situation. The final outcome of this first phase was a document called the general report.

Austria provides an illustrative example of the League's procedure. It also shows how the League succeeded in weakening the initial resistance by creditor governments, underwriters and even borrowers. Austria was the first country that appealed for the League almost as soon as the EFO was settled up.⁵¹ Given the novelty and uncertainty of the future of this initiative, Austria's government simultaneously looked for direct support from other governments and private banks. In March 1921, it informally received the backing of the League's council. The League's initial plan was to set up a relief credit plan and evoked the necessity of obtaining a long-term reconstruction loan. But the committee's work turned out to be very difficult as the Austrian case brought out not only financial questions but also diplomatic ones, linked to the Peace Treaty and to the reparations settlement.⁵² Arthur Salter, the first Director of the EFO, remained optimistic however and wrote (somewhat altruistically) in his memoirs:

"I well remember a Sunday picnic on the Lake of Geneva, a few days before the formal work began, when Monnet, Blackett and I discussed the question in both its financial and its political aspects, and concluded that the League could save Austria, and we will do our utmost to see that it does."⁵³

Between May and June 1922, Austria received a first set of governmental bilateral short-term loans that helped it to cope with the most urgent problems.⁵⁴ The League pursued a set of enquiries between 1921 and early 1922, and among a set of recommendations in terms of economic policies and institutional needs, they strongly recommended a long-term loan to provide a definitive solution to Austria's financial needs.

2) *The General Agreement*. The next step concerned the joint work necessary to define the strategy for the reconstruction plan. Delegations sent by the Financial Committee would gather information, establish the individual tasks to pursue and define the economic reforms. A

⁴⁹ These phases are defined in order to highlight some specific functions pursued by the League. They are by no means explicit or contained in any specific legal document. A report issued in 1930 classifies these phases differently, but it contains the same caveat.

⁵⁰ Santaella, "Stabilization Programs," 596.

⁵¹ LONA, A.95.1921.II.C.342.1921.II/E.F.S.179/E. F. 65, p. 5.

⁵² Piétri, *La Société Des Nations*, 34–40.

⁵³ Salter, *Memoirs of a Public Servant*, 177.

⁵⁴ Piétri, *La Société Des Nations*, 34–43.

Commissioner General would be appointed to meet these aims and would be sent to the country to work and advise the governments on fiscal issues, and in some cases on the establishment of a central bank. Most of the loans had macroeconomic purposes—though two were more related to extraordinary expenses due to the massive entrance of political refugees, Greece and Bulgaria. The reconstruction plan undertaken was mainly focused on currency stabilization. It consisted of the adoption of economic policies to be pursued in order to meet all the necessary conditions for this aim: the existence of an independent central bank, the necessary amount of gold reserves, and a free exchange market. Healthy public finances were considered an important intermediate step, for which the reduction of deficits through reforms in the taxation system and the reduction of expenditures were generally introduced. A long-term loan was regarded as necessary for the transitory period before the budget could be balanced, as well as for allowing the central bank to obtain the necessary gold reserves to restore the gold standard monetary regime. The program was given a legal basis through one or several agreements approved by the Council and signed by the government, called the Geneva Protocols.

3) *The Loan planning phase.* Once the amount of the long-term loan and its precise purposes were defined, the central objective of the next step was to obtain the loan in the best terms possible. The main task that followed, therefore, was to gain the “confidence of issuing houses and the investment public”.⁵⁵ In the last loans issues, this objective was legally embodied in a clause of the Protocols. Moreover, the League also strongly recommended dealing only with “first class” issuing houses, and also reserved for itself the power to approve the loan terms: the method of issue, the issue price, the rate of interest, the amortization and the expenses of the issue.⁵⁶ The League had justified this given the experience of the first loans (see next section). The League further included the necessity to float each loan on several markets (to avoid having exclusive national interests emerge). The need to turn only to first-class issuing houses (even if inferior houses may have offered better terms) was justified because the League recognized that it could not alone maintain the credit of the borrowing country on the market. In general, the League concluded, the terms obtained by the borrowing country should not be the result of its weaker position against issuing bankers or bondholders, and contracts had to conform with the Protocols.

In 1930 the League considered it had succeeded in achieving this initial goal, as the association of the League to new loan issues was a most important factor in obtaining more favorable terms for Governments than they would otherwise have obtained.⁵⁷ This was achieved by successfully implementing the stabilization programs, something regarded as a condition *sine qua non* for the survival of the programs itself. The Council and the Financial Committee regarded themselves as accountable for the adequate implementation of the economic program – to the Leagues’ Assembly, to the borrowing Government and to investors. The building of confidence was equally related to other items such as the provision of a delegated monitor through the appointment of a Commissioner. Its tasks included the final assignation and authorization for the utilization of the proceeds from the loans, which had to adhere to the same terms as agreed to in the Protocols. The Protocol could also include the provision of an advisor to the central bank, and the appointment of a trustee for the payment of the debt service. The existence of a trustee and/or a fiscal agent was consistent with the common practice of the time. Fiscal agents were in charge of making interest payments—it would most frequently be

⁵⁵ Secretariat of the League of Nations, *Principles and Methods*, 37.

⁵⁶ *Ibid.*, 54.

⁵⁷ “Soundings of this kind have often created or confirmed an impression that a loan would only be possible or, at least, would be very much cheaper if it were issued on the basis of a scheme drawn up in collaboration of the League”. *ibid.*, 18.

the underwriters themselves who pursued this task. Trustees were mostly appointed by the Council, and represented the interests of the bondholders. They were in charge of monitoring and managing the funds necessary for debt service, and to act in case of default (for instance, the seizure of the guarantees or the use and administration of reserve funds).

4) *Market placement.* This final step was almost solely the responsibility of underwriters and borrowing governments, although the League increasingly participated in securing a successful placement among intermediaries. This phase involved the elaboration of the prospectuses (for each market) and the general bond, which provided a summary for investors of the engagements adopted by the borrowers towards the loan. The League also specified the bond issues' dates and timings. It then concentrated all the information generated in the financial centers where the loans were issued, and communicated the results of the placements to all parties. The banks responsible for each tranche would send a telegraph with the results, the amount of bonds subscribed and the first price quotations.

Gaining credibility: facts and figures from the League loans

The League actively participated in the issues of a total of nine loans on behalf of six countries between 1923 and 1928.⁵⁸ As we mentioned above, most of these loans had reconstruction and currency stabilization purposes, though in the case of the first Greece and Bulgaria loans other aims were evoked. Each loan was issued in tranches, each of which corresponded to a distinct national financial market, denominated in the respective currency but coupled with the same pledges and guarantees.⁵⁹ No fixed exchange rate clauses were included in the first issues, though they became common once the gold standard was reestablished in the countries where these loans were issued. However, the last loans were only issued in dollars and sterling pounds (though the tranches continued to be issued in different financial markets), thereby diminishing the potential currency risk stemming from fluctuations between the currencies in which the bonds were issued.

The first of these loans was the Austrian 6% loan of 1923, which, as we already mentioned, had a special guarantee from several countries in Europe.⁶⁰ Subsequent loans did not enjoy any explicit guarantees from third states nor from the League itself, though the arrangements of the loans did foresee to provide the most reliable guarantees through the pledge of specific taxes and revenues that were to be managed by the trustees. The bonds were mostly issued through public offerings. These offerings took place in different locations often at the same time, though the timing would sometimes differ for marketing purposes. Table 1 shows the main characteristics of these loans. Besides Austria and Hungary, Greece, Danzig, Bulgaria and Estonia benefited from the League's support.

<Table 1 around here>

For this paper's purposes, we can identify three main activities through which the League facilitated market access. First, it resolved the credibility of an economic program by assuming responsibility and undertaking the planning of a project until its final achievement. Second, the League supported borrowing governments and pursued diplomatic work to remove any obstacle that may have impeded the rapid and favorable issue of the bonds. This was important for countries that were in

⁵⁸ Danzig was part of Germany before the war. It was declared a free city in the Treaty of Versailles in 1919.

⁵⁹ Both Danzig loans were the exception, as they were only issued in London.

⁶⁰ Each guaranteeing government had deposited a certain amount of their own long-term bonds at Switzerland's central bank. This amount was equivalent to each country's part of the total guarantee.

default and that still had open negotiations with banks or bondholders of previous loans. And third, the League provided the monitoring functions for the stabilization projects and for the use of the loan proceeds through the nomination of trustees, permanent agents and, in some cases, advisers to newly created central banks. Some figures, counterfactual comparisons and illustrative examples sustain our contentions. In this section we describe and show that credibility was gained through a difficult (and expensive) process. We then evaluate the League's work through direct comparisons with other loans in subsequent sections.

The League dealt with some of the most risky issuers and faced therefore a major challenge in attempting to gain the confidence and support of governments and financial markets. As we mentioned, the first issue on behalf of Austria could only be arranged through the special guarantee obtained by the League. Despite this and despite the League's support, confidence was not established automatically. In the early 1920s, governments in creditor countries were rather reluctant towards foreign lending, and some of the most important financial intermediaries in London and New York would only agree to underwrite a loan once an agreement by their governments or the central bank was obtained. This is, at least, how the first loan on behalf of an Eastern-European country (Czechoslovakia) was issued in London in 1922.⁶¹ Chandler argued that Morgan would “never float a loan that Strong disapproved,” though he recognized that “less conservative investment banks” were less influenced by the Federal Reserve opinion.⁶² However, given the general environment of hostility toward foreign lending in the major financial markets, confidence had to be painfully earned.⁶³

The League's first task was therefore to obtain, almost simultaneously, the support of central banks and financial intermediaries. Austria's government first approached J.P. Morgan in February 1920 through its Paris branch, Morgan Harjes & Co.⁶⁴ That bank became a key actor in issuing the Austria loan.⁶⁵ For a period of three years, the bank had frequent contact with Vienna's representatives, League's experts, French and American governments' officials and the British banks Rothschilds, Barings and Schrodgers.⁶⁶ During this entire period, even if Morgan's partners showed strong reluctance to engage in a large loan for Austria, they maintained close relations with the EFO. The main concern that appeared to impede them to act as underwriters was their perception of the difficulty to place such a loan in US financial markets. Nevertheless, they finally agreed to underwrite the American tranche of the League loan in May 1923.⁶⁷ According to Beyersdorf, it was a “competitive offer by Gordon Leith, the European representative of the US bank Speyer & Co [that

⁶¹ Orde, *British Policy*, 123.

⁶² Chandler, *Benjamin Strong*, 286.

⁶³ On the proposed restrictions to foreign lending in the US, see *ibid.*, 265.

⁶⁴ “Letter from Harjes Morgan & Co. to Reparations Commission, 26 Feb. 1920”, Morgan Bank European and Argentinean Records (ARC 1221), Box 35, Austrian bonds 1919-1926, “Austrian bonds 1 1919-1920” file, The Morgan Library & Museum, New York.

⁶⁵ On the J.P. Morgan Bank and its European branches' implication from 1920 to 1923, see : Morgan Bank European and Argentinean Records (ARC 1221), Box 35, Austrian bonds 1919-1926, “Austrian bonds 1 1919-1920” file, The Morgan Library & Museum, New York ; Morgan Bank European and Argentinean Records (ARC 1221), Box 35, Austrian bonds 1919-1926, “Austrian bonds 2 1921” file, The Morgan Library & Museum, New York ; Morgan Bank European and Argentinean Records (ARC 1221), Box 35, Austrian bonds 1919-1926, “Austrian bonds 3 1922” file, The Morgan Library & Museum, New York ; Morgan Bank European and Argentinean Records (ARC 1221), Box 35, Austrian bonds 1919-1926, “Austrian bonds 4 1923” file, The Morgan Library & Museum, New York. See also (Beyersdorf, 2011)

⁶⁶ “Letter from Charles Wigham to Herman Harjes, 25 May 1922”, Morgan Bank European and Argentinean Records (ARC 1221), Box 35, Austrian bonds 1919-1926, “Austrian bonds 3 1922” file, The Morgan Library & Museum, New York.

⁶⁷ “Cable from J.P. Morgan, New York, to Morgan Grenfell & Co, London, 23 May 1923”, LONA, Box C5, Reconstruccion financière de l'Autriche 1922-1924, Report re. Long term loan mission.

seemed to] have put an end to J.P. Morgan's hesitations".⁶⁸ This may have been part of the explanation, though this was unlikely given the strong preference shown by the League and central bankers to have Morgan as the main underwriter. Our own research does acknowledge however that the bank's will to keep the lead in this first postwar, important European loan contributed to Morgan's final positive decision to participate.⁶⁹

These factors were certainly not the only ones. Further evidence demonstrates that Morgan regarded the Austrian loan as strongly risky. The bank therefore sought the support of governments and central banks, for which the League also strongly advocated. The Bank of England could be directly implicated, as a loan promoter among governments and as underwriter of the British tranche. Piétri links this involvement to the role of the Anglo Austrian Bank Ltd., largely controlled by the Bank of England, in a first short-term British loan of 1922.⁷⁰ Further archival evidence suggests that in February 1922, the British governor considered the restoration of Austria, in the short and the long-run, as a necessity in which central bankers had to participate.⁷¹ He therefore reaffirmed and extended this view to the whole ex-Austrian Empire in April 1923, saying that: "If we can thus set up Austria, we must tackle Hungary next, so as to establish one by one the new parts of old Austria".⁷² Salter equally argued that: "The Governor of the Bank of England, Montagu Norman, became interested in the plan, and there was no other man who could so effectively take the lead in the difficult loan negotiations which were essential to success".⁷³

An additional element to which the League strongly contributed was precisely the securing of the direct guarantees from governments across Europe. We regard this as the decisive contribution by the League to assure the necessary support of Morgan and other underwriters in Europe. In fact, the governor of the Bank of England attached a great deal of importance to the role of JP Morgan.⁷⁴ In short, the setting up of the Austrian loan probably benefited from several "good fortune[s]"— to use Arthur Salter's words — for which the League was probably most responsible.⁷⁵ First of all, the creation of the EFO settled an international institutional framework to accommodate and manage the Austrian request. Second, the League also played a role of guarantor for the country among potential lenders. Third, its joint action with the Bank of England, J.P. Morgan, and its European branches, succeeded in making the project concretely feasible.⁷⁶ Ultimately, the overall action of some the League's members can be considered as having been a crucial element for obtaining this general

⁶⁸ Beyersdorf, "'CREDIT OR CHAOS'?", 145.

⁶⁹ Thomas Lamont, on of JP Morgan's partners, evoked "public duty" when the banker was asked about its participation and about the managing commissions that the bank received for the underwriting of the Austrian Loan in the Hearings before the Committee of Finance of the US Senate in 1931. He also explained that the loan was issued "for the purpose of trying to rehabilitate the economic situation of a people suffering from depression and almost in despair, and we made a very extraordinary endeavor to have this expense [the managing commission] as light as possible." United States. Congress. Senate. Committee on Finance, *Sale of foreign bonds or securities in the United States. Hearings before the Committee on finance, United States Senate*, 7. As we shall see, JP Morgan total underwriting commissions were not as light as this public duty suggested.

⁷⁰ Piétri, *La Société Des Nations*, 41.

⁷¹ "Letter from Norman to Strong, 6th February 1922", Federal Reserve Bank of New York archives (FRBNY), New York, Strong papers, Folder 2 1116.3, Norman to Strong 1922.

⁷² "Letter from Norman to Strong, 9 April 1923", FRBNY, Strong papers, Folder 2 1116.4, Norman to Strong 1923-1924.

⁷³ Salter, *Memoirs of a Public Servant*, 178.

⁷⁴ "Letter from Norman to Strong, 28 April 1923", FRBNY, Strong papers, Folder 2 1116.4, Norman to Strong 1923-1924.

⁷⁵ Salter, *Memoirs of a Public Servant*, 178.

⁷⁶ This is also concluded in Beyersdorf, "'CREDIT OR CHAOS'?", 148–150.

support. In fact, we may even speculate that without the permanent communication and lobbying efforts they made among the different actors involved, the Austrian loan would not have been feasible.

But breaking the ice required some additional costs that Austria's government was obliged to assume. Figure 1 shows the underwriting fees that the country had to pay to underwriters in each financial center where the loan was issued. Underwriting fees and the particular terms of the issue of each tranche of the bonds were negotiated individually with underwriters. The variation is therefore significant and their values were not necessarily correlated with the amount underwritten.⁷⁷ JP Morgan issued for instance only a 16% share of the amount, and yet charged the highest fee (4.96).⁷⁸ Austria certainly accepted this amount due to the signaling effect of having the loan issued in NY and because JP Morgan offered a positive reputational effect.⁷⁹ For comparative purposes, JP Morgan issued in the same year a loan on behalf of the Swiss government and charged a fee which was more than 2% lower [2.37].⁸⁰ In other words, despite Austria's own guarantees, governmental guarantees and despite the League's own support, considerable skepticism remained; the banks priced this accordingly.

<Figure 1 around here>

A second strategy to minimize the risk assumed by the banks included the decision to set an attractive price of issue. The banks insisted on this condition because they were required to make a firm commitment on the bonds. In other words, it was requested that the banks assume the risk of a placement failure, as they had to buy the bonds themselves and assume responsibility for their successful sale to the final investors. This was part of the general strategy employed by the League in order to assure the proceeds from the loans. The price at issue for the London tranche, for instance, was therefore set at a considerable low level (80%), representing a yield to maturity of 7.5%, while the UK consol was offering a yield of 4.26%. This was a considerable spread despite the UK government's own guarantee.

Austria's bonds were therefore considerably underpriced. To the extent that underpricing can be related to information asymmetries, by which investors request a premium for their risk taking, this element was an indicator of the challenges that the League faced with the first issues.⁸¹ We have represented this general behavior in Figure 2. With the exception of the American tranche (whose

⁷⁷ On the determinants of underwriting fees in different historical periods see Flores, "Information Asymmetries and Conflict of Interest During the Baring Crisis, 1880–1890" for the late 19th century and Flandreau, Gaillard, and Panizza, "Conflicts of Interest, Reputation, and the Interwar Debt Crisis" for the 1920s. In general terms, underwriting fees are positively correlated with the bonds' yields, i.e. riskier issues are accompanied by higher underwriting fees. The British tranche amounted for a total of 41% of the total amount issued, yet the Bank of England charged a fee of 2.24, which was less than half of the amount charged by JP Morgan.

⁷⁸ The League initially set a wide marge of between 3% to 5% in which it was willing to negotiate. Morgan sized the upper-bound of the interval, and generously lowered a 0.25% from the maximum level. See "Letter from Franckenstein, Bark and Nixon to JP Morgan, 26 May 1923" in LONA, Box C5, "Reconstruction financière de l'Autriche, 1922-1924". The League did not offer this open option to any other bank.

⁷⁹ Both the League and Montagu Norman were unwilling to have other bank than JP Morgan because they believed that no other bank would offer the "necessary influence to drive the loan issue to a satisfactory end". See the "Letter Franckenstein m.p. to Austria's Prime Minister", in LONA, Box C5, "Reconstruction financière de l'Autriche, 1922-1924". Traduction from German by the authors.

⁸⁰ Data on Underwriting fees for issues done in the New York Stock Exchange are from Flandreau et al., "The End of Gatekeeping."

⁸¹ Underpricing of foreign bonds in the early 19th century London Stock Market has been analyzed in Flandreau and Flores, "Bonds and Brands". Some authors demonstrate that underpricing increases if underwriters assume that an issue has a high probability to fail. See Reilly and Hatfield, "Investor Experience with New Stock Issues" and Bear and Curley, "Unseasoned Equity Financing."

price had slightly fallen) and the French tranche,—whose behavior was more related to the particularly unfavorable situation of France's Stock markets and the French franc—the first quotations of the bonds were considerably higher than the issue price.⁸² In the most extreme case, bond prices of the Swedish tranche increased from 78 to 102, which translated into a 30% gain for an initial investor. In December 1924, a year after the issue took place, this trend was mostly confirmed and prices stabilized at levels considerably higher than the prices at issue. Even the price of the American tranche increased by 7.5%.⁸³

The next country the League financial committee had to deal with was Hungary. In August 1923, once the reparations commission had agreed on the amounts to be paid by Hungary, the government applied for the support of the League. To the extent to which Austria's loan was considered a success, and given the fact that Hungary was not in the same desperate position as Austria, obtaining financial support for the stabilization plan was at first considered a more accessible task. Again, the League applied for Morgan to underwrite the American tranche of the loan in 1924. However, the bank refused, evoking the fact that the American market was not really favourable for the launching of a new loan. Thomas Lamont added that he was aware that the League had been “approached by some other American banking group, and it may be with such group that [the loan] will have success”.⁸⁴ This time, however, and contrary to Austria's loan, the EFO commission was already in contact with the American bank Speyer & Co. The commission decided not to insist that Morgan issue the loan. After the 24th of June refusal by Lamont, negotiations continued with Speyer & Co and on the 30th of June the contract was signed. A point of contention arose with Speyer's initial attempts to tie their participation to a clause that gave “them [an] exclusive right to do other Hungarian business [in] New York” for the duration of the currency loan. The EFO refused but convinced Speyer & Co. to accept the contract without the clause.⁸⁵

The apparent self-confidence of the League during the setting up of the Hungarian loan is noteworthy. They went further without the support of J.P. Morgan and firmly rejected the inclusion of a clause requested by Speyer. Moreover, and perhaps more important, Hungary's loan had been possible to launch without any third party government's support, showing that the League had gained credibility among investors. Arthur Salter summarized this, arguing that: “With the prestige the League had gained in Austria it was possible to issue the Hungarian reconstruction loan without governmental guarantees, and Hungary's recovery was even more rapid”.⁸⁶

<Figure 2 around here>

Obviously, Speyer's offer was no free lunch. Hungary's government had to pay a 9.3% underwriting fee. Besides, the loan offered an 8% interest rate and a price at issue of 87.5% for the American tranche —representing a yield to maturity of 8.6% at a moment when the US Treasury long-term bonds were offering a yield of 3.9%—. The Commissioner-General of the League loan to Hungary regretted “to see an issue made in the United States, on terms which must necessarily create

⁸² We have estimated that the price of the French 3% rentes fell in the same period 11% from its June 1923 value. Source: NBER Macroeconomic Historical data.

⁸³ Our own computations from data in Karl and Österreichische Nationalbank, *Die Österreichische Völkerbundanleihe*.

⁸⁴ “Letter from Lamont to Salter, 23 June 1924”, LONA, Box C5, File “Long term loan to Hungary, dossier concerning the American tranche”, Box R413, 10/37289/35908.

⁸⁵ See “Different telegrams from Felkin to Salter: 24, 26 and 27 June 1924”, LONA, File “Long term loan to Hungary, dossier concerning the American tranche”, Box R413, 10/37289/35908.

⁸⁶ Salter, *Memoirs of a Public Servant*, 181.

the impression that the bonds are a speculative investment”.⁸⁷ Figure 3 plainly shows the market's pricing of an early League loan in the absence of a guarantee by third governments. Besides Speyer's high underwriting fee, its average value for the rest of tranches (other than the tranche reserved for the domestic market) reached more than 5%. At the end, however, and despite these bankers' apparent fears, the issue was a success.⁸⁸ The first quotations in New York offered investors a 2% gain, and for those keeping their bonds one year after their initial investment could obtain a reward of almost 5% increase (in London this figure doubled to almost 12%). Hungary's loan, though expensive, allowed the country to acquire the necessary funds to proceed to its stabilization program.

<Figure 3 around here>

Nevertheless, once the dues were paid, subsequent League loans benefited from more favorable terms. Admittedly, market conditions improved in most financial places, but tangible results and general approval in the press and in contemporary publications certainly contributed to the League's reputation.⁸⁹ Austria had succeeded in stabilizing its currency and budgets. Hungary was on the same path and the League's commissioner in that country released frequent reports on the League's program achievements. The conditions with which the League operated were clear and in broad terms, the rules of the game were openly defined. The continuously improving perception of the League can also be seen in the effects on the government bonds' markets of the news of its intervention. In figure 4 we show how the Austrian gold rentes reacted to the announcement of the League's participation and to the final signature of the Geneva Protocols.⁹⁰ The continuous, albeit slow, increase observed before the announcement of the final Protocols was likely related to incertitude and apathy regarding the conditions that the government would have to meet in order to obtain the League's support. An illustration of this general mood can be found in Austria's *Neue Freie Presse's* recommendation to its readers to “get rid of any susceptibilities (and to) see the good will behind the humiliating conditions of the League, and to allow themselves to be helped...”⁹¹

<Figure 4 around here>

Nevertheless, and despite the hardness of the League's conditionality, the reactions of governments bonds' prices to the announcements of the League's intervention were thereafter consistently positive. In figures 5-7, the prices of Hungary, Bulgaria and Greece bonds are shown around two dates (request for a League's program, and signature of the Protocols). Hungary's gold and paper rentes reacted positively though differently to the initial announcement and the signature of the first protocol. Overall, there was a general increase in both cases; Bulgaria's bond prices also experienced an increase, even before the country made an arrangement with the bondholders of the defaulted pre-war bonds (10 September 1926). The League accelerated the negotiations with the countries participating in the reparation commission, and conditioned its support to a rapid agreement

⁸⁷ “Letter from Jeremiah Smith to Arthur Salter, 28th June 1924” in LONA, File “Long-term loan for Hungary. Miscellaneous correspondence”, Box R413.

⁸⁸ *The Economist* reported on the 5th July that the loan was heavily oversubscribed. Also in LONA, Box R413 (Files 10/37287/35908 and 10/37289/35908), underwriting banks in Britain and New York informed the League by telegraph about the positive results of their respective issues.

⁸⁹ *The Times* for instance published after the success of Hungary's loan issue that: “It [...] shows that the public appreciates the good work which the League of Nations has been doing in this sphere of its activities. There were many doubting Thomases when the first scheme –the Austrian- was launched. [...]. Its success has converted many of the skeptics”. “City Notes. Hungarian Loan over-subscribed”, 03 July 1924.

⁹⁰ These figures come from the newspapers *Neue Freie Presse* and the *Prager Blatt*. We thank Marcus Nathan for making us aware of these sources.

⁹¹ Authors' translation from German. “Signature of the three Geneva's Protocols”, 5th October 1922.

with bondholders and underwriters of the pre-war defaulted bonds.⁹² Finally, the prices of the Greek's 4% monopoly loan increased more than 61% from the prices before the announcement of the League's intervention.

<Figure 5 around here>

<Figure 6 around here>

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It would be therefore safe to assert that despite the difficulties of the first two loans to attract investors and underwriters, the League could finally add the support of its name to the loans it promoted. A final and anecdotic example is the importance of its name on the prospectuses. The prominent role of this new brand was not overlooked by those designing these important documents. Whereas Austria's and Hungary's and the first Greek loan's prospectuses would only mention the League's resolutions and Protocols in passage, all other loans showed the League's support just below the main name of the loan. The phrase: "An international loan issued under the auspices of the League of Nations" became a common trademark in all subsequent advertising documents of the bonds. Speyer confirmed before the US Senate Commission in 1932 that "the League of Nations' moral endorsement of course had a great deal of weight with many people".⁹³ When a Senator asked why the bank would nonetheless buy Hungary's bonds at a price as low as 80 (equivalent to a high underwriting fee), Speyer simply replied that he would not think that the loan could have been sold "*at any price without the endorsement of the League of Nations*".⁹⁴

The decreasing evolution of fees in the main financial markets where the League loans were issued can also be appreciated in Table 1. A useful benchmark to evaluate this performance are the differences between the League loan underwriting fees compared with the lowest fees that underwriters charged in the New York market every year. These "fees' spreads" can be also interpreted as a measure of placement failure risk. In 1924, they were 6.45 and 5.45 for Hungary's and Greece's loans respectively. The last League loan for Bulgaria in 1928 had a lower fee's spread (3.58), though the lowest fee's spread was precisely the one charged for Bulgaria's previous loan of 1926 (1.35), not coincidentally. This was a direct consequence of the League's increased participation in the negotiations of the loans' terms with the banks. Since the Bulgaria loan of 1926, the League added a clause in the Protocols in which it requested its approval of the loan's terms (among which were issue price, rates of interest, and all the expenses of the issue; see Tyler).⁹⁵ In the case of Estonia's loan of 1927, for instance, the negotiations with the banks were directly carried out by the EFO Chairman, Dr. Vilem Pospisil.⁹⁶ The League's work therefore was not limited to assuring market access. It increasingly did so while minimizing borrowing costs, partly through its direct involvement in negotiations with underwriting banks.

⁹² From the LON Archives, we know that some underwriters that still held Bulgaria's pre-war bonds approached the League to be sure that Bulgaria would meet its engagements before the issue of the new loan. So for instance, Disconto-Gesellschaft argued that it still held bonds from a 1914 loan and listed those tax revenues (such as the customs duties) that Bulgaria's government had committed as guarantee and that the League foresaw to engage for the new loan (Box R 434, File 10/52854/46369; see also the general strategy for the League's negotiations with the reparation commission and the bondholders in File 10/52422/46369).

⁹³ United States. Congress. Senate. Committee on Finance, *Sale of Foreign Bonds*, 617.

⁹⁴ *Ibid.*, 618.

⁹⁵ Tyler, *The League of Nations*, 54.

⁹⁶ LONA, Box R 423, File 10/59713/38855.

A final measure of this general improvement in the terms under which the League loans were issued is the comparison of the prices of issue and the first prices quoted on the market. Their differences almost evaporated or were minimal (less than 2% absolute change).⁹⁷ After Hungary's loan of 1924, none of the League loans experienced a significant change in their bond prices. In other words, unlike the first loans for Austria and Hungary, the bonds were not underpriced. Still, all of them were successfully placed. For instance, London's newspaper *Outlook* published after the first Bulgarian loan issue that as a result of the loan being oversubscribed, those having asked for large amounts were allotted only about 4%, though opening prices in the London Stock Exchange were quoting at only about a ½% premium.⁹⁸ The article comforted disappointed investors by announcing Estonia's "similar" incoming loan, though the newspaper was unable to specify the times and terms of the new issue.

Market access with and without the League

Countries asking for the support for the league did so because they had hardly any other option if they wanted to access capital markets. Other countries, however, did have an open choice. The reasons advanced in the literature for why they refused to have the League involved were diverse, but were mainly related to the fact that they did not want to have the same treatment as the defeated countries of the war. Meyer suggests that the fact that the first League loans programs were developed on behalf of Austria and Hungary, two defeated nations in WWI, provoked some reluctance in other ex-Allied countries to turn to the EFO. But probably more importantly, according to Meyer, was the unattractiveness of having a stringent control over the use of the proceeds of the loan and over the revenues forming the principal security of the loan.⁹⁹

We have looked at the conditions of other stabilization programs in Eastern Europe and find that they were similar to those imposed on the countries that had the support of the League, including foreign control of the loan's proceeds, a permanent foreign commissioner and conditions regarding public finances and monetary reform. Moreover, the markets treated these countries to similar or worse terms to those of the League loans. In order to further test our "market access under improved conditions hypothesis", direct comparisons can be done for specific cases—chosen based on common initial conditions and whether there was a comparable alternative scenario, which was bilateral support instead of the multilateral approach as implied by the League's methods. We also provide the counterfactual cases where no alternative options existed, but countries decided nonetheless to refuse the League's conditions.

a) *First-time issuers.* A first and straightforward comparison can be pursued for first-time borrowers in international financial markets. Poland and Estonia provide a perfect and straightforward case.¹⁰⁰ Both countries were created after the war. They both faced political instability and high

⁹⁷ The notable exception is Bulgaria, whose issue price fell from 92 in December 1928 to 87 in February 1929 when it started to quote on the Stock Exchange. This fall can be however generalized to other securities in the New York Stock market.

⁹⁸ The London Outlook, 1st January 1927.

⁹⁹ Meyer, *Bankers' Diplomacy*, 2.

¹⁰⁰ Czechoslovakia was left aside because even if it was a recently created country it rapidly achieved a relative macroeconomic stability before its loan issue in 1922 and had therefore fewer necessities than most of its neighbor countries for additional support. The League was however implicated in the issue. Czechoslovakia's government requested the arbitration of the League in case of dispute. This clause was included in the final contract. See ING Baring Archive, 200873 Czechoslovakia, Affairs of Vol 15.

monetary and financial distress. Poland had to achieve monetary unification and, later, monetary stabilization. The government first applied for a foreign loan with JP Morgan in 1924, but the bank refused, evocating budget instability. The country obtained a small loan through the *Banca Commerciale Italiana*, though it was apparently insufficient for the country's needs.¹⁰¹

Poland could, however, stabilize its currency and establish a new central bank. It later contracted a foreign loan in the US in 1925, with Dillon, Read and Co. as underwriters, though the issue apparently failed.¹⁰² A fall in exports due to a customs war with Germany put additional pressure on the zloty, and could only temporarily temper its depreciation thanks to a direct credit by the Federal reserve. The Polish government sought to avoid the League of Nations because the "control of Poland's finances by means of the League of Nations was undesirable for Poland".¹⁰³ Under the recommendation of Dillon Read, the Polish government requested the advice of a mission headed by Edwin W. Kemmerer. But the adoption of a stabilization plan and the issue of a new foreign loan were delayed until October 1927, once the complicated interaction moving between rivalry and cooperation among the main central banks – the Federal reserve, the Bank of England and the Bank of France- was solved. The central banks (under the head of the Federal reserve) conditioned their support and direct credit on a set of requests. The macroeconomic conditions and the necessity to appoint a foreign advisor to the central bank were similar to the conditions generally requested by the League.

b) Previous defaulters. A second comparison concerns countries that defaulted on previous debts. Romania was in financial distress as a consequence of WWI and continued political tensions both inside the country and with its neighbors. Though the political regime established in 1922 was hostile to foreign capital, in 1926 the new regime led by Alexandru Averescu actively sought the foreign resources that were necessary for the stabilization of the leu and the development of the country.¹⁰⁴ The government explored different possibilities, including the League of Nations, though this was rapidly rejected due to their unwillingness to adopt the conditions that the League would certainly request, including the installation of a foreign adviser at the National Bank.¹⁰⁵ Other negotiations included British banks (mainly Schröder) and German Banks (mainly Disconto Gesellschaft) though they all failed given the dispute over some unpaid pre-war bonds issued by Romania's government and held by German investors.¹⁰⁶ The final solution was finally reached in the summer of 1928, when an arrangement with bondholders was met and a consortium of central banks, led by the Bank of France accorded a direct credit to Romania's central banks. The Bank of France also arranged a stabilization program with similar conditions to the League loans.¹⁰⁷ The loan was finally issued in February 1929, almost three years after the initial negotiations.

Romania's loan was issued some months before the crash of the New York Stock market. Market conditions were therefore more adverse than in the previous years, and the spread at issue was 4.55%, which was higher than all the League loans (other than Hungary's 1924 loan, see Table 1). The

¹⁰¹ Meyer, *Bankers' Diplomacy*.

¹⁰² Wandycz, *The United States and Poland*, argues that Dillon was unable to place the entire loan. He also argued that this was confirmed by its prices rapid decline on the Stock market. A detailed description of the Polish loan's negotiations and results is provided in Pease, *Poland*.

¹⁰³ Letter from Jan Ciechanowski to Benjamin Strong, quoted in Chandler, *Benjamin Strong*, 392.

¹⁰⁴ *Ibid.*, 408; Răceanu, *La Roumanie Face Aux Rivalités*, 74.

¹⁰⁵ Chandler also evokes diplomatic disputes between the central banks in Britain and France, which caused the Bank of France's veto over Romania's government going through the League for financial support. Chandler, *Benjamin Strong*, 404.

¹⁰⁶ Roberts, *Schroders: Merchants & Bankers*, 199.

¹⁰⁷ Ureche-Rangau, *Dette souveraine en crise*; Răceanu, *La Roumanie Face Aux Rivalités*.

prices of the bonds remained stable (albeit at the initial low level) for some months and strongly fell thereafter.¹⁰⁸ While New York banks charged relatively reasonable fees, underwriting fees in Paris and London were far higher (6.5 and 7.69, respectively).¹⁰⁹ In Table 2 we have represented the conditions for loans to Eastern European countries that were issued for the first time, and those with reconstruction purposes.

The first loan in Table 2 was issued on behalf of Czechoslovakia's government in 1922. As we mentioned, the macroeconomic conditions of the country were far better than in the rest of the region and yet, as a new borrower, investors charged a high risk premium and underwriting banks' requested high underwriting fees. This country did however improve its borrowing terms in further loans in 1924 and 1925 (not shown in the table). Poland, also a first time issuer, issued a first loan in 1925 and a second in 1927. Both loans had high spreads and underwriting fees. These terms were considerably worse than all the League loans, particularly when compared to the League's first-time issuers (Danzig and Estonia). In fact, *The Economist* commented on the second Polish loan, saying that it was "different from most preceding stabilization loans in that it has been issued after, and not before, budgetary equilibrium has been attained and at a time when the zloty has been substantially stabilized for over a year. In these circumstances the terms may seem somewhat severe..." It concluded that it was probable that "better terms could have been attained if the scheme had been organized through the Finance committee of the League of Nations".¹¹⁰ This seems in fact to be the case for the rest of the loans in Table 2.

c) *Historical counterfactuals.* A final test about the importance of the League in facilitating market access is the historical counterfactual of countries that for different reasons would not benefit from the League's support and therefore remained unable to tap for financial resources in international capital markets. Though the League dealt with a number of countries that asked for advice and support, only some of them had specifically asked for the support of a foreign loan since they first approached the League. Once a foreign loan was planned, the conditions set by the League had to be met. This was not a minor item, as the League did not really enter into bargaining with the governments it supported. Some would accept—and access capital markets—while others would refuse and remain excluded. Estonia for instance tried to negotiate the imposition of a foreign advisor for its central bank. As the first enquiry report of the EFO was elaborated—a document which would become the basis for the reconstruction plan afterwards—, a disagreement arose about the section related to the transformation of the central bank. While Estonia's government advocated keeping a foreign advisor as optional and subject to a proper decision, the League firmly opposed and considered the condition obligatory.¹¹¹ The final text of the EFO's recommendations did foresee to provide more independence to Estonia's central bank and recognized that its transformation would need the "services of [foreign] experts acquainted with central banking," on the same principles as those adopted for Austria, Hungary and Danzig.

¹⁰⁸ On the factors driving Romania's bond spreads in the interwar period see Oosterlinck and Ureche-Rangau, "Interwar Romanian Sovereign Bonds."

¹⁰⁹ Both figures are estimated from Ureche-Rangau, *Dette souveraine en crise*. This source gives each issue's total expenses. We subtracted the stamp duty to be paid by Romania's government and have assumed that the resulting figure was a proxy of the underwriting fee. This assumption is reasonable as in most loan contracts this is the case and banks take charge of all other issue expenses.

¹¹⁰ *The Economist*, 22 October 1927.

¹¹¹ The correspondence around this disagreement can be found in LONA, Box R421, File 10/43393/38855, "La situation économique et financière de l'Estonie".

Among the countries that refused the League's conditions —and were excluded from financial markets— were Albania, Armenia and Portugal.¹¹² Albania is a case where the League rapidly recognized the political and economic need for its support. The country made a formal request on the 25th March 1922, and after the report elaborated by the commission of enquiry, the EFO designed a plan for the reorganization of the public administration and the creation of a new central bank.¹¹³ The League also appointed a permanent advisor to Albania's government. However, the collaboration did not last due to the Albanian government's perception that the reforms were not obtaining the expected results. It terminated the contract with its advisor before the conditions were established for the issue of a foreign loan. With the flow of political refugees into the country, the government returned to ask for the League's support for a foreign loan that would allow the country to finance an office in charge of arranging the establishment of these refugees. Besides punctual and humanitarian support from the League, no further assistance was foreseen.¹¹⁴ Albania was thereafter unable to issue a long-term loan in the 1920s.

Portugal is also an interesting case. After the military coup in May 1926, the return to the gold standard became a priority for the government.¹¹⁵ Thus, the fiscal budget had to be balanced and the ongoing institutional reforms of the central bank had to be consolidated. The government tried to directly negotiate a loan with Barings in London in early 1928, though the bank ultimately refused because of, among other reasons, “the doubtful constitutional standing of the government”.¹¹⁶ Probably expecting this negative outcome, the government had already made a formal request to the League to obtain its support for the issue of a foreign loan in November 1927. *The Times* summarized the general feeling at the EFO:

“It may be noted that in some quarters doubts are entertained as to the advisability of extending too readily the facilities of the League to States in financial difficulties. It is pointed out that application to the League enables a State to get better terms than it could on its own merits, and that puts the states which stand on their own financial merits at a disadvantage in the credit market. The League may legitimately help a country that is palpably on the verge of ruin and if it be almost a case of propping up a tottering Government”¹¹⁷

Even if the EFO's final decision was to accept the request, negotiations failed given the Portuguese government's refusal to accept a permanent agent (named “trustees agent”) appointed by the League. The main tasks of the permanent agent would have been to inform the body about the evolution of the economic situation, to liberate the necessary resources for each item outlined by the protocol to be signed and to receive the revenues assigned for the service of the loan. This was in fact the only disagreement after a couple of months of discussions and the report of the League's delegation in Lisbon (Cosoiu, 1934). Both sides had already agreed upon the necessary measures to follow for the stabilization plan: a fiscal reform, the use of the loan's proceeds (consolidation of the floating debt and funding of a country's program for infrastructure improvements). Other measures remained open –

¹¹² Other countries approached the League in the 1930s, though mostly for advising purposes. They were Saarland, India, Liberia, China and Romania. See Cosoiu, *Le Rôle*.

¹¹³ The report observed the serious and pressing necessity for the improvement of the economic conditions of the country, including high budget deficits, inflation, exports stagnation and high levels of misery among the population. See Box R374, LONA, File 10/22258/19892, “Enquiry concerning the economic situation of Albania”.

¹¹⁴ Cosoiu, *Le Rôle*.

¹¹⁵ Carvalho, “Answers.”

¹¹⁶ Ziegler, *The Sixth Great Power : Barings 1762-1929*, 354.

¹¹⁷ *The Times*, 6 December 1927. “Imperial and Foreign News. The League council”.

though no major dispute was foreseen-, such as the modifications to be introduced to the central bank status and the reorganization of the colonial banks' system.¹¹⁸ Portugal was unable to obtain a foreign loan thereafter, though it continued its plan to stabilize its currency and balance its budget with Salazar as Minister of Finance.

Monitoring and its limitations: contagion, external shocks and volatility

A final and important task pursued by the League was the monitoring of the economic situation of the countries where it intervened. This was done through the continuous publication of reports and other documents which were related to the League agent's direct activities. It also maintained control of the loan proceeds through the trustees it appointed. The results of the enquiries and the suggestions provided by the League's agents were sent and distributed to interested governments, central banks, the press and banks. Moreover, the appointment of a Commissioner-General was an important decision which was mainly based on the candidates' connections with the most important investment banks. In the case of Hungary's loan, for instance, Salter forecasted that in the future, the role of the Commissioner-General would be critical to obtaining favorable borrowing terms. This would be pursued precisely through its monitoring functions: a situation in the country would be certified by this agent in whom "American issuing houses have confidence" in order to "be a favorable factor in negotiating with America".¹¹⁹

This information gathering was intensive and detailed. In the case of Austria, for instance, the Commissioner-General published monthly reports on every aspect of the country's economy, among which were public finances, the monetary situation, unemployment, trade, industry, agriculture, exchange rates and banks. It also reported on the use of the funds stemming from the loans, and complimented the work of the trustee who also reported on the revenues it had obtained and on the funds being used to service the debt. This structure was also the case for Hungary, Danzig, Estonia and Bulgaria. In Greece, the use of the proceeds was supervised by the International Financial Commission that had been set up since 1898 after the Greco-Turkish war. In the cases where a permanent advisor to the central bank was also appointed, similar reports were released.¹²⁰ Overall therefore, the League possessed the most relevant information on the performance of their stabilization programs, and kept control over the use of the loan proceeds and the revenues used to service the resulting debt.

This permanent supervision certainly contributed to the League's stabilization programs' credibility, which in turn facilitated the loans' placements.¹²¹ We maintain however, that these monitoring functions were mainly pursued to facilitate market access and *not* to provide the functions of modern rating agencies. In fact, all the devices set up by the League had an expiry date, agreed since the planning of the loan. The Protocols for each loan included a clause that determined when the Commissioner-General was expected to leave. The date agreed was dependent on the economy's

¹¹⁸ "Summary of the conversations held by Arthur Salter and the Portuguese Ministers of the Colonies and Finance, 22.2.1928", LONA, Box S57, 4.

¹¹⁹ LONA, "Letter from J.A. Salter to Jeremiah Smith, Commissioner-General of the League", Box R413, 10/35939/35908.

¹²⁰ This was the case for all countries with the exception of Danzig.

¹²¹ This was also confirmed by Speyer, when the banker described Hungary's loan saying that: "Mr Jeremiah Smith, an American, stayed there for quite a while and helped supervise their finances. This, no doubt added to the confidence, and this loan of \$70,000,000 was made". United States. Congress. Senate. Committee on Finance, *Sale of Foreign Bonds*, 614. This echoed Salter's own perception on the Commissioner-General.

performance, and was fixed when the stabilization phase was over and not when the loan was fully repaid. The Council decided when the work could be considered finished and when the Leagues' immediate responsibility for it and association with it terminated.¹²²

In the long-term, therefore, the supervision of the use of the loan proceeds did not rely on the League. It was a task for which the trustees held entire responsibility. In the cases of Austria and Hungary, both Commissioners left on the 26th June 1926. However, in none of them did bond prices react to the monitoring cessation. This shows that the League, contrary to the primary market, did not add value by itself in the *secondary market*: it did so through the macroeconomic performance of the countries where it intervened, as demonstrated by the continuous fall in spreads (see Figure 8). This situation also had a reverse side. When an adverse shock hit any of these countries, the spreads reacted as in any other case. This was the case of the Credit Anstalt crisis in May 1931. When the Commissioner General returned to Austria in September, there was little to be made. Conceptually, the power of this agent to influence a country's economic policy was through the conditioned provision of the loan's proceeds. Once the funds were used, the Commissioner had only a limited marge of maneuver, which was further diminished once the perspective of new loans decreased due to deteriorated conditions in international capital markets. This fact also explained why the return of Austria's General Commissioner did not have an impact on Austria's bonds prices. In the case of Hungary, the Commissioner-General regretted that public expenditure had more than doubled since he left (League of Nations, 1945:63). Monitoring did therefore influence spreads, but it did so through the positive impact of the League's programs on the macroeconomic position of the country. On the other hand, the League programs were successful and a priori credible due to the monitoring itself.

A more systematic and broad consequence of this structure can be analyzed if we compare the bond prices behavior of the League loans with other countries in the region. As we have shown in the last section, the League provided a signaling effect whereby the announcement of a regime switch would be effectively realized. It was therefore unsurprising that prices raised once a country made the formal request to the League and when the formal conditions of the plan were established in the protocol. In the long term, however, this signaling effect could either have had a medium-term duration or just vanish if anticipations were not realized, just as for any other borrower. Take for instance a state whereby a country deviated from the behavior initially agreed (an increase in the monetary issue or an unexpected public deficit). If the League's signaling effect prevailed, prices would not react because investors would expect the League to correct the situation. This would have implied that the League had the means to do this—which it did not once the proceeds of the loan were utilized—.¹²³ Therefore, we expect bond prices of League countries to consequently react to any new state of the economy just as other governments' bonds would do. This would also be the case for external shocks, with countries under the League auspices being perceived as having the same probability to adjust and return to the initial situation as any other country in similar economic conditions.

A straightforward mean to test this signaling effect is the following. Given the fact that the League acted under the same principles and methods in every country, it would be natural to ask whether there was a common element in the behavior of the bond prices issued by the governments it supported, or if they were less volatile than the bond prices from other, Eastern European countries.

¹²² Tyler, *The League of Nations*, 40.

¹²³ This reasoning would only hold if we assume the League was unable to threaten the country to retire its support in the future.

We have looked at long-term bond prices quoted in the New York Stock Exchange and compared them with other benchmark prices from countries in that region.¹²⁴

As a first measure we have computed correlation coefficients between bond spreads for countries from Eastern Europe quoting in the New York Stock Exchange market. They are shown in Table 3. We do not appreciate any difference in their values between countries with the participation of the League than without—rather the opposite. Estonia (a League loan country) has a correlation coefficient as low as 0.21 with Bulgaria (another League loan country), but as high as 0.8 with Poland (a non-League country). Serbia, on the contrary, shares a high correlation coefficient with League loan countries such as Bulgaria or Hungary (0.83). In fact, average correlation coefficients for each country with the sub-groups League vs Non-League bonds (shown at the bottom of the table) confirm that there are no major differences between them.

We used a second method to confirm these results through principal component analysis. This technique allows us to group the most relevant information by computing eigenvectors from the data variance-covariance matrix. The analysis has been conducted in three stages. First, we have included the bonds from all the countries in our sample. Results are reported in Table 4. The first principal component explains 73% of the variation of the sample, whereas the second explains 15% (a total of 88%). The factor loadings in Table 4 can be interpreted as the correlations between individual spreads and the principal components. Their behavior is positive and uniform, which means that all countries moved together with the first principal component. The correlations with the second principal component change signs in all but Poland (a non-League country) and Estonia (a League country). Therefore no pattern seems to emerge.

Next, we divide our sample between League and non-League countries (Tables 5 and 6). For the League countries, the first principal component explains 74% of the common variation, and the second one tops off at 90% (a similar result as that of the total sample). We can appreciate that all the factor loadings also have positive correlations with the first principal component, but they become heterogeneous with the second principal component. Finally, Table 6 confirms that the results are similar for the non-League loans. The regional and individual patterns of the spreads' behavior are therefore uncorrelated to the presence of the League.

Conclusions

The League of Nations allowed for capital market access. Despite the adverse and difficult conditions under which the first loans were issued, the League acquired an improved position to influence borrowing costs through the successful implementation of the first stabilization plans—as perceived by the markets—and EFO's activities in terms of monitoring and funds control. The League also used its rising reputation to gain credibility on the enforcement of the conditions it requested of the countries where it intervened, and this assured the continuity of the League's stabilization programs. In a sense, it was a short-term commitment. Once the objectives were attained, the commissioner would leave and the country would then have the open choice to determine its economic policy, for which the League held no responsibility. We maintain therefore that previous works concentrating on the performance of the loans in the secondary markets missed the League's main contribution, which was to attract capital for the reconstruction of Central and Eastern Europe. The novelty of this paper is

¹²⁴ Bond prices data were kindly shared by Marc Flandreau. The original source is the Official quotation of the New York Stock Exchange.

precisely its focus on the primary market conditions of the loans, which was the main objective of the League's work. It is equally worth noting that this mechanism relied only on private capital. In other words, in the success of its main aim —market access— also laid its main weakness. On the one hand, even if objectives were attained, the markets' judgment continued. As the world economic activity in the 1930s, international trade and capital exports fell, the economies of countries having had the support of the League weakened. Similarly to any other country, the incentives to pursue orthodox economic policies decreased, aggravating the probability of default. Without rapid, powerful support, these loans were destined to fail.

On the other hand, the Leagues' own lack of capital impeded its potential capacity to act as a lender of last resort, an important contrast with today's IMF. The procedure followed by the League, however, had several advantages that were adapted to the situation of the 1920s —including the impossibility of suffering from moral hazard— when financial markets were in a position to invest if they were provided with trusty and profitable investment projects. The situation in the 1930s was different, with the internal shocks of borrowing countries being accompanied by shocks in the main financial centers of Europe and the US. When the Great Depression hit Europe, borrowing countries would have needed a kind of rapid assistance that the League was unable to provide. Still, the League continued to support countries in financial distress through the conception of stabilization programs and the planning of long-term loans, such as Austria's second guarantee loan in 1933. There is in fact a consensus among historians that countries such as Romania —which approached the League once its previous stabilization program failed— or Poland would have benefited from earlier collaboration with the League. In the 1930s, the financial conditions again deteriorated and worldwide defaults negatively affected any prospects for new investments —promoted or not by the League—. With the establishment of the Bank for International Settlements in 1930, a new institution complimented the League's work through its historical trademark, the bridge loans, acting as a *de facto* lender of last resort. Foreign capital therefore continued to flow when it was urgently needed, and the League continued to operate on this and on the new challenges opening up before World War II.

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Tables and Figures

Table 1. League of Nations' Loans.

| Country | Year | Total amount (in mill. £) | Spread at issue (NY) | Places of Issue | Currencies | Maturity (years) | Moody's ratings | Fee in NY | Fee in London | Underwriter in NY | Underwriter in London |
|----------|------|------------------------------|-------------------------|---|---|---------------------|--------------------|--------------|------------------|-------------------------------|--|
| Austria | 1923 | 33.78 | 3.44 | Vienna, Paris, NY, Prague, Bruxelles, Geneva, Stockholm, Milan, Madrid, London, Amsterdam | Dollar, Belgian franc, florins, sterling, Czech crowns, French francs, lire, pesetas, Swiss francs, Swedish crowns | 20 | A | 4.96 | 2.23 | JP Morgan | Bank of England |
| Hungary | 1924 | 14.38 | 4.63 | NY, London, Geneva, Prague, Stockholm, | Sterling, dollar, lire, Swiss francs, Swedish crowns, Dutch florins, | 20 | A | 9.4 | 4.76 | Speyer | Baring, Rothschild and Schröder |
| Greece | 1924 | 21.0 | 3.99 | Amsterdam, Hungary, Italy US, London, Greece | Czech crowns. Dollar and Sterling | 40 | Baa | 8.3 | 6.02 | Speyer | Hambro |
| Danzig | 1925 | 1.5 | 3.39 ^(a) | London | Sterling | 20 | Baa | -- | 4.65 | -- | British Overseas Bank, Helbert Wagg |
| Bulgaria | 1926 | 3.3 | 4.05 | London (Milan, Zurich, Amsterdam), NY | Dollar and Sterling | 40 | Baa | 4.54 | 4.54 | Speyer, Blair, Schröder NY | Ottoman Bank, Schröder and Stern Midland Bank, British Foreign & Colonial Bank |
| Estonia | 1927 | 1.5 | 4.07 | London (Amsterdam), NY | Sterling | 40 | Ba | 4.13 | 3.28 | Hallgarten & Co. | British Overseas Bank, Helbert Wagg |
| Danzig | 1927 | 1.9 | 2.54 ^(a) | London (Amsterdam) | Sterling | 20 | B | -- | 4.6 | -- | |
| Greece | 1928 | 7.56 | 3.41 | London, New York London, (Amsterdam, Prague), New York, (Bruxelles, Milan, Zurich), Paris | Dollar and Sterling | 40 | Baa | 5.81 | 5.81 | National City Co. | Hambro and Erlanger Ottoman Bank, Schröder, Stern, Czechoslovakian syndicate. |
| Bulgaria | 1928 | 5.53 | 2.99 | Paris | Dollar, Sterling, French francs | 40 | Baa | 5.43 | 4.35 | Speyer | |

Sources: Amounts, places of issue, maturities, underwriters and currencies are from League of Nations (1930) and Hofrat (1925). Underwriting fees are calculated directly from debt contracts and original documents. Spreads are our own computations from yield to maturity (ratio of interest rate to price at issue) and the yield of a long-term US treasury bond. Moody's ratings are from Flandreau et al. (2010) database. (a): London.

Table 2. Other (reconstruction) loans in Eastern Europe.

| Country | Year | Total amount (in mill. £) | Spread at issue (NY) | Places of Issue | Currencies | Moody's ratings | Fee in NY | Fee in London | Underwriter in NY | Underwriter in London |
|----------------------------|------|------------------------------|-------------------------|---|---------------------------------|--------------------|--------------|------------------|----------------------|------------------------------------|
| <i>First issuers</i> | | | | | | | | | | |
| Czechoslovakia | 1922 | 3.3 (L) | 3.91 | London , Prague and New York | Dollar and Sterling | Baa | 7.22 | 5.49 | Kuhn Loeb | Baring, Rothschild and Schröder |
| Poland | 1925 | 10.28 | 4.53 | New York | Dollar | Ba | 10.14 | -- | Dillon, Read | -- |
| Poland | 1927 | 12.9 | 4.5 | London, Paris, Amsterdam, Stockholm, Milan, Zurich and New York | Dollar and Sterling | Ba | 6.98 | 6.98 | Bankers Trust | Lazard |
| <i>Previous defaulters</i> | | | | | | | | | | |
| Romania | 1929 | 20.7 | 4.55 | NY (Milan, Berlin, Geneva, Bruxelles, Amsterdam, Romania, Vienna, Prague), London, Stockholm | French francs, Dollar, Sterling | Baa | 4.18 | 7.69 | Blair | Hambro, Lazard |

Sources: Amounts, places of issue and currencies are from prospectuses published in The Times and The Economist. Underwriting fees for New York are from the database from Flandreau et al. (2010). For London it is ING Baring archives for Czechoslovakia and Meyer (1970) for Poland. Romania's loan information is from Ureche-Rangau (2008). We also used her original figures to estimate the fee for NY and London, based on total expenses less stamp duty in the UK.

Table 3. Correlation coefficients.

| | Austria | Bulgaria | Czechoslovakia | Estonia | Greece | Hungaria | Poland | Serbia |
|--------------------------|----------------|-----------------|-----------------------|----------------|---------------|-----------------|---------------|---------------|
| Austria | 1.00 | 0.83 | 0.86 | 0.52 | 0.80 | 0.93 | 0.71 | 0.72 |
| Bulgaria | 0.83 | 1.00 | 0.88 | 0.21 | 0.89 | 0.92 | 0.60 | 0.83 |
| Czechoslovakia | 0.86 | 0.88 | 1.00 | 0.28 | 0.89 | 0.91 | 0.66 | 0.80 |
| Estonia | 0.52 | 0.21 | 0.28 | 1.00 | 0.21 | 0.38 | 0.80 | 0.21 |
| Greece | 0.80 | 0.89 | 0.89 | 0.21 | 1.00 | 0.88 | 0.61 | 0.92 |
| Hungaria | 0.93 | 0.92 | 0.91 | 0.38 | 0.88 | 1.00 | 0.68 | 0.83 |
| Poland | 0.71 | 0.60 | 0.66 | 0.80 | 0.61 | 0.68 | 1.00 | 0.62 |
| Serbia | 0.72 | 0.83 | 0.80 | 0.21 | 0.92 | 0.83 | 0.62 | 1.00 |
| <i>Correlation with:</i> | | | | | | | | |
| All countries | 0.77 | 0.74 | 0.75 | 0.37 | 0.74 | 0.79 | 0.67 | 0.71 |
| League countries | 0.77 | 0.71 | 0.76 | 0.33 | 0.70 | 0.78 | 0.68 | 0.70 |
| Other countries | 0.77 | 0.77 | 0.73 | 0.43 | 0.81 | 0.81 | 0.64 | 0.71 |

Sources: Own computations.

Table 4. Principal component analysis (PCA) results. Factor loadings of the first and second principal components. All countries (Eastern Europe)

| | Principal Component 1 | Principal Component 2 |
|-----------------------|------------------------------|------------------------------|
| Eigenvalue | 5.87 | 1.18 |
| Variance proportion | 0.73 | 0.15 |
| Cumulative proportion | 0.73 | 0.88 |
| <i>Eigenvectors:</i> | <i>Vector 1</i> | <i>Vector 2</i> |
| Austria | 0.38 | 0.06 |
| Bulgaria | 0.39 | -0.16 |
| Czechoslovakia | 0.38 | -0.18 |
| Estonia | 0.22 | 0.72 |
| Greece | 0.37 | -0.27 |
| Hungary | 0.39 | -0.05 |
| Poland | 0.31 | 0.50 |
| Serbia | 0.35 | -0.26 |

Source: Own computations.

Table 5. PCA results. League countries.

| | Principal Component 1 | Principal Component 2 |
|-----------------------|------------------------------|------------------------------|
| Eigenvalue | 3.71 | 0.81 |
| Variance proportion | 0.76 | 0.16 |
| Cumulative proportion | 0.76 | 0.92 |
| <i>Eigenvectors:</i> | <i>Vector 1</i> | <i>Vector 2</i> |
| Austria | 0.48 | 0.06 |
| Bulgaria | 0.48 | -0.21 |
| Estonia | 0.28 | 0.91 |
| Greece | 0.45 | -0.33 |
| Hungary | 0.50 | -0.07 |

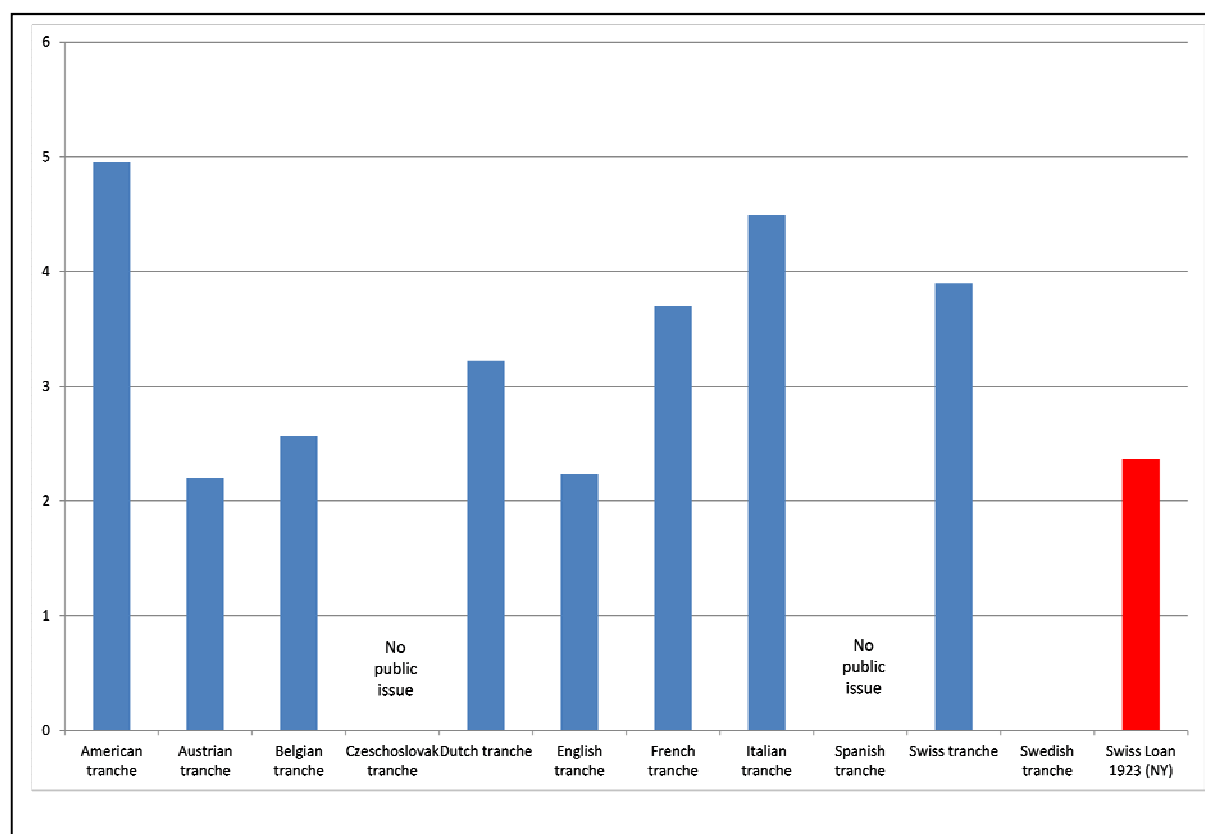
Source: Own computations.

Table 6. PCA results. Other Eastern European countries.

| Component | Principal Component 1 | Principal Component 2 |
|-----------------------|-----------------------|-----------------------|
| Eigenvalue | 2.41 | 0.42 |
| Variance proportion | 0.80 | 0.14 |
| Cumulative proportion | 0.80 | 0.94 |
| <i>Eigenvectors:</i> | <i>Vector 1</i> | <i>Vector 2</i> |
| Czechoslovakia | 0.59 | -0.31 |
| Poland | 0.54 | 0.83 |
| Serbia | 0.58 | -0.45 |

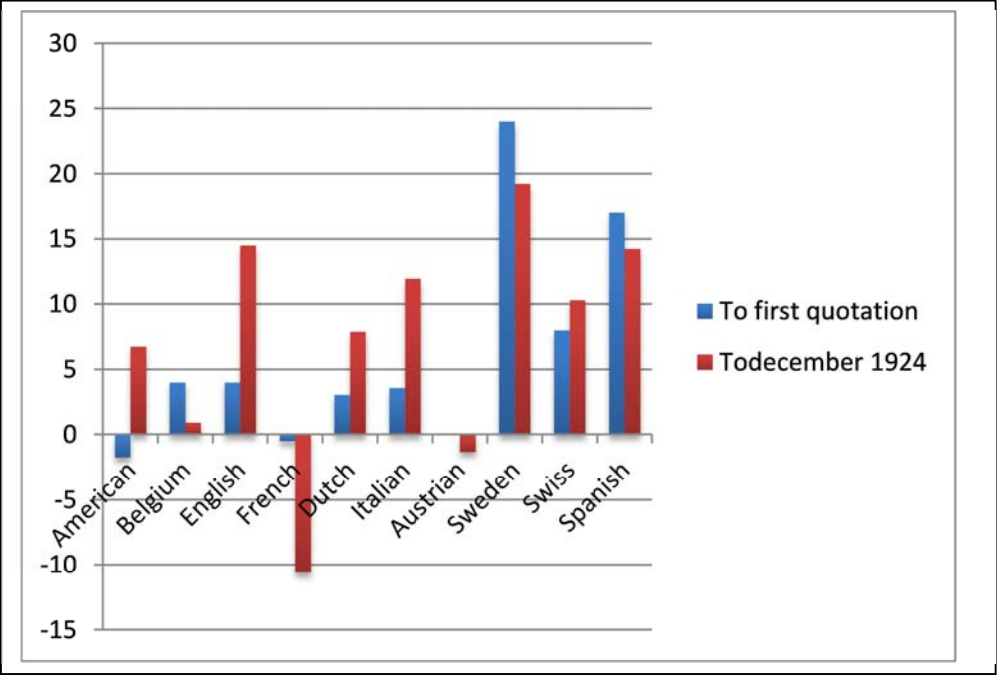
Source: Own computations.

Figure 1. Underwriting fees for Austria's 1923 loan.



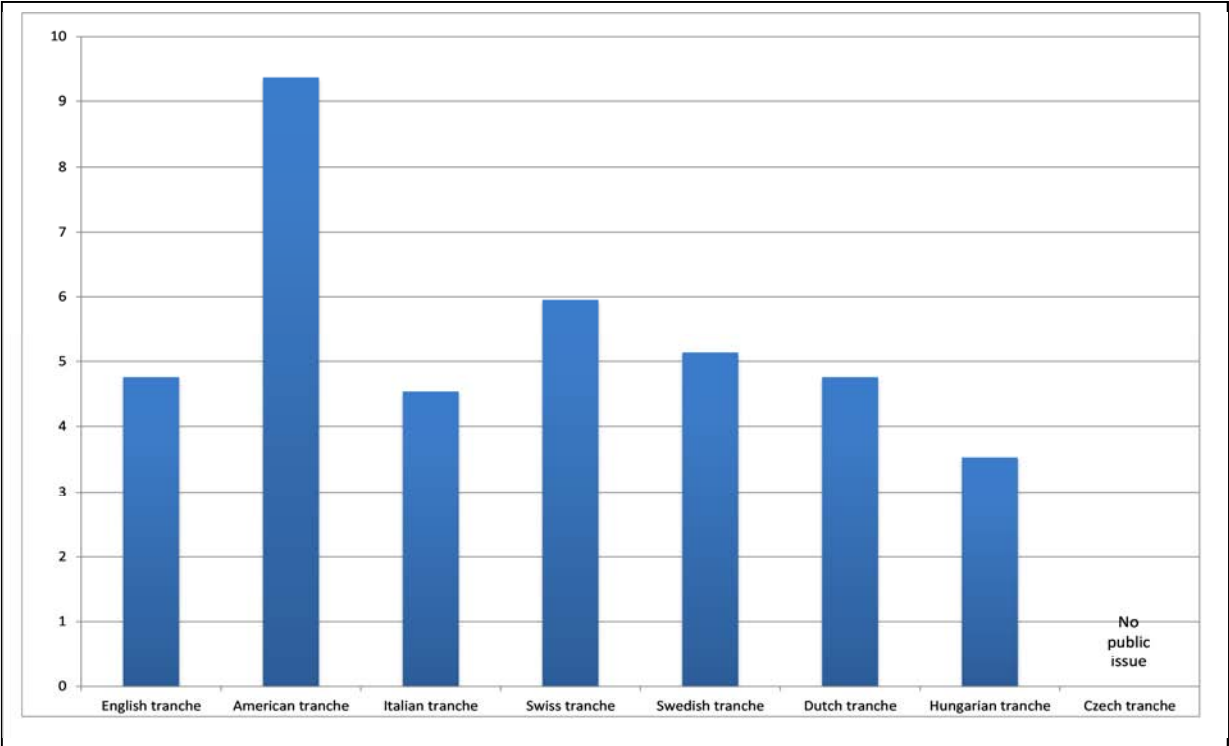
Sources: See text.

Figure 2. Austria's loan absolute differences from issue prices.



Source: Authors' computations from data provided in Hofrat (1925).

Figure 3. Hungary's loan underwriting fees. Sources: See text.

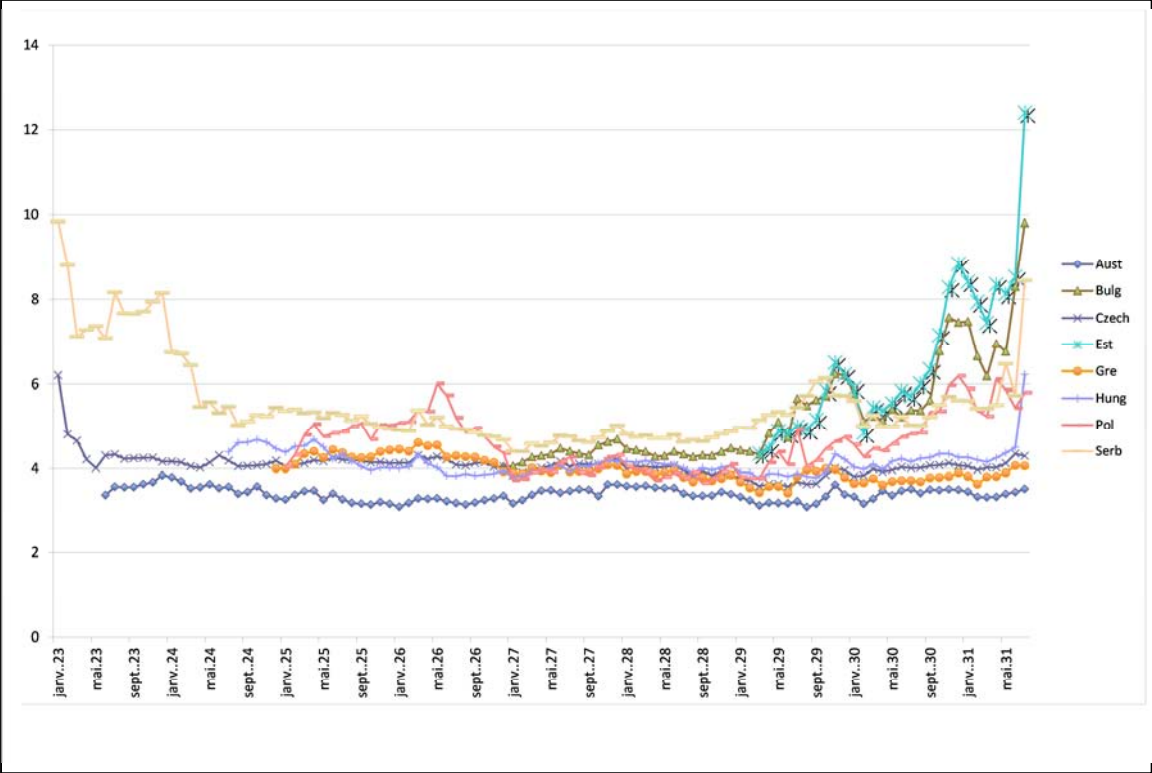


Figures 4 to 7. Financial markets' reactions to League's involvement in Austria, Hungary, Bulgaria and Greece.

Sources: Austria and Hungary: *Neue Freie Presse* and the *Prager Blatt*. Bulgaria and Greek bond prices are from the *Investors' Monthly Manual*.



Figure 8. Spreads of government bonds from Eastern European countries in the NY Stock market.



Source: See text.