

## THE NEW REICHSBANK LAW

Laws providing for liquidation of the Rentenbank and for establishment of a new bank of issue in Germany were passed by the Reichstag on August 30. These laws, drafted in compliance with the Dawes Committee plan of financial reorganization and currency stabilization, had previously been submitted to the Reparation Commission for approval. After the flotation of the 800,000,000-mark loan an executive decree giving effect to the new legislation was issued in the second week of October, 1924.

**Organization committee.**—A complete plan for organization of a proposed new bank of issue embodied in the Dawes report provided for appointment of an organization committee which should supervise the writing of a new bank law, carry the organization through its initial stages, and decide in its discretion whether an entirely new institution should be created or the old Reichsbank be reorganized. This committee, consisting of Sir Robert Kindersley and Dr. H. Schacht, determined to transform the Reichsbank; the new bank of issue has, therefore, been legally created by amendment of the Reichsbank law of March 14, 1875, which has been extensively rewritten, although important sections have been taken over intact from the old law. While the new law follows the Dawes Committee plan closely, important deviations from the plan are found in provisions fixing reserve percentages (above those proposed in the plan), and in provisions relating to the distribution of profits. Taken as a whole, although its operations have been more specifically delimited by law, the fundamental character and functions of the Reichsbank are to remain unchanged. It is to continue to operate as a commercial bankers' bank and as practically the sole bank of issue, whose function it will be to regulate the supply of currency and credit.

How soon the condition of the new Reichsbank will justify it in undertaking full performance of all functions assigned to it remains to be seen. At the moment one can but examine the provisions of the new law. The new Reichsbank is an autonomous institution independent of the German Federal Government. It possesses the attributes of a corporate body. It is located in Berlin, as heretofore, and its name remains unchanged.

**Note issue.**—The note-issue function will be one of the principal functions of the new as it has been of the old Reichsbank. Practically exclusive right of note issue for a period of 50

years is given to the new Reichsbank.<sup>1</sup> The Rentenbank may not increase its note circulation and the issue privilege of the Gold Discount Bank is revoked. Notes to be issued by the Reichsbank will be denominated reichsmarks. The Reichsbank will call in all its present circulation and convert it into reichsmarks at the rate of one trillion marks for one reichsmark. This exchange must be completed within such period as may be determined upon by the managing board.<sup>2</sup> Outside of gold currency, the notes of the Reichsbank will be the only unlimited legal tender in the country. Notes will not be issued in denominations smaller than 10 reichsmarks. Foreign bank notes or other non-interest bearing bearer obligations may not be used in making payments within Germany.

**Capital.**—According to the law, the capital of the new Reichsbank must amount to at least 300,000,000 and may not exceed 400,000,000 gold marks. From present reports, it appears that the new bank is expected to begin operations with a capital of 300,000,000 gold marks. Shares in the new bank must be paid for exclusively in gold or exchange, excepting those shares of stock which will be issued in exchange for the shares in the old Reichsbank and for the shares in the Gold Discount Bank. In making these exchanges the shares of the Gold Discount Bank<sup>3</sup> will be accepted at par at the current rate of exchange. As to the old Reichsbank shares, the law provides that not more than 100,000,000 marks of new shares may be issued against the capital stock of the old Reichsbank. Before this exchange could take place, therefore, it was necessary for the old Reichsbank to reduce its capital of 180,000,000 to 100,000,000 or less. At a meeting of the stockholders of the old Reichsbank held on October 4, it was decided to reduce the capital of the old bank from 180,000,000 to 90,000,000, so that 90,000,000 gold marks of new shares will be issued to the stockholders of the old Reichsbank. Finally, it is provided that stockholders shall not be personally liable for the obligations of the new Reichsbank—a provision taken over from the old law.

**Organization.**—The organization of the new Reichsbank will be closely analogous to that of the old bank. Its administration will be

<sup>1</sup> Existing issue privileges of the Bayerische Notenbank, the Württembergische Notenbank, the Sächsische Bank, and the Badische Bank are not invalidated; the combined issues of these four institutions may not, however, exceed 194,000,000 marks and will, therefore, continue to be insignificant items in the total circulation.

<sup>2</sup> According to the latest reports, this exchange will have to be completed within three months after call, but no call date has yet been fixed.

<sup>3</sup> Although there has been some discussion recently of continuing the Gold Discount Bank as an independent institution, both the Dawes report bank draft and the new Reichsbank law contemplate the absorption of this institution into the new bank.

in the hands of a board of directors, or managing board, as was true of the old bank. Until 1920, when the Reichsbank became autonomous, governmental supervision was carried out through the Reichsbankkuratorium, and under the present program certain foreign powers—in place of the German Government—will henceforth exercise supervision, acting through the general board, which replaces the Reichsbankkuratorium. In modified form the functions of the annual meeting of stockholders and of the council chosen from the ranks of the stockholders have been embodied in the new law. The only real innovation, which is adopted from the Dawes report, is the addition of a foreign commissioner of note issue.

The plan proposed in the Dawes report was specific in its provisions as regards methods to be followed in electing the commissioner of note issue, the members of the managing board, and the members of the general board. Furthermore, the powers, functions, and interrelations of these three agencies were clearly defined. All of these provisions, which were designed to insure efficient administration and at the same time adequate control, have been embodied in the new law with insignificant changes. (See Dawes report, annex 1, Sections IV-VIII, inclusive.)

**Managing board.**—The managing board, whose members must all be of German nationality, will as heretofore exercise predominating influence in the administration of the bank. Not only is the practical management entirely in its hands, but the exclusive control of the currency, discount, and credit policy also is vested in it. The managing board may submit its plans or proposals to the general board for an opinion, but this is not obligatory. In three instances only is assent of an outside body essential. One of these is found in the provision that the affirmative vote of every member but one of the general board is necessary if the reserve ratio is to be reduced below the legal minimum of 40 per cent, a provision taken over from the Dawes report draft. A second is the requirement of consent not only of the general board but also of the Federal Government before redemption of the Reichsbank's notes in gold or its equivalent may be resumed. The third instance relates to collateral loans and will be discussed below.

**Transfer committee.**—Neither the agent general of reparations nor the transfer committee is given any positive control over the administration or the policy of the bank. The law states merely that in handling the reparations

account, the relation between the agent general and the Reichsbank shall be that of a customer and bank. On this point the Dawes plan itself went no farther than to state that: "When the committee (transfer committee) is of the opinion that the bank's discount rate is not in relation to the necessity of making important transfers, it shall inform the president of the bank" (Dawes report, annex 6, to the report of the first committee of experts, Section VII). Nor are the London protocols more specific. So that the powers of the agent general and of the transfer committee over German currency and credit policy will be limited to those inherent in their control over the reparations account.

**President.**—The chairman of the managing board, who is also chairman of the general board, will be the president of the bank and its managing director. He must be of German nationality. On recommendation of the managing board he will appoint the officials of the bank, and he will have full charge of the bank's technical organization. The first president of the new bank will be the present incumbent, Dr. Hjalmar Schacht.

**General board.**—The general board, composed of seven foreigners<sup>4</sup> and seven German members, will exercise its control over the Reichsbank chiefly through its electoral powers. By a majority vote of nine members, six of whom must be German, it will elect the president of the bank, subject to the approval of the president of the German Republic. The president of the bank in turn will appoint the members of the managing board. These appointments, however, will require the approval of the general board in the form of an affirmative vote of at least nine members, six of which must be Germans.<sup>5</sup> Finally, the general board, by a vote of at least nine members, six of which must be foreign, will elect from the members of the board, or outside the board from the citizens of a country represented on the board, the commissioner of note issue, who in case he is not already a member, becomes a member of the general board, to the exclusion of that one of the foreign members of the same nationality as himself.

The administrative function of the general board will for practical purposes be advisory

<sup>4</sup> One member of each of the following nationalities: United States, British, French, Italian, Belgian, Dutch, and Swiss. The foreign members of the first general board were appointed by the organization committee. The appointments are: Gates McGarrath (United States), Sir Charles Stewart Addis (Great Britain), Charles Sergeant (France), Carlo Feltrinelli (Italy), Prof. G. W. J. Bruin (Netherlands), M. E. Jansen (Belgium), and Prof. Bachmann (Switzerland).

<sup>5</sup> According to the latest reports, the directorate of the old bank has become the managing board of the new bank practically without change.

only. This has already become apparent in the discussion of the relation of the managing board to the general board. Nevertheless, the general board's actual influence may in practice exceed its theoretical powers. It is not unlikely that conditions may arise which will make it seem desirable to the managing board to seek the assent of the general board, even if such assent is not legally essential.

**Council.**—The council of stockholders, which even before the war was becoming of less and less importance, will be reduced to a merely advisory body with whom the managing board may from time to time discuss questions of policy.

**Annual meeting.**—The annual meeting of stockholders will have the power to determine upon the distribution of profits in so far as this distribution is not already determined by provisions of the law. Furthermore, the election of the council of stockholders and the German members of the general board will devolve upon them. Finally upon proposal by the managing board, the meeting of the stockholders may with the consent of the general board amend the statutes<sup>6</sup> of the bank.

**Commissioner.**—The commissioner of note issue will have no control over the administration or the policy of the bank. His function will be merely to enforce compliance with the provisions of the law in regard to the issue of notes and the reserves. His responsibility will be signified by the fact that each note issued will bear his signature. Prof. G. W. J. Bruins (Netherlands) has been designated as the first commissioner of note issue.

**Scope of operations.**—Although closely following the Dawes report draft, the sections referring to the scope of operations of the new bank are so important as to justify their reproduction in full:

The bank is authorized to transact the following types of business:

(1) To buy and sell gold and silver coins or bullion as well as exchange.

(2) To buy, sell, or discount bills of exchange maturing in not more than 90 days, bearing at least three names of known solvency, and checks bearing at least three names of known solvency. The requirement of the third name may be dispensed with provided satisfactory collateral is substituted. The volume of such paper, however, may not exceed 33½ per cent of the total bills held. All bills must relate to bona fide commercial transactions.<sup>7</sup>

<sup>6</sup> The statutes of the bank are relatively unimportant; they deal in the main with the requirements for the meetings of the various boards and committees and lay down certain principles of valuation for the annual balance sheet. The first set of statutes was drawn up by the organization committee.

<sup>7</sup> The old law required "at least" two signatures to make bills of exchange eligible for discount. Under the new law an additional signature is required supposedly with the purpose of eliminating finance bills.

(3) To grant interest-bearing loans up to 90 days against the following collateral:

(a) Gold and silver, minted or unminted.

(b) Fully paid common or common priority stock or priority obligations of German railroads whose lines are in operation, as well as debentures of agricultural, communal, or other German land credit institutions under Federal supervision, and debentures of German corporate mortgage banks, up to 75 per cent of the market value. Obligations of public land credit institutions, as well as bearer obligations of the above-mentioned institutions and banks, issued on the basis of loans granted to domestic, communal corporations, or guaranteed by such a corporation, are given the same status as debentures mentioned above.

(c) Bearer obligations of the Federal Government, of a German State, or a domestic communal corporation or interest-bearing obligations, the interest on which is guaranteed by the Federal Government or by one of the States, up to 75 per cent of the market value. The maturity on the above-mentioned obligations must not exceed one year. Loans guaranteed by such collateral may be granted to banks of known solvency only.

(d) Interest-bearing bearer obligations of foreign states as well as state-guaranteed foreign railway priority obligations, up to 50 per cent of the market value.

(e) Bills of exchange bearing names of known solvency with a discount of at least 5 per cent.

(f) Merchandise warehoused within the country up to two-thirds of its value. The bank may with special authorization of the general board<sup>8</sup> take as collateral long-term obligations of the Federal Government for loans maturing in 90 days or less if there are two guarantors liable for the obligations outside of the collateral, both of whom must be doing business within Germany, one of whom must be a bank. It is, however, stipulated that secured loans for which long-term obligations of the Federal Government are collateral may not exceed the paid-up capital of the bank plus its reserves.

(4) To buy and sell the securities mentioned under 3(c); the purchase of such securities for its own account is permitted only in so far as it is essential to maintain its current business with its customers.

(5) To handle collections for institutions, official bodies, and private persons; to make payments and transfers for their account, provided the bank has received countervalue.

(6) To buy for customers' account securities of any kind as well as precious metals, provided the countervalue has been received, and to sell the same provided delivery has been made.

(7) To receive money without interest on deposit or in giro (transfer account).

The law further provides that the bank may not accept time bills of exchange drawn against it. It may not grant loans against mining property, oil fields, or stock, unless they be secondary security, nor may it buy or sell real estate, stocks, or goods, except for the purpose of liquidating assets or carrying on its own banking business.

These provisions show that within the specified limits the Reichsbank will be empowered to transact essentially all kinds of banking

<sup>8</sup> This is the third instance in which the assent of the general board is required before action may be taken by the managing board. See above, p. 355.

operations except those of an investment house. This is no innovation as compared with pre-war conditions, except that the present law is somewhat more rigid in respect principally to its provisions devised to prevent excessive amounts of Government paper from getting into the bank (sections 3(c) and 3(g)).

**Clearance.**—Another important function of the Reichsbank, after note issue, will be that of clearance. This function arises out of paragraph 7 of the above provision. Through its branches situated all over the country the Reichsbank will continue as heretofore to conduct the country's clearing system (*Giroverkehr*).

**Discount market.**—Paragraphs 2 and 3 of the provisions indicate the relation that the Reichsbank is to have to the money market. These sections contemplate that the Reichsbank shall in the future engage in market operations of the same general character as before the war, i. e., that it shall act not primarily as a credit-granting agency but rather as the pivotal factor in the discount market by standing ready to rediscount any good commercial bill running 90 days or less.<sup>9</sup> The control of the money market by its discount policy will, as formerly, be one of the more important, if not the most important, function of the new Reichsbank.<sup>10</sup>

**Fiscal agency.**—A fourth function of the new bank will be to serve as fiscal agent of the Federal Government. It will execute free of charge all operations connected with the flotation, redemption, and payment of interest on Government bonds. On all other transactions, the Reichsbank may make the same charges as to any other customer. The granting of credit to the Government will be strictly limited. The Reichsbank may extend to the Government credit for working capital up to 100,000,000 marks for 90 days, but there must be no indebtedness at the end of the fiscal year. It is further authorized to grant credits up to 200,000,000 marks to the

<sup>9</sup> Actually the average maturity of bills held is likely to be considerably less. Until recently when it relaxed its restrictions, the Reichsbank was confining itself to the discounting of very short maturities, preferably 10 days or less. The volume of agricultural paper held was, however, so great that it is improbable that the pre-war average of about 30 days was attained.

<sup>10</sup> At the moment the discount market is still practically nonexistent in Germany, and the recent efforts to reestablish one have not been successful. The prime essential of a discount market is that some institution be prepared at any time to rediscount any amount of paper at its rediscounting rate. In order to preserve the stability of the currency, the Reichsbank was forced to ration its volume of rediscounts, beginning Apr. 7; furthermore, it began to discriminate in favor of bills of exceptionally short maturities. The recent decision to raise its volume of rediscounts by 10 per cent, and to accept longer maturities has not contributed much toward reestablishing a discount market. One result of this situation has been that individual banks have been compelled to rely on themselves for reserves. Incidentally it may be noted that this throws light upon the discrepancy between long-term and short-term interest rates in the money market.

railroads and the post-office system. With these exceptions, the Reichsbank may not extend any credit directly or indirectly to the Government, or to the states, or the communes, or to any foreign government.

These provisions will not, however, affect the loans extended to the Government by the agreement made between the Government and the Reichsbank relative to the liquidation of the old Reichsbank. This agreement was approved by the meeting of the stockholders mentioned above. In lieu of the granting of the note-issuing privilege for 50 years, and in lieu of relinquishing its claim to any residue arising out of the liquidation of the old Reichsbank, the Government received the following considerations: The Reichsbank assumed liability for the repayment of the dollar loan, amounting to 252,000,000 gold marks, due April, 1926; furthermore the floating debt of the Government with the Reichsbank, amounting to 235,000,000 gold marks, and arising presumably out of exchange payments made by the bank on behalf of the Government to support the mark early in 1923, will be funded. The Reichsbank will grant the Government a permanent loan of 100,000,000 gold marks at 2 per cent, repayable with the recall of the note issue privilege, and a loan of 135,000,000 gold marks at 3 per cent, repayable in equal installments over a period of 15 years.

**Reserves against notes.**—As noted above, the new law differs from the Dawes report draft in respect to its provisions fixing the reserve percentages. The new bank will be required to maintain a 40<sup>11</sup> per cent reserve against its notes in circulation. At least 75<sup>12</sup> per cent of this reserve must be in the form of gold, in vault or with foreign banks of issue at the free disposal of the Reichsbank, the pound of fine gold<sup>13</sup> being reckoned at 1,392 Reichsmark. The balance of the 40 per cent reserves may be in the form of exchange, exchange being defined as (a) foreign bank notes, (b) bills of exchange running not more than 14 days, (c) foreign checks, or (d) deposits with any bank located in a foreign financial center and known to be solvent. Against the balance of 60 per cent, the Reichsbank will be required to hold eligible bills of exchange or checks.

Under special circumstances and with the consent of the general board the reserve percentage may be allowed to drop below 40 per cent. In case the reserve percentage remains

<sup>11</sup> The draft in the Dawes report called for 33½ per cent only.

<sup>12</sup> No such requirement was embodied in the Dawes plan draft.

<sup>13</sup> Reckoned at 500 grams to the pound.

below 40 per cent for more than a week the Reichsbank will be required to pay a deficiency tax to the Government, according to a sliding scale similar to that embodied in the Federal reserve act. Whenever a deficiency tax is to be paid, the discount rate must be raised by one-third of the tax rate to be paid and to at least 5 per cent.

**Reserve against deposits.**—Against its total deposits, exclusive of the account of the agent general, the bank is required to hold a special cover of 40 per cent. This reserve is to consist of deposits in other banks or abroad, checks on other banks, bills of exchange maturing in not more than 30 days, or callable secured loans. The old Reichsbank law required no reserves against deposits. The Dawes draft, however, called for a reserve of 12 per cent in gold or its equivalent, in addition to a reserve of 30 per cent instead of 40 per cent in the form of liquid assets. In comparison with the Dawes draft, therefore, the present law is considerably less rigid as regards its requirement of reserves against deposits. The type of assets which may be legally employed as cover seems in fact so comprehensive as to admit assets of almost every kind.

**Convertibility.**—The bank is required to purchase any gold offered by the issue of its notes at the fixed rate of 1,392 reichsmark to the pound of fine gold. This makes the gold content of the new reichsmark equivalent to that of the old mark. Furthermore, the bank is compelled to redeem its notes to any bearer upon presentation in gold or gold coin at par or in foreign exchange at the current rates of exchange. Foreign exchange is defined as checks on or transfers on the books of specified foreign banks. If redemption is made in the form of foreign exchange a charge not exceeding the expense of shipping gold may be made. None of these provisions, excepting those referring to the purchase of gold, go into effect with the rest of the law. As intimated above, they will require the assent of the managing and general boards, and, according to present indications, the definite return to a working gold standard is not contemplated at this time.

**Profits.**—The bank is to maintain a reserve fund, and so long as this fund amounts to less than 12 per cent of the notes in circulation, up to 20 per cent of the net profits each year are to be added to it. Shareholders are entitled to a cumulative annual dividend of 8 per cent, which will be paid after the reserve fund requirements have been met. Of the balance of the net profits, the government will receive an important share in lieu of taxes. Of the first 50,000,000 gold marks, one-half is to go to the Government, and one-half to the shareholders; of the second 50,000,000 marks, three-quarters is to go to the Government and one-fourth to the shareholders; on any balance nine-tenths is to go to the Government and one-tenth to the shareholders.

The first statement of the new Reichsbank is given below. The various items of the statement represent assets and liabilities taken over from the old Reichsbank converted to a gold basis. A recent statement of the old Reichsbank appeared in the BULLETIN for August, 1924, page 637. The liability for notes in circulation is on old Reichsbank notes to be redeemed at a trillion to one. The reserve against notes, according to this statement, is 43.9 per cent in gold and 58.6 per cent in gold and foreign currency.

FIRST STATEMENT OF CONDITION OF THE NEW REICHSBANK, OCTOBER 15, 1924

| ASSETS  |  | Reichsmarks          |
|---|--|----------------------|
| Shares not yet issued.....  |  | 210,000,000          |
| Gold and bullion (of the gold and bullion, 172,143,000 reichsmarks are deposited abroad)..... |  | 613,625,000          |
| Reserve in foreign currencies.....  |  | 204,541,000          |
| Bills of exchange and checks.....   |  | 2,158,943,000        |
| Silver and other coins.....   |  | 59,859,000           |
| Notes of other German banks.....  |  | None                 |
| Advances on collateral.....   |  | 15,947,000           |
| Securities.....   |  | 77,517,000           |
| Other assets.....   |  | 929,901,000          |
| <b>Total assets.....</b>  |  | <b>4,264,833,000</b> |
| LIABILITIES   |  |                      |
| Capital.....  |  | 90,000,000           |
| Increase of capital as decided upon at recent general meeting.....                            |  | 210,000,000          |
| Surplus.....  |  | 900,000              |
| Notes in circulation.....   |  | 1,396,748,000        |
| Other demand liabilities.....   |  | 828,511,000          |
| Due to the Rentenbank.....  |  | 800,000,000          |
| Other liabilities.....  |  | 938,674,000          |
| <b>Total liabilities.....</b>   |  | <b>4,264,833,000</b> |