

# ***The Banque Nationale de Belgique and the Belgian economy during the XXth century.***

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Two facts are striking when considering the Belgian financial system's historiography. Firstly, apart from the Banque Nationale de Belgique itself, historians and economists have paid little attention to the central bank's role in the economy<sup>1</sup>. Secondly, the harsh controversy about the Belgian franc devaluation, which was decided without the knowledge of the central bank in 1936, needs to be considered in a long-term perspective. It cannot be understood without taking into account the major changes the Belgian financial system experienced since the First World War. Therefore this paper will focus on the balance of power between the central bank, banks and the state and it will attempt to evaluate the Banque Nationale's part in economic policy during the XXth century.

*The Banque Nationale at dawn of 20th century.* At the dawn of the XXth century, the Belgian financial system was dominated by mixed

<sup>1</sup> The Banque Nationale sponsored the publishing of two books on its history : P. Kauch, *La Banque Nationale de Belgique I. 1950-1918*, (Bruxelles, Banque Nationale, 1950) and H. Van der Wee & K. Tavernier, *La Banque Nationale de Belgique 1918-1940*, (Bruxelles, Banque Nationale, 1975). They were written with an extensive use of its archives. For further periods, see Banque Nationale's Honorary Secretary V. Janssens' works : *Le franc belge. Un siècle et demi d'histoire monétaire*, (Bruxelles, 1976); *De beheerders van ons geld. Negentien gouverneurs van de Nationale Bank van België*, (Tielt, Lannoo, 1997); "Changements dans le rôle d'une banque centrale au XXe siècle (la Banque Nationale de Belgique)", paper delivered at the colloquium of the European Association for Banking History on *Financial Institutions and Financial Markets in Twentieth Century Western Europe and North America* (Zürich 27/28 May 1993).

banks which combined activities of investment banks or holding companies with those of deposit banks. Owing to very liberal legislation, foreign banks and other financial companies had flourished, stimulating the internationalization of the Belgian capital market. Despite growing competition, the Belgian banking system was still dominated by its oldest joint-stock bank, the Société Générale, and its subsidiaries. On the eve of First World War, the Société Générale was a powerful international financial group controlling numerous banking and industrial companies in Belgium and abroad<sup>2</sup>.

Central banking was born in Belgium in the Middle of the XIXth century. The Banque Nationale de Belgique was established as a joint-stock company in 1850. As a central bank of issue, banker to government and to other banks, it was to restore and reinforce confidence in the Belgian financial system after the 1848 crisis. An organic law determined the operations it was permitted to carry out, without assigning the bank any general mission. In the early XXth century, it performed the main functions of a central bank of the time. It monopolized the issue of banknotes, kept the centralized money reserves and foreign exchange reserves. It performed as a rediscount bank, a lender of last resort and a central clearing, payment and transfer body. It controlled credit and money circulation, maintained exchange stability. It acted as the government's banker, agent and adviser<sup>3</sup>.

Banknote issuing was the Banque Nationale's main activity. Following the "banking principle", the extent of issue depended on the demand for banknotes and this limited the bank's ability to control the volume of money and credit.

As a metallic standard prevailed in the international monetary system before 1914, fluctuations in exchange rates were tightly limited. Consequently, preserving currency stability was not a priority. On the domestic market, the Banque Nationale aimed primarily at supplying

<sup>2</sup> G. Kurgan-van Houtenryk, "Finance and financiers in Belgium 1880-1940", in Y. Cassis, ed., *Finance and Financiers in European History*, (Cambridge-Paris, Cambridge University Press, 1992), pp. 317-322.

<sup>3</sup> Kauch, pp.76-77.

credit needs by practising a cheap discount policy. Contrary to its statutes, it went so far as allowing revolving credits to enterprises through its discount offices. Two reasons explain this behaviour. Firstly, as a joint-stock bank, the Banque Nationale had to pay its shareholders and had to generate profits. Secondly, most of the first-rate bills were discounted by the mixed banks, which developed wide networks of branches and subsidiaries since the end of the 19th century<sup>4</sup>.

For several decades, the Banque Nationale did not have to deal with serious problems of credit supply. So its management followed a traditional and pragmatic line. New problems emerged, however, with bank-money expansion and the decay of the France-dominated Union Latine. While its control over money circulation decreased, monetary union with France made the exchange with Paris more and more costly. Banque Nationale's leaders became aware of the threats to the monetary system only a few years before the First World War, under Albert Janssen's influence. As a young lawyer, Janssen entered the bank in 1908 and for the first time since the 1850s, he initiated studies on money and credit and was interested in new trends in monetary theory and practice. In 1914, Janssen became the Banque Nationale's General Secretary, and Director after the war. Owing to his high reputation as a monetary expert, he became Finance Minister of the first Catholic - Socialist government in 1926, as will be seen below<sup>5</sup>.

*The disruption of World War I.* The First World War generated deep changes in the Banque Nationale's role in Belgian monetary and financial policy with the emergence of a new balance of power between private finance, government and the central bank. Contrary to other countries, where the central bank took a major part in national and international finance with a growing influence on economic policy, in Belgium the Banque Nationale was largely supplanted by

<sup>4</sup> Kauch, pp. 260-261.

<sup>5</sup> Kauch, pp. 236-239. A.-M. Dutricue, "Janssen Albert-Edouard" in G. Kurgan-van Hentenryk, S. Jaumain, V. Montens (ed.), *Dictionnaire des patrons en Belgique. Les hommes, les entreprises, les réseaux*. (Bruxelles, De Boeck-Université, 1996), pp. 387-389.

the private banks in its relations with government. Both war circumstances and the Banque Nationale leaders' policy after the conflict led to this loss of influence.

When Belgium was invaded in August 1914, conflict broke out with the German authorities following the discovery, after the fall of Antwerp, that the Banque Nationale had transferred its assets to London. As the Belgian government refused to authorize the issuing bank to return the cash and the banknotes, the Banque Nationale was forbidden to carry on any operations in the occupied territories.

During the war, the Société Générale was the leader of the bankers' consortium for state loans and treasury bills. As such, it became the main interlocutor with the German occupying authorities. Jean Jadot, its governor, was at the core of the negotiations between the Germans and the Belgian civil authorities on monetary matters and war taxation. Following its rupture with the Banque Nationale, the German occupation entrusted the issue of banknotes on its behalf to the Société Générale<sup>6</sup>.

The Société Générale also played a key role in the Comité National de Secours et d'Alimentation, an organization dispensing food and general aid all over the country. Emile Francqui, one of its directors, who had business with Herbert Hoover in China, became the linchpin of the C.N.S.A. This organization became largely responsible for feeding the Belgian people thanks to the funds Hoover collected in the United States. Under Francqui's strong leadership, the C.N.S.A. had become essential to the proper functioning of the country. As a consequence, the nation would rally behind the Société Générale, while Jadot and Francqui were considered as mentors both in business and political circles<sup>7</sup>.

Other financiers, like Edouard Empain and George Theunis, also

<sup>6</sup> Kauch, p.269 ff. Janssens, *Le franc...*, pp. 151 ff. G. Kurgan-van Hentenryk, "The Société Générale 1850-1934", in E. Buyst *et al.*, *The Generale Bank 1822-1997*, (Tielt, Lannoo, 1997), pp. 176 ff.

<sup>7</sup> L. Ranieri, *Emile Francqui ou l'intelligence créatrice, 1863-1935*, (Paris-Gembloux, Duculot, 1985), p. 115 ff. G. Kurgan-van Hentenryk, *Gouverner la Générale de Belgique. Essai de biographie collective*, (Bruxelles, De Boeck-Université, 1996), pp. 121 ff.

played an important part in helping the war effort of the Belgian government abroad.

The First World War wrought a profound disruption in the Belgian economy. The industrial base was in large measure looted or destroyed, and the state's financing needs provoked a shift of resources from commercial and industrial banking towards the public sector. Inflation, penury and lack of investment swelled bank deposits while the country became poorer in real terms.

On 12 November 1918, the day after the armistice, the issuing department of the Société Générale was dissolved and the Banque Nationale took over all its assets and liabilities. However, this restitution was not to prevent the Société Générale and the leading business circles from taking an active part in clearing up the post-war monetary problems<sup>8</sup>.

On their return to Belgium, the Banque Nationale's leadership was bewildered at the post-war problems and proved unable to adapt its policy in a macroeconomic perspective. It shared the widespread illusions of quick restoration of the prewar gold standard system and recovery of German war reparations. Even though the Banque Nationale gained high prestige for its opposition to the enemy, the directors' conservative attitude and their isolation during the war gave way to the growing involvement of private bankers in post-war financial and economic policy<sup>9</sup>.

Undoubtedly, the experience and influence which certain eminent financiers, like Georges Theunis and Emile Francqui, had gained through their wartime activities led to their being called upon to take part in government during the economic and financial crisis. Thus, after being asked to be the main expert and negotiator of reparations for Belgium, George Theunis was to become Prime minister from 1921 to 1925<sup>10</sup>.

Thanks to their network of overseas contacts, and especially to Emile Francqui's prestige, the private bankers had the upper hand

<sup>8</sup> Kauch, p. 306. Kurgan-van Hentenryk, "The Société Générale 1850-1934", p.189.

<sup>9</sup> Van der Wee & Tavernier, pp. 27 ff.

<sup>10</sup> Kurgan-van Hentenryk, "The Société Générale 1850-1934", p. 249. About Theunis' role during the early 1920s, see R. Depoortere, *La question des réparations allemandes dans la politique étrangère de la Belgique après la première guerre mondiale*, (Bruxelles, Académie Royale de Belgique, Classe des Lettres, 1997).

over the Banque Nationale in the negotiations over German reparations and the repayment of marks withdrawn from the Belgian market by the government at the end of the war.

As in other belligerent countries, the financial and banking system was destabilized by inflation. This was worsened in Belgium by the fact that paper marks had been put into circulation during the war, and the assets in marks of the Banque Nationale and the Société Générale had been compulsorily transferred to Germany. In spite of the preventive measures taken by the Belgian government before its return to the country, it could not bring about the withdrawal of the marks in circulation sufficiently rapidly to prevent speculation. As the exchange rate for marks had been fixed at 1.25 francs, that is to say at the parity imposed by the occupying power, the operation cost 7.6 billion francs. The Banque Nationale financed 5.8 billion francs, which it paid in notes, thus stimulating inflation. By accepting into its reserves marks, which had greatly depreciated in value and which it could not get Germany to redeem, the Banque Nationale found itself in a difficult position to fight inflation. Moreover, by financing the state, the Banque Nationale had to contravene its legal status which limited advances to discounting the state and treasury bills to 20 millions francs. So it considered these operations as exceptional ones and concluded an agreement with the government recognizing its debt and legitimating the violation of its statutes<sup>11</sup>.

In spite of its concern about its huge reserves of marks, the Banque Nationale was soon excluded from interallied negotiations because of divergent opinions with the government on financial matters. Following the British *Cunliffe Report*, which advocated returning to prewar monetary parities and inspired the British policy of restoring the gold standard, the Banque Nationale authorities championed a drastic deflation policy<sup>12</sup>. On the other hand, the government's policy aimed at a progressive monetary stabilization with regard to the level of domestic prices, in order to balance the budget and support the

<sup>11</sup> Van der Wee & Tavernier, pp. 79 ff. Janssens, *Le franc...*, pp. 162 ff. R. Depoortere, "La Banque Nationale de Belgique et les négociations relatives aux réparations - 1918-1932", in *Relations internationales*, LVI, 1988 pp. 457-473.

<sup>12</sup> Van der Wee & Tavernier, pp. 35 ff.

franc. Finally, since 1923, business circles advocated a strong devaluation of the franc to stimulate the Belgian economy whose prosperity depended greatly on its exports<sup>13</sup>.

The Banque Nationale's relations with the commercial banks soured also after the war because of its concern to restore its commercial activity. To fight the prewar private bank competition in discount operations, it founded in 1919 the Société Nationale de Crédit à l'Industrie. By clearing out its portfolio of bills, which was too short term, it promoted mid-and-long term credit to small and medium-sized firms and produced a new profitable activity for its shareholders. The mixed banks considered this as a challenge when they were rationalizing, developing and concentrating their banking and industrial interests<sup>14</sup>.

The Société Générale obliged the banks it patronized to collect bills free of charge, thus channeling a large part of the paper in circulation for the benefit of its network. This policy was revealed to be detrimental to the Banque Nationale's commercial activity. In 1926, the Société Générale collected bills 10 times higher than the portfolio of the central bank and overtook it as far as the number and value of bills discounted were concerned<sup>15</sup>. Thus, its function as a discount bank gave way progressively to that of an issuing bank and this process was accelerated by the monetary and financial crisis of 1926. In these circumstances, the Banque Nationale lost the opportunity of a decisive come-back in leading monetary and financial policy.

*The monetary and financial crisis of 1926.* Since the end of 1924, the Theunis cabinet underwent enormous difficulties. Its efforts to

<sup>13</sup> Janssens, *Le franc...*, pp. 174 ss. E. Bussière, *La France, la Belgique et l'organisation économique de l'Europe 1918-1935*, (Paris, Comité pour l'Histoire Economique et Financière, 1992), p. 207.

<sup>14</sup> Kauch, pp. 261-262 and 305. Van der Wee & Tavernier, p. 66 ff. and 345.

<sup>15</sup> Kurgan-van Hentenryk, "The Société Générale 1850-1934", p. 233 ff. The Société Générale collected in 1926 4,419,922 bills, worth 7,866,506.000 francs, and discounted 1,262,267 bills, worth 4,135,207.000 francs, while Banque Nationale collected 475,661 bills, worth 3,020,570.000 francs, and discounted 738,809 bills, worth 4,045,112.000 francs (idem, p. 235).

restore the Belgian franc with the aid of American finance came to naught. Its deflationary policy and the question of the University of Gent becoming a Flemish institution brought about its defeat in the elections of April 1925. For the first time in Belgium, after a two-month crisis, a catholic-socialist coalition cabinet came to power.

The political and financial crisis of 1926 has been discussed in very detailed studies, stressing the role played by the banks in the failure of the stabilization plan of the Finance Minister Albert-Edouard Janssen and the government's fall in May 1926<sup>16</sup>. In addition to the opposition of conservative circles to the arrival of a left-wing coalition to power, two factors were essential in the campaign conducted against the government. Firstly, unlike his predecessors, Janssen, who was director of the Banque Nationale, had prepared his plan with experts of the Banque Nationale without consulting the private banks. Secondly, the fiscal policy adopted by the government to deal with the budget deficit had stirred up intense criticism from the opposition.

At this time, the Banque Nationale's position was critical because of the government's increasing floating debt and the market's loss of confidence. It had to deal with the risky choice of redeeming treasury bills, thus stimulating inflation, or raising interest rate, thus increasing debt service.

The Janssen plan was elaborated by a team of the Banque Nationale economic studies service lead by Paul Van Zeeland<sup>17</sup>. Following the passing of the *Gold Standard Act* by the British

<sup>16</sup> See Van der Wee & Tavernier, Ranieri, Bussière, Kurgan-van Hentenryk, "The Société Générale 1850-1934", cited above and two articles of G. Vantemsche, "De val van de regering Pouillet-Vandervelde: een samenzwering der bankiers?", in *Revue Belge d'Histoire Contemporaine*, IX, 1978, 1-2, pp. 165-214 and "Preciseringsen omtrent het verloop van de politiek-financiële crisis van 1926", *Revue Belge d'Histoire Contemporaine*, XVI, 1985, 1-2, pp. 107-128.

<sup>17</sup> After studying law at the Université Catholique de Louvain, Van Zeeland took an M.A. in economics at Princeton University in 1921 and graduated as a Doctor of UCL with a thesis on banking reform in United States. He entered the Banque Nationale economic studies service in 1921 and succeeded Janssen as secretary (1924) then director (1926) of the bank. On his role in Belgian finance and politics, see B. Henau, *Paul van Zeeland en het monetaire, sociaal-economische en Europese beleid van België. 1920-1960*, Brussel, Koninklijke Academie voor Wetenschappen, Letteren en Schone Kunsten, 1995 en V. Dujardin & M. Dumoulin, *Paul van Zeeland, 1893 - 1973*, (Bruxelles, 1997).

Parliament, the devaluation of the Belgian franc appeared as unavoidable. The first objective of the plan was the de-coupling of the Belgian franc from the French franc and its devaluation at 107 francs per pound sterling in order to issue a loan on the American and British markets. Secondly, the state would repay its debt of more than 5 billion francs towards the Banque Nationale by issuing a foreign loan of 150 million dollars and revaluing the Banque Nationale's gold assets. Public finances would be brought into balance by increasing taxes.

Albert Janssen's efforts to convince American and British bankers were undermined by the bankers' opposition to his policy and Francqui's influence in international circles. Because of the assaults against the floating debt and the deterioration of the exchange rate of the Belgian franc on the foreign exchange markets, Janssen could no more rely on the Banque Nationale's financing of the Treasury. Violently attacked by the Liberals and the right wing of the Catholic party, the cabinet fell on 11 May 1926.

The failure of Janssen's stabilization plan resulted in the eclipse of the Banque Nationale in favour of the private banks in relations with the state and the consolidation of the Société Générale's position at the head of the banking sector. Emile Francqui was the main architect of this. He entered the new cabinet of national unity as Minister without Portfolio, later to become Treasury Minister.

Within six months, Francqui had led a strong policy to restore the public finances and create monetary stabilization. By privatizing the state railways, he had succeeded in consolidating two thirds of the floating debt. He also concluded a stabilization loan of 100 million dollars thanks to his special relationship with English and American bankers. The Belgian franc was stabilized at 175 francs per pound versus the rate of 107 set by the previous government. Meanwhile, Francqui took advantage of his position in the government to reorganize the Banque Nationale<sup>18</sup>.

Making use of his relations with Montague Norman and Benjamin

<sup>18</sup> Van der Wee & Tavernier, pp. 356 ff.

Strong, Francqui got the government to dismiss the Banque Nationale's governor Fernand Hautain. The latter was replaced by Louis Franck, a liberal politician, with whom he set about reforming the central bank. His main objectives were aimed at guaranteeing the independence of the Banque Nationale from the state and focusing once more on its function of issuing banknotes and its role as bankers' bank.

A major aspect of the reform aimed at reducing the Banque Nationale's role in regulating credit and extend the influence of private banks over it.

Having failed to have the Banque Nationale's discounters closed down, the government imposed a limit on their operations in rediscounting prime short-time commercial paper. On the other hand, the Société Nationale de Crédit à l'Industrie, founded by the Banque Nationale in 1919 to the acute displeasure of the banks was removed from the issuing institute. The main banks redeemed the shares and the board was reorganized with a majority of members belonging to business circles.

In addition to the dismantling of the Banque Nationale's competition in the credit area, Francqui reorganized the Banque Nationale's constituent organs in order to ensure private banks' presence in the management. The board was replaced by two bodies, the management committee, chaired by the governor, who was appointed by the King, and the regency council, composed of nine members mostly from the world of banking and industry. In Francqui's view, the regency council ought to be the decision-making body in the Bank. The management committee was given the task of looking after day-to-day running. When he left government in November 1926, he had himself appointed as a member of the regency council, along with Georges Theunis.

Numerous studies and discussions arose about the devaluation in 1926. Economists belonging to the Banque Nationale and the so-called *Ecole de Louvain* considered the Belgian franc undervalued, thus benefiting banking and industrial groups controlled by the major mixed banks. These institutions entered a period of accelerating

financial and industrial concentration with huge speculative profits<sup>19</sup>. On the other hand, recent studies point to a rapid growth of real incomes and domestic consumer-spending following the devaluation, thus concealing the export industries' nascent difficulties and delaying the necessary modernization of the Belgian economy<sup>20</sup>.

Following the monetary stabilization and central bank's reform, the Banque Nationale lost its role as the lender of last resort because it did not have the means at its disposal to deal with the inflationary increase of capital imports and bank money. It failed in its fight against inflation by selling foreign currencies and trying to dissuade public authorities and private business from contracting loans abroad. The management then focused on foreign exchange transactions and implementing the gold-exchange standard with the aim of achieving the security, liquidity and profitability of its investments<sup>21</sup>.

The authoritarian rule of governor Louis Franck further weakened the central bank's influence on economic policy. Franck was an eminent lawyer and politician, but he lacked any training or experience in economics and monetary matters. Clinging to the liberal principles of central banking, he had faith in gold and convertibility. When the crisis of the pound sterling broke out in 1931, he considered that money was in no way responsible for the economic crisis, thus a monetary therapy was useless<sup>22</sup>.

Successive Catholic - Liberal governments tried to save the parity of the Belgian franc by a deflationary policy and cooperation with the

<sup>19</sup> L.H. Dupriez, *Les réformes monétaires en Belgique*, (Bruxelles, 1948), p.83. When elaborating the Janssen plan, Van Zeeland took advice of a group of economists of the Institut des Sciences Economiques (later IRES or Institute for Economic Research of Leuven University) lead by L.H. Dupriez. The *Ecole de Louvain* refers to a small group of researchers and former students of IRES brought together with Dupriez, who exerted a growing influence in catholic circles from the 1930s (I. Cassiers, *Croissance, crise et régulation en économie ouverte. La Belgique entre les deux guerres*, (Bruxelles, De Boeck Université, 1989), p. 178).

<sup>20</sup> Cassiers, p. 154. R.L. Hogg, *Structural Rigidities and Policy Inertia in Interwar Belgium*, (Brussel, Koninklijke Academie voor Wetenschappen, Letteren en Schone Kunsten, 1986), p.17.

<sup>21</sup> Van der Wee & Tavernier, p. 390.

<sup>22</sup> Van der Wee & Tavernier, p.357. Janssens, *De beheerders...*, pp. 115.

countries of the *Bloc or*. To deal with the fall in international prices, their policy tended to cut production costs, which worsened the slump. While production and purchasing power were dropping, unemployment increased dramatically, thus generating social troubles. In 1934, the banking sector was also near collapse. Speculation against the Belgian franc accelerated the withdrawal of bank deposits while the Banque Nationale had to deal with considerable gold withdrawals. It was facing the dilemma of either returning to the banks the banknotes it had exchanged for gold, thereby defeating the deflation policy, or triggering a series of bank failures. Besides, the Banque Nationale leaders sharply criticized the costly conditions of the loan negotiated by the government with the banker Mendelssohn in order to solve its financial problems<sup>23</sup>.

After the fall of the so-called "bankers' government" in March 1935, the Banque Nationale was put aside by the new National Unity government headed by Paul Van Zeeland, who was at the time vice-governor of the Banque Nationale. As Franck's power and conservatism made it impossible to elaborate a new monetary policy for the central bank, Van Zeeland had secretly negotiated with the Socialist party leader Henri De Man. When his government came to power, it decided a devaluation of 28% .

The devaluation was elaborated with experts of the Banque Nationale and economists of the *Ecole de Louvain* like Léon Dupriez and Fernand Baudhuin. The latter played a leading part in the campaign against the "bankers' government's" policy<sup>24</sup>. Contrary to the Banque Nationale's governor, they were convinced since 1933 that Belgian economic troubles were mainly monetary ones which required devaluation. They calculated the extent of devaluation scientifically, according to the disparity in purchasing power's between Belgium and Great Britain<sup>25</sup>.

Van Zeeland's coming to power is considered a turning point, since in some way the "technocrats", represented by the central bank's

<sup>23</sup> Cassiers, pp. 155 ff. M.-R. Thielemans, *La grande crise et le gouvernement des banquiers. Essai*, (Bruxelles, Institut de Science Politique, 1980), pp. 56 ff.

<sup>24</sup> Van der Wee & Tavernier, p. 360. Henau, pp. 125 ff.

<sup>25</sup> Cassiers, pp.178-179.

experts and academic economists, got even with the “technicians” belonging to the business world<sup>26</sup>.

The banking reform of 1934/1935 was the starting point of the eventual containment of private bankers in politics and a new balance of power between the Banque Nationale, the commercial banks and the state.

*The Banking Reform of 1934/35 and its consequences.* In most Western countries, the banking crisis of the 1930s triggered public intervention and reform of the banking system. In the countries where mixed banking had developed, the crisis revealed the dangers of combining deposit banking with industrial investment. Public authorities thus took measures designed to separate short-term credit operations from industrial investment. The reform of Belgium’s banking system illustrates this turning point in exemplary fashion, although recent research on the history of the Société Générale displays the determining part played by the bankers in the legal reform of 1934/35.

The royal decree of 22 August 1934, compelling the mixed banks to segregate their deposit banking activity from investment banking activity, was inspired by Emile Francqui to conceal and water down the Société Générale’s heavy losses. The segregation would allow the restructuring of the balances without alerting public opinion<sup>27</sup>.

When the Van Zeeland cabinet came to power in March 1935, it undertook a broader reform of the financial sector. During his secret negotiations with the Socialist leader Henri De Man, whose plan aimed at nationalizing the whole financial sector, Van Zeeland had gained socialist consent for a compromise. Instead of being nationalized, banks would be submitted to state control. Similarly, the Socialists gave up their plan for a state central bank, giving the state a preponderant influence over the Banque Nationale in order to guarantee that the general interest would prevail.

<sup>26</sup> J.-F. Crombois, *Camille Gutt. Les finances et la guerre (1940-1945)*, Bruxelles, Quorum-Ceges, 1999, pp.41-42.

<sup>27</sup> G. Vantermsche, “The Bank from 1934 to date”, in E. Buyst *et al.*, *The Generale Bank 1822-1997*, (Brussels, 1997), pp. 299-300.

Using its special powers, the Van Zeeland government instituted the royal decree of 9 July 1935, which reformed the banking system. Not only did this confirm the division of functions of the universal banks, but it also submitted all institutions with bank status to the control of a new body, the *Commission bancaire* (Banking Commission).

Because of Louis Franck's opposition to devaluation the Banque Nationale had been put aside during the banking reform process<sup>28</sup>. The banking reform was seen at the time as a victory for the proponents of state intervention in the economy. A closer examination of the creation and content of the royal decree reveals the close collaboration between the Liberal Finance Minister, Max-Léo Gérard, and the bankers. Moreover, in their anxiety to restore public confidence and avert the socialist threat of nationalization, the banks themselves were the main force behind the reform. They accepted the regulation of banking activities only with a close eye on the preservation of their own interests<sup>29</sup>.

According to article 185 of the royal decree of 9 July 1935, a "bank" was now allowed to collect deposits repayable over a period of 2 years maximum and to use them for short-term operations. It was forbidden to acquire interests in industry. As the demand for short-term credit for industrial firms was not very great, the banks were very soon compelled to channel their resources into state borrowing. Even before the war, Belgian banks had taken on the characteristics of deposit banks : a small element of shareholders' funds in their resources, a fall in advances to private enterprise, growth in short-term loans to the state and the development of investments made up of government stocks<sup>30</sup>. This evolution added to Banque Nationale's loss of influence on credit to the private sector.

Following the bankers' request, the Banking Commission was organized as a body independent of the Banque Nationale and the Finance Minister.

<sup>28</sup> Van der Wee & Tavernier, p. 364.

<sup>29</sup> G. Vantemsche, "L'élaboration de l'arrêté royal sur le contrôle bancaire (1935)", in *Revue Belge d'Histoire Contemporaine*, XI, 1980, 3, pp. 389-437.

<sup>30</sup> Kurgan-van Hentenryk, "Finance and financiers...", p. 328.

The Banque Nationale's reticence about government policy convinced the Finance Minister, Henri De Man, of the necessity of reorganizing the central bank in order to adapt it to the economic evolution of the last decade and increase its integration with the increasing state intervention in the economy. A royal decree of 10 June 1937 reorganized its credit and monetary functions<sup>31</sup>.

Discount conditions were broadened, but this had no effect because the central bank's part in providing credit to enterprises had become insignificant. Both the Banque Nationale and the Banking Commission were entrusted with the whole credit policy of the country. While the Banking Commission had to exert prudential control over the banks, the Banque Nationale had to control the volume of credit granted by the banks and itself. It was also allowed to practise open-market policy. The two bodies of the central bank were preserved, but the governor and the board of directors held the decision-making power while the regency council was reduced to a consultative body. By putting an end to private bankers' control of the SNCI, the government achieved a new balance of power between state, central bank and commercial banks and entered the era of a mixed economy. However, in order to protect monetary stability and defend the gold-exchange standard, the principle of the Banque Nationale's autonomy versus the state was maintained. Thus, the discounting of treasury bills was limited to 1.5 billion francs. As a consequence, the Banque Nationale's ability of using the new monetary instrument of open-market policy was actually restricted.

The government of the bankers and its fall had been followed by a violent press campaign denouncing collusion between finance and politics. It gave way to the creation in 1936 of a parliamentary committee of inquiry and proceedings. The Banque Nationale was also hit by financial scandals. Governor Franck had to resign and Van Zeeland left the government at the end of 1937<sup>32</sup>.

Meanwhile, the bankers, relieved at first by the new banking

<sup>31</sup> Van der Wee & Tavernier, pp. 365 ff. Crombois, p. 60.

<sup>32</sup> Janssens, *De beheerders...*, pp. 122 ff.

statute, which sheltered them from public control over their long-term operations and industrial investments, had become dissatisfied with the way the Banking Commission was exercising its control. Their relations with the Banking Commission and the Banque Nationale became strained when the Banking Commission's chairman, Georges Janssen, became the Banque Nationale's governor in 1938<sup>33</sup>. Janssen's strong personality contributed much to restore the central bank's position by carrying out monetary and credit policies with some macro-economic perspective and acting as the Treasury's banker and adviser<sup>34</sup>. Despite of this new style, Van der Wee and Tavernier point that, throughout the interwar period, the Banque Nationale was actually unable to carry out an efficient monetary policy. It had no control over international capital flows nor over bank money which both dominated the monetary system of the time<sup>35</sup>.

World War II, however, gave the Banque Nationale the opportunity to take advantage of the banking system reforms of the late thirties.

Contrary to the First World War, the balance of power between the central bank and commercial banks in their relationship with the state was overturned soon after the German invasion of Belgium on 10 May 1940. On the eve of the Belgian government's departure, Banque Nationale's authorities decided, at the request of the Finance Minister, to transfer the central bank's seat to where the Belgian government would settle during the war. Thus, the Banque Nationale was closed<sup>36</sup>. Before leaving Brussels, Prime Minister Paul-Henri Spaak and Finance Minister Camille Gutt had summoned the three key men of Belgian finance : the governor of the Société Générale, Alexandre Galopin, and the presidents of the Banque de Bruxelles and Kredietbank, Max-Leo Gérard and Fernand Collin. Their meeting on 15 May gave way to a bitter controversy about the mission entrusted by the ministers to the financiers, which had significant consequences

<sup>33</sup> H. Van der Wee and M. Verbeyt, *La Générale de Banque. Un défi permanent* (Bruxelles, Racine, 1997), pp.236-237.

<sup>34</sup> Janssens, *De beheerders...*, pp. 127 ff. Crombois, pp. 50 ff.

<sup>35</sup> Van der Wee & Tavernier, p. 393.

<sup>36</sup> Janssens, *Le franc belge...* p. 278. Crombois, p.199.

for the relationship between bankers and public authorities after the war.

Undoubtedly, the ministers gave the bankers a mandate for paying the civil servants' salaries during the occupation. What is less clear is whether the ministers gave the bankers a mission to lead big business policy towards the German occupiers. The question was controversial since, during its exile in London, the government disagreed with the policy of 'moindre mal' (less evil) carried out by the Belgian business world under the leadership of the committee of prominent financiers and industrialists headed by Galopin. Galopin's doctrine was to carry on with industrial production with the aim of feeding the population and keeping the labour force in Belgium while avoiding to support German war effort<sup>37</sup>.

As they feared the Banque Nationale's closing would endanger banknotes issuing, the bankers had planned the creation of an issuing bank, but they could not avoid the German authorities taking control over it. Moreover the Banque Nationale's offices in Belgium were reopened and operated with the new Banque d'Emission. When governor Georges Janssen died in June 1941, the occupying authorities appointed a new governor with the bankers' agreement. As the Belgian government in London considered that as illegal, it decided to appoint a new board of the Banque Nationale outside the occupied territories with Georges Theunis as governor. On its return to Belgium in September 1944, it purged the board of Brussels and appointed senior executives of the Banque Nationale who had collaborated closely with Finance Minister Camille Gutt during the war<sup>38</sup>.

The Comité Galopin's policy had come to a dead end and caused harsh controversy. Thus, at the end of the war, the position of the Société Générale and other banking groups had been weakened and they had to face campaigns from the left for the nationalization of

<sup>37</sup> Among recent works about Galopin's doctrine and policy, see Kurgan, *Gouverner la Générale...*, pp. 180 ff. ; Crombois, p. 184 ff. ; P. Nefors, *Industriële "collaboratie" in België. De Galopindoctrine, de Emissiebank en de Belgische industrie in de tweede oorlog*, (Leuven, Van Halewyck, 2000).

<sup>38</sup> Crombois, pp. 198 ff.

banks and industry. While the leaders of the Société Générale had emerged from the First World War as glorious patriots and mentors of the national life, things had dramatically changed at the end of World War II. On the contrary, the Banque Nationale had taken advantage of the leading part its experts Adolphe Baudewijns and Hubert Ansiaux had played in Camille Gutt's monetary reform. The first was appointed vice-governor and the latter director of the new board headed by Maurice Frère, former president of the Commission Bancaire<sup>39</sup>.

Contrary to Van Zeeland and his circle, who anticipated an economic crisis following the war and advocated a large devaluation of the franc, Camille Gutt and the Banque Nationale experts favoured a limited devaluation and a strong restriction of liquidity in order to prevent the dangers of galloping inflation. In October 1944, the so-called 'operation Gutt' was an attempt to rehabilitate the currency by freezing bank assets and the conversion of notes issued by the Banque Nationale. Although it created a psychological shock, it did not quite manage to curb inflation.

With respect to banks, the Second World War resulted in the strengthening of the system introduced in 1935. The Gutt operation was followed in 1946 by a ruling of the Banking Commission imposing banking ratios aimed at securing a cheap supply of finance for the public authorities. In addition to liquidity and solvency ratios, banks were required to provide adequate cover for deposits in the form of treasury bonds, which might amount to 65 per cent of their commitments. For ten years or so, interest on this short-term debt was kept at a reduced rate of 1.15 per cent, which limited their ability to remunerate depositors. Thus, over 20 years, private commercial banks enjoyed a stable environment protected by regulations mainly aimed at stability, under the joint control of the Banque Nationale and the Banking Commission. Meanwhile, public-credit institutions were rising to prominence in the Belgian banking system<sup>40</sup>.

<sup>39</sup> About the monetary reform, see Janssens, *Le franc belge...*, p. 302 ff. and Crombois, pp. 445 ff.

<sup>40</sup> G. Kurgan, "Commercial Banks in Belgium 1935-1990", in Y. Cassis, G.D. Feldman and U. Olsson (eds), *The Evolution of Financial Institutions and Markets in Twentieth-century Europe*, (Aldershot, Scolar Press, 1995), pp. 47-48.

*Monetary orthodoxy and economic growth after World War II.* The Belgian economy recovered quickly after the liberation in September 1944. Contrary to the First World War, industrial capacity had been undamaged, while its neighbouring countries had suffered heavy losses. The so-called "Belgian miracle" owed much to its industries' ability to satisfy the strong demand for Belgian goods in the first years after the war. While American troops staying on Belgian territory until August 1945 were big customers, the reconstruction of the neighbouring countries generated great demand for Belgian traditional export products like coal, metals, glass and cement. Domestic demand was also strong. Government policy gave priority to monetary stability and social peace. Consequently it favoured production and consumption over investment.

Because of the growing openness to trade, international competitiveness and the external balance became main concerns during the second half of the century. The high import content in Belgian production and exports raised particular concern for the foreign-exchange rate, and the fear of imported cost-push inflation largely inspired monetary policy<sup>11</sup>.

During the war, Socialist and Christian trade-unions, employers and the ministry of Labour had initiated long, secret negotiations leading to a social solidarity pact laying down the foundation of postwar social relations. Its principles were implemented through the integrated social security system for wage-earners (1944) and the laws relating to 'the organization of the economy', both of which institutionalized current industrial relations. Belgium then entered a mixed economy era<sup>12</sup>.

As a major result of post-war economic and social policy, Belgium shifted from a low-cost to a high-wage economy with the constraint

<sup>11</sup> For the Belgian economy during the last half-century, see I. Cassiers, P. De Villé and P.M. Solar, "Economic growth in post-war Belgium", *Center of Economic Policy Research . Discussion Paper Series*, n° 986, 1994 ; I. Cassiers (ed.) *Que nous est-il arrivé ? Un demi-siècle d'évolution de l'économie belge, Reflets et perspectives de la vie économique*, XXXIX, 2000, n°1.

<sup>12</sup> D. Luyten & G. Vantemsche (eds), *Het Sociaal Pact van 1944. Oorsprong, betekenis en gevolg*, (Brussel, VUB PRESS, 1995).

of defending the open sector's international competitiveness by increasing productivity.

In the renewed framework of economic and social relations, the status of the Banque Nationale was revised in order to strengthen its links with the State<sup>43</sup>.

The law of 28 juillet 1948 was defended in Parliament by Finance Minister Gaston Eyskens. It sought two main objectives : modifying the bank's basic law and stabilizing its balance sheet by clearing the remains of war inflation. Thus, its capital was increased from 200 millions to 400 millions francs. The state became a shareholder by subscribing the 200 millions increase which was financed by the profits made by the Banque Nationale during the war. Changes occurred also in the management. The regency council consisted from now on of three Finance Minister's representatives, two members from public-credit institutions and five members representing the pressure groups from trade-unions, employers' federations and agricultural organizations. The directors were appointed by the government on the nomination of the regency council.

The clearing of state war debts was implemented by the revaluation of the Banque Nationale's gold reserves, the products of the Gutt operation and the profits made by the bank during the war. Finally, the state debt to the bank was consolidated at 35 billions francs and the Banque Nationale was authorized to make advances to the state with a limit of 10 billion francs instead of 5 million before the war.

The law was violently attacked by the small shareholders of the Banque Nationale and the right wing of the Catholic party and the Liberal opposition, who considered it as a creeping nationalization of the central bank.

The monetary reform carried out after the war with the Banque Nationale's collaboration had a lasting effect on Belgian economic policy. It implied the indirect control of global expenditure by limiting

<sup>43</sup> Janssens, *Un siècle...*, pp. 342-343. G. Eyskens, *De Memotres*, Tielt, Lannoo, 1995, p.229 ff. As a member of the Christian Democratic party, Minister, then Prime Minister in numerous governments after the war, Eyskens played a leading part in Belgian politics and especially economic policy from 1945 to 1972.

the available liquid assets to finance them. Thus, direct controls could be removed and a market economy restored. The exchange rate became central in implementing monetary policy, with a strong preference for a fixed-exchange system.

During Maurice Frère's governorship, the Banque Nationale gave priority to monetary stability linked to gold and a strong Belgian franc policy. Thus, credit policy depended primarily on the level of gold reserves. According to Frère, the Banque Nationale's mission consisted of a strong credit-control and anti-inflationist policy. Such was its faith in gold and the Banque Nationale's authority that on the governor's initiative the law of 12 April 1957 restored the gold denomination of the Belgian franc and reintroduced the compulsory margin of one third of its liabilities in gold. Because of his lack of macroeconomic perspective, Maurice Frère was considered in international circles as too conservative and old-fashioned. He enjoyed nevertheless great authority in Belgium and it was only after his departure in 1957, that the Banque Nationale's direction acknowledged that monetary policy had to be related to economic policy as a whole<sup>44</sup>.

Meanwhile, during the decade following the war, the Banque Nationale played the most important international part of its history. This was the consequence of Belgium's foreign policy of international cooperation for resolving political and economic problems after the war. Thus, Camille Gutt and his fellow partners of the Banque Nationale contributed actively to the Bretton Woods conference. During these negotiations, Belgium's monetary union with the Grand Duchy of Luxemburg was concluded and the Banque Nationale took charge of the administration of the new-born Institut Belgo-Luxembourgeois du Change. When Gutt was elected first IMF Managing Director in 1946, Hubert Ansiaux was appointed as a member of the IMF management board<sup>45</sup>. Being in charge of the Banque Nationale's foreign department, Ansiaux became a major actor in the policy of restoring free trade and international payments in

<sup>44</sup> Janssens, *Un siècle...*, p. 360 ff. ; *De beheerders...*, pp. 157 ff.

<sup>45</sup> Crombois, pp. 360 ff.

Europe. During the Marshall Plan negotiations, he was one of Minister Paul-Henri Spaak's main advisers<sup>46</sup>.

Despite its rapid economic recovery and growing exports, Belgium suffered in 1947 from a high deficit in dollar trade while being a creditor of European countries. Thus, it requested no direct aid, but American help in financing its exports to other European countries. Ansiaux actively promoted a plan for channeling American aid in financing intra-European deficits and was appointed chairman of the OEEC Payments Committee. After British opposition wrecked his project of a multilateral payments system, he contributed actively to the foundation of the European Payment Union in 1950. His hope that, through EPU, Belgium could more easily recover its European partners' debts was, however, partly disappointed.

Such was the Banque Nationale's position on the domestic and international scene that, when the British government decided suddenly on devaluing the pound by 30% in September 1949, the Belgian decision of devaluing by 12,345% was determined by the Banque Nationale's experts. Maurice Frère was in favour of limiting devaluation to 50 Belgian francs per dollar. His strong position prevailed<sup>47</sup>. Following the general realignment of exchange rates, the Belgian franc was thus revalued and the policy of a strong currency confirmed. Such was the faith in that policy held by political and public opinion, that the government had to justify devaluation with reference to the experience of 1932-1934 which evidenced the failure of a deflationary policy. However, as the openness of the Belgian economy was growing, it became impossible to control all international capital and current flows. So in 1955, Belgium established a double exchange market, which was sharply criticized by the IMF and Anglo-Saxon economists, but lasted 30 years<sup>48</sup>.

<sup>46</sup> G.Kurgan-van Hentenryk, "Le Plan Marshall et le développement économique de la Belgique", in Acqs E. e.a. (eds.) *Studia Historica Economica. Liber amicorum et Liber alumnorum Herman Van der Wee*, (Leuven, 1993), pp. 157-172 ; "La Belgique et le plan Marshall ou les paradoxes des relations belgo-américaines", in *Revue Belge de Philologie et d'Histoire*, 71, 1993-2, pp. 290-353.

<sup>47</sup> Janssens, *Un siècle...* pp. 344 ff. Eyskens, pp. 265 ff.

<sup>48</sup> A. Lamfalussy, "Stratégie et politique monétaire", in Cassiers (ed.), *Que nous est-il arrivé ?...*, p. 147.

When comparing European growth rates, Belgium lagged far behind its neighbouring countries during the 1950's<sup>49</sup>. Many economists have explained this lag by the strong Belgian franc policy and the Banque Nationale's credit policy which hindered investment<sup>50</sup>. But they fail to consider how the "Belgian miracle" and the priority of preserving social peace checked Belgian industrial modernization. Both leading business circles and government favoured defensive investments in the traditional production of standardized semi-finished goods without anticipating the loss of their European customers when they were rebuilding modern and competitive industries with Marshall aid<sup>51</sup>.

The constraints imposed on commercial banks after the war channeled most of their resources towards financing the state. They tried, however, to engage in wider activities by acquiring current deposits. It may have been a slow process, but the renewal of operations in the private sector was supported by the Banque Nationale. The central bank promoted the reappearance of bills by providing visas and offering rediscount rates that stimulated discount and acceptance credits, while maintaining the ability to intervene rapidly on the market and control inflation. However, from the late 1950s the return to external convertibility, the increase in international trade and the inflow of American investment in Europe made the system of ratios more and more unbearable for the banks. Moreover, the coexistence of banks, private saving banks and public credit institutions had led to growing competition and lack of specialization. The result was a process of deregulating the banking system, taking into account both 'despecialization' and internationalization and at the same time developing new rules to deal with the changes in the credit system<sup>52</sup>.

In this process, the Banque Nationale was closely associated with the Banking Commission after the ratios imposed in 1946 were radically

<sup>49</sup> Belgian growth rate during the 1950s was 3% p. a while the Netherlands reached 4.83%, France 4.57%, Germany 8.17%, the average Northwestern Europe rate being 4.70% (Cassiers, De Villé..., p.3).

<sup>50</sup> Cassiers, De Villé..., pp. 14-15.

<sup>51</sup> See n. 46.

<sup>52</sup> Kurgan, "Commercial Banks in Belgium 1935-1990", pp. 48 ff.

amended at the beginning of the 1960s. The cash and 'cover' ratios were cancelled in December 1961 and the banks had now to hold only a minimum of government securities. These ratios were replaced by a new instrument, a "monetary reserve ratio". This measure authorized the Banking Commission to freeze a percentage of bank deposits, some of which had to be deposited at the Banque Nationale without bearing interest. This ratio was applied for the first time in 1964. As revising of the regulations of the banking system aimed at monetary and macro-economic goals, legislation was changed in 1967 and 1973 in order to involve officially the Banque Nationale in the decision-making process. The central bank was not only associated in determining the structural ratios of the banks, but it could also impose specific ratios for some constituents of the banks' assets and liabilities<sup>53</sup>.

When, at the end of the 1950s, politicians became concerned at the lag in the rate of growth of the Belgian economy, the "De Voghel commissions", named after their chairman, Franz De Voghel, deputy-governor of the Banque Nationale, were set up to study these problems. The central bank's experts contributed actively to their recommendations which advocated the enlargement of development opportunities for the different types of financial institutions in order to stimulate the financing of the economy<sup>54</sup>.

Despite its influence and expertise, the problem of the Banque Nationale's autonomy versus the government was a main concern for its leadership. It sometimes gave way to strained relations under Hubert Ansiaux's governorship<sup>55</sup>. The first significant episode occurred in October 1957. The Treasury having exceeded the limit of its credit of 10 billion francs by 2,675 billion, the Banque Nationale demanded the immediate repayment of the government's surplus debt. In view of the bank's strength, the government complied. It had to sell treasury

<sup>53</sup> G. Vantemsche, "The Bank from 1934 to date", pp. 395 ff.

<sup>54</sup> *Commission gouvernementale pour l'étude des problèmes de financement de l'expansion économique. Rapport 31 mars 1962*, (Bruxelles, Banque Nationale de Belgique, 1962). *Commission gouvernementale pour l'étude des propositions de réforme des lois relatives à la banque et l'épargne. Rapport 30 novembre 1970*, (Banque Nationale, 1970).

<sup>55</sup> Ansiaux was governor from 1957 to 1971. G. Kurgan, "Hubert Ansiaux", *Nouvelle Biographie Nationale*, 4, 1997, p.11-13. Janssens, *De beheerders...*, pp. 187 ff.

bills abroad to repay. That incident raised the problem of the Treasury's credit limit and the deflationary policy of the central bank. Critics pointed out that, by selling treasury certificates in foreign currencies, the state turned only to the Banque Nationale after having borrowed abroad on very expensive terms. Thus, the Banque Nationale appeared to be powerless when government spending grew faster than national product during the golden sixties. Such was the consensus on the limit of advances that it was revised only in 1968 by an agreement between the Banque Nationale and the state. The limit was increased from 10 to 16 billions and was immediately used. It had no effect on the growing inflation which the Belgian economy was suffering from the early sixties<sup>56</sup>.

Governor Ansiaux's stance against government interference in the central bank's management produced a clash in 1971. As deputy-governor De Voghel was retiring, Ansiaux opposed government pressures for appointing a former chief of cabinet of Prime Minister Eyskens. By resigning his position, he ensured, however, that the tradition of selecting the deputy-governor from among the members of the board of directors would be respected.

*The collapse of the Bretton Woods system and the debate on the Banque Nationale's monetary policy.* During the twenty years that followed the war, exchange stability was key to economic growth in two respects, firstly, by protecting a small open economy against imported inflation, and, secondly, by promoting increased productivity to balance wage inflation. Floating exchange rates were then considered detrimental to the balance of payments that would need to be adjusted for the benefit of the strongest economic power. However, since the 1960s, the Banque Nationale's defence of a strong Belgian franc was held in check both by the rigidities of the Belgian industrial structure, and by new developments in budget and income policy. Economic growth and financing investment had become paramount and thus monetary

<sup>56</sup> F. Baudhuin, *Histoire économique de la Belgique 1957-1968*, (Bruxelles, Bruylant), pp. 279-282..

stability was thrown aside. The Belgian economy overtook other European countries thanks to inward foreign investment and productivity increases. But the government's loosened control of public expenditure, increasing salaries and social welfare costs exerted inflationary pressures, thus jeopardizing the international competitiveness of the open sector<sup>57</sup>. The decrease in demand for banknotes and the increasing bank money outside the commercial banks weakened the central bank's ability to control monetary aggregates. Moreover, the Banque Nationale's management was losing faith in gold reserves, which had prevailed during the previous decades. By the end of the 1960s, it became increasingly difficult to comply with the legal obligation to keep one third of its liabilities in gold. The Banque Nationale negotiated actively with the IMF and the government and obtained the equivalence of the Belgian special drawing rights with gold reserves associated with legal changes to its margin obligations<sup>58</sup>.

The collapse of the Bretton Woods system stimulated the Belgian monetary authorities in looking for ways to quickly restore exchange stability. After the United States suspended dollar convertibility on 15 August 1971, Belgium and the Netherlands were the only industrialized countries which rejected floating exchange rates. They decided to maintain exchange stability between the Benelux countries and joined the "European monetary snake" in 1972<sup>59</sup>.

In the aftermath of the oil crisis of 1973, Belgium entered a period of increasing imbalance between the open and domestic sectors of its economy, which was felt in the labour market, the public finances and the balance of payments. As a small open economy in which about 40% of total expenditure was covered directly or indirectly by imports, the exchange rate was a determining factor in domestic prices and costs. Furthermore, owing to the automatic price indexation of wages, salaries

<sup>57</sup> From 1958 to 1962, the inflation rate, calculated on the consumer price index, fluctuated between 0.3 and 1.4 % p.a. Between 1963 and 1972, it fluctuated between 2.1 and 5.4 % (R. Vandeputte, *L'histoire économique de la Belgique 1944-1990*, (Bruxelles, LABOR, 1993), p. 306).

<sup>58</sup> Janssens, *Un siècle...*, pp. 393-395.

<sup>59</sup> G. Quaden, "La nouvelle orientation de la politique de change en Belgique", in *La Revue Banque*, n° 517, juin 1991, p. 627.

and other incomes including social benefits, the effect of any external price shock spread quickly throughout the economy. Since government relied primarily on monetary policy to keep inflation in check, these imbalances were greater than in other European countries<sup>60</sup>.

From the early 1970s, the Banque Nationale was deeply concerned with the growing 'cost-push' inflation<sup>61</sup>. In its annual report, it complained systematically against inflation, recommended moderate wage increases and warned against the rapid growth of public expenditure. On the board of directors, the exchange rate was prevailing over the interest rate in arguments over monetary policy's contribution to growth. At the same time the ability of the Banque Nationale to influence the banking system through fixing interest rates was waning. It decided during the 1970s to detach its discount branches, which further reduced its leverage at the microeconomic level. On the other hand, from 1974 the Belgian Banking Association fixed the base rate for cash and acceptance credits, which the big banks applied. Thus, the former supremacy of rediscount and rates for advances of the central bank was replaced by a mix of short-term public bill rates, inter-bank market borrowing rates, and the rates for straight loans and large fixed-term deposits<sup>62</sup>. The increasing indebtedness of public authorities resulted in an upturn in the credit offered to the public sector from 1980. Moreover, the public bills market had long been the monopoly of Belgian financial intermediaries and was regulated by a semi-official body, the Consortium des Banques, which was dominated by the Générale de Banque. This made banks all the keener to help finance public authorities as the inversion of interest rates would provide them with higher profits. They became more independent from the central bank<sup>63</sup>.

<sup>60</sup> See n. 41 and G. Quaden (ed.), *L'économie belge dans la crise*, (Bruxelles, Editions LABOR, 1987).

<sup>61</sup> Concerning the last 30 years' history, I owe very much to the testimonies of Messrs Alfons Verplaetse, Honorary Governor of the Banque Nationale and Robert Tollet, President of the Conseil Central de l'Economie. Some colleagues at Université Libre de Bruxelles were also very helpful and I offer my grateful thanks to Françoise Thys, Mathias Dewatripont, Jean-Victor Louis and Jean-Jacques Rey.

<sup>62</sup> A. Minguet, *Les Marchés financiers belges*, (Bruxelles-Louvain-la-Neuve, 1990), pp.75 ff.

<sup>63</sup> *Idem*, pp.162 ff.

Besides its loss of influence in the financial markets, the Banque Nationale was suffering from a lack of attention from political circles. In addition, institutional reforms prevailed over economic policy during the 1970s, as a consequence of the process of federalization. A political agreement preserved the Banque Nationale's status as a national institution and it thus withstood the reforms unchanged. However, it became somewhat disconnected from the new reality generated by the regionalization process.

The Banque Nationale's exchange policy began to be questioned after the decline in the rate of growth and the continuous decline in Belgium's share of foreign markets. Hints of devaluing the franc in order to restore Belgian international competitiveness began to circulate. The Banque Nationale's governor Cecil De Strijcker was strongly opposed to any hint of a devaluation. He instructed the economic studies department of the bank to prepare a report defending the central bank's position and sent it in March 1975 to the Finance Minister. The Banque Nationale refused the benefit of a devaluation on Belgian exports because it would be neutralized by both the price increase generated by higher costs of imported products, and automatic wage increases owing the index-linking system. Inflation was primarily imported according to the bank and Belgium was more vulnerable than other countries because it imported energy, raw materials and other products in greater quantities. Thus, devaluation would stimulate inflation, capital flight abroad and interest rate increases on the capital market. The Banque Nationale urged the government to use budgetary and fiscal policy to stem inflation. The governor declared publicly that income cuts were unavoidable. In 1976, the Banque Nationale rejected the German claim to devalue the Belgian franc. The board of directors defended its exchange policy in the bank's *Review*, arguing that defending the exchange rate was the last disciplinary element in the Belgian economy<sup>61</sup>. Its opposition to devaluation was supported by the

<sup>61</sup> Janssens, *De beheerders...*, p. 218 ff. *Bulletin de la Banque Nationale de Belgique*, septembre 1976.

Socialist party and trade-unions who feared the loss of purchasing power for the wage earners.

From the spring of 1978, the debate about devaluation was growing acrimonious when the economist Etienne S. Kirschen sharply criticized the Banque Nationale's policy. Under the leadership of Banque Nationale's director Roland Beauvois, also a fellow academic at the Université Libre de Bruxelles, the department of economic studies published in the bank *Review* of April 1978 a voluminous report demonstrating that exchange-rate policy had not caused deterioration in the economy's competitiveness between 1970 and 1977. Accordingly, it would be foolish to believe devaluation would be the crisis 'wonder drug'<sup>65</sup>.

Controversy reached the Media in September 1978, when the Belgian main newspaper, *Le Soir*, published long articles by Kirschen and Beauvois. Kirschen's critic emphasized mainly the negative consequences of the central bank's policy on employment<sup>66</sup>. Other economists supported devaluation. Among them, Paul De Grauwe stressed the monetary policy's influence in the sharp decline of industrial employment<sup>67</sup>. The Banque Nationale responded to these critics with another report published in 1980. It maintained its position by arguing that the decline of industrial employment had started before 1970 and denied that it was closely related to exchange-rate fluctuations<sup>68</sup>.

Although Beauvois's thesis prevailed on the board, differences in opinion existed in the lower levels of the central bank.

While the central bank's early warnings remained unheeded, the fundamental imbalances in the Belgian economy had worsened. From 1971-1973 to 1981, nominal wages had increased by 12 % per year while real wages had increased by 3.5%. Unemployment rose from

<sup>65</sup> "Politique de change. Choix et implications", *Bulletin de la Banque Nationale de Belgique*, (avril 1978), pp.5-69.

<sup>66</sup> *Le Soir*, 16, 17-18 septembre 1978.

<sup>67</sup> P. De Grauwe and C. Hoolvoet, "On the effectiveness of a devaluation in the E.C.-Countries", in *Tijdschrift voor Economie en Management*, vol. XXIII, nr. 1, 1978, pp. 67-82. P. De Grauwe, "Le taux de change, l'emploi et la Banque Nationale", in *Revue Nouvelle*, 1980, pp. 148-157.

<sup>68</sup> "Les relations entre le cours de change et l'emploi industriel", in *Bulletin de la Banque Nationale de Belgique*, juillet-août 1980, pp. 3-36.

2% to 8%. The public deficit rose from 4% of GNP to 13% and the current balance of payments which was positive (+ 3%) reached a deficit of 4.5%. To maintain the Belgian franc, the Banque Nationale had to borrow foreign currencies so that, at the end of 1981, the exchange reserves had fallen dramatically. Finally Belgium's international competitiveness had fallen by 10%<sup>69</sup>. The Banque Nationale was still opposed to devaluing the franc. For several months, R. Beauvois advocated cuts in all incomes by 5%, breaking the wage index-linking mechanism and either the abolition of - or severe cuts in several social benefits.

For the government and leaders of the Flemish Christian Democrat majority, such a solution was unthinkable because it would generate strong opposition from the Socialist party and the trade-unions.

At the end of 1981, a Christian Democrat-Liberal government came to power. Prime Minister Wilfried Martens appointed Alfons Verplaetse as its economic adviser. Verplaetse was a member of the economic studies department of the Banque Nationale. He disagreed with director Beauvois's monetary policy and was a member of the 'think tank' of the Flemish Christian Democrat party. He accepted the mission, provided he could operate as an independent technician with the Banque Nationale's agreement. He was convinced that, while the Belgian economy was suffering the deepest crisis in Western Europe, maintaining a strong currency was intolerable<sup>70</sup>.

At the same time a team of economists from Université Libre de Bruxelles reached the same conclusions in their econometric studies. A forecasting study of the Belgian economy to 1985 revealed the likely worsening of the three main imbalances : unemployment, public deficit and current-account deficit. They pointed out that neither devaluation nor an incomes policy would be sufficient to restore

<sup>69</sup> A. Verplaetse, "Van devaluatie tot euro. Het economische en meer bepaald het monetaire beleid van België 1980-2000", in *Res Publica Belgica 1980-2000 "Beleid en besluitvorming"*, p. 5.

<sup>70</sup> For the 1982 devaluation events, see, H. de Ridder, *Le cas Martens*, (Paris-Louvain-la-Neuve, Editions Duculot, 1991), pp. 141 ff. and Janssens, *De beheerders...*, pp. 228 ff.

equilibrium and that only a general economic policy change would improve the situation<sup>71</sup>.

From the start, Alfons Verplaetse suggested devaluing the franc by 10%. He had to convince the Finance Minister and negotiate with the trade unions a suspension of the wage index-linking mechanism. The Finance Minister asked the Banque Nationale's advice on a possible devaluation. While he was unsatisfied with the theoretical considerations of the bank and was asking for further information, Alfons Verplaetse quickly devised a concrete devaluation programme with the King's chief of cabinet. The Belgian government secretly contacted the IMF without the knowledge of the Banque Nationale's governor. On February 19, the government advised governor De Strycker, who was about to retire, and his successor Jean Godeaux, of its decision for devaluing. Despite his strong opposition, the governor was compelled to defend the government's position at the summit meeting of the European Monetary Committee. After sharp discussions with its European partners, Belgium had to accept the German proposal for devaluing the franc by 8.5%. The devaluation was announced on February 21 with a temporary price and wage freeze to optimize its effects.

As in 1926 and 1935, the devaluation of 1982 had been prepared outside the Banque Nationale. It ended dramatically governor De Strycker's long career, dedicated to exchange stability. R. Beauvois qualified it as "the shameful devaluation" because its main promoters were linked to the Banque Nationale and had acted behind the governor's back<sup>72</sup>.

In the event, the 1982 devaluation confirmed the decline of the Banque Nationale's influence on economic policy since the early 1970s. During the following years, A. Verplaetse and its "Poupehan

<sup>71</sup> M.-C. Adam, M. Dewatripont, F. Thys-Clément, D. Van Regemorter, "La problématique du taux de change en Belgique : une approche macro-économique à moyen terme", *Cahiers économiques de Bruxelles*, n° 93, 1982, 1, pp.3-24.

<sup>72</sup> Beside Verplaetse who was an official of the bank, Jef Houthuys, head of the Christian Democrat trade-unions, was member of the regency council and Hubert Detremmerie, banker of the Christian Democrat organizations, was a member of the censor's college of the Banque Nationale (Janssens, *De beheerders...*, p. 230).

friends" were the main decision-makers of Belgian economic policy led by the numerous governments headed by Wilfried Martens<sup>75</sup>.

*Returning to stability.* Beside its technical effect on restoring international competitiveness, the main consequence of the devaluation was the psychological shock it generated. This allowed for a radical change in income and budgetary policy by putting pressure on the social actors. The fear of successive devaluations generated by inflation was turned to advantage by the government for carrying out a policy of stronger wage and price control. It used special executive powers to suspend the system of social programming and negotiate with the trade-unions new criteria for calculating index-linked salaries. The argumentation was based on avoiding inflationary pressures of the past and maintaining Belgian competitiveness with its main commercial partners. These measures produced an effective real-wage cut and a redistribution of primary income from households to firms. While the balance of trade was restored, government was less successful in restoring public finances. The "snowball" effect of rising interest charges on the government deficit could not be halted in spite of decreasing public expenditures. Growth remained very slow and unemployment went on rising and exceeded 10% until 1988. The inflation rate fell decisively from 1986<sup>76</sup>.

After the trauma of devaluation, the Banque Nationale's main priority was exchange stability in order to contain inflation. Under the governorship of Jean Godeaux it had first to restore trusting relations with the Luxemburg authorities that had not been informed about the Belgian government decision to devalue. During the years following the devaluation, the exchange rate was maintained at the average rate of the EMS currencies, with a progressive trend to bring it into line with the strongest currency, namely the German mark.

<sup>75</sup> This nickname refers to several meetings organized at Verplactse's week-end cottage in the small village of Poupehan between 1982 and 1987 with Prime Minister W. Martens, Jef Houthuys and Hubert Detremmerie.

<sup>76</sup> See n. 60.

On the domestic market the instruments of monetary policy were revised. Contrary to other countries, the Banque Nationale never used monetary aggregates to define its policy of monetary stability. Owing to the monetary union with Luxemburg and the openness of its capital market which experienced an extreme mobility of capital flows, defining growth standards for components of the money supply was useless. Therefore the central bank relied on macroeconomic analyses of the financial balances. During the 1980s, increasing deposits made banks ever more independent from the Banque Nationale. Discounting bills became obsolete. When the banks needed liquidity they were selling treasury bills, thus forcing the Treasury to borrow abroad; the borrowed currencies were in turn sold to the Banque Nationale, which was powerless in dealing with that liquidity creation. As a consequence, the treasury bill rate replaced the discount rate as the instrument for controlling credit. The discount rate's status symbol was formally abolished in 1985. The Banque Nationale also started the break up of the Fonds des Rentes, which was used by the Treasury for borrowing from the banks. Meanwhile, it began to sell its gold reserves. According to the law of 23 December 1988, the legal price of the Belgian franc in terms of gold was abolished. Notwithstanding its declining influence on banks, the Banque Nationale's ability to fix a liquidity reserve ratio was extended<sup>75</sup>.

With the return of A. Verplaetse, the Banque Nationale recovered influence on Belgian economic policy<sup>76</sup>.

During the nineties, the role of the central bank greatly changed both for external and domestic reasons. It contributed decisively in integrating Belgium in the European Monetary Union and in modernizing the money market and instruments of monetary policy.

<sup>75</sup> G. Quaden, "La nouvelle orientation de la politique de change en Belgique", in *La Revue Banque*, n° 517, juin 1991, p. 627-630. A. Verplaetse, "La politique monétaire du Benelux", in *Innovation, intégration : mélanges pour Pierre Werner*, (Saint-Paul Luxembourg, 1993), p.173-180. Janssens, *De beheerders...*, pp. 243 ff.

<sup>76</sup> A. Verplaetse came back as director of the Banque Nationale on January 1988. Five months later, he was appointed vice-governor and he succeeded Jean Godeaux as governor on July 1990 (Janssens, *De beheerders...*, p. 260).

Since the 1980s, the exchange-rate policy maintained the Belgian franc at the average rate of the EMS currencies, with a trend to bring it into line with the German mark. According to an IMF audit of the Belgian economic and monetary situation during the spring 1989, it was suggested that the Belgian authorities base their exchange policy on the EMS strongest currencies, namely the German mark and the Dutch guilder. The Banque Nationale came round to this position to reduce and later eliminate the remaining positive interest rate differential in relation to short-term investments in marks. As a consequence public-debt servicing would be alleviated and the stronger value of Belgian currency would reduce capital exports. In June 1990, the government decided officially to ratify this "hard-currency policy" by formally deciding to peg the franc to the German mark. A few months earlier, in March 1990, the two-tier exchange market had been abolished under pressure from European partners<sup>77</sup>.

With regard to domestic monetary policy, the Banque Nationale gave up regulatory instruments for market instruments. In this new process, it recovered more autonomy versus the government, while it regained influence over the financial intermediaries as far as short-term credit was concerned.

Since 1981, the Banque Nationale had given up addressing the financial institutions "monetary policy recommendations", such as limiting credit expansion or buying many treasury bills. According to a law of 2 January 1991, which reformed the financial markets, the Banque Nationale lost its discretionary power of fixing the rate for treasury bills in cooperation with the Finance Minister. The liabilities of the central bank and the Finance Ministry were now clearly separate. The Banque Nationale was solely responsible for interest rate and liquidity policy and had to use exclusively market instruments in orienting short-term interest rates. Its advances to the Treasury were limited to 15 billion francs instead of 181 billion. On the other hand, the treasury bill market was much changed. The old Monopoly of the consortium of Belgian

<sup>77</sup> Quaden, p. 628. Verplactse, "La politique monétaire du Benelux", pp.159-161. Janssens, *De bebeerders...*, p. 261.

banks was abolished. The Finance Ministry periodically put the treasury bills out to tender and opened the market to foreign banks.

By the renewal of its monetary instruments, the Banque Nationale intervenes in the money market with the aim of achieving everyday a global balance taking into account the interest rate it wishes to reach. Its main objective is to supply the economy with enough liquidity, while maintaining price stability. It grants advances for a week to banks, thus orienting interest rates via the amount of advances and the rate obtained by the banks. It intervenes in the market by buying and selling bills, by implementing open-market and inter-bank operations as well as currency swaps. Rediscounting trade bills has been restored, but in a very limited way. The Banque Nationale regains influence over the banks by offering them the opportunity to clear their operations at the end of each day, at a rate very close to the market rate, but sometimes higher.

By A. Verplaetse's involvement in the economic recovery policy of the 1980s, his return gave the Banque Nationale the opportunity to participate more actively in economic policy during the 1990s and to play a prominent part in Belgium's admission to the European Monetary Union. Under his governorship, the Banque Nationale extended its services to the community by developing numerous economic data banks and taking charge of the Belgian national accounts. In that way, it disposes of an outstanding information tool for implementing its policy.

While A. Verplaetse's participation in the so-called "global plan" and the reform of the wage-index-linking mechanism in 1994 is considered as a personal one, it must be pointed that for the first time, a Banque Nationale's governor used his position to advise publicly the government on economic policy. When the global plan was accepted, he pointed out openly the margins within the government could implement economic policy, in order to influence the employers and the trade unions. The governor's Commentary in the Banque Nationale's annual report has become an event followed by economic analysts. The report, now divided into three parts, is dedicated to the Banque Nationale central bank's activity, its third-party services and its participation in international institutions.

Under Verplaetse's leadership, the Banque Nationale decisively helped the government to fulfill the conditions of the Maastricht Treaty for admission in the EMU. As a matter of fact, Belgian political leaders have seized on the constraints of the Maastricht Treaty to carry on their rigorous income and budgetary policy. They were aware that referring to European Union pressure was the means for getting the popular consensus that they would not have obtained by themselves.

The main problems for Belgium were reducing the budget deficit to reach the standard of 3% of GNP and resolving the problem of its huge public debt, the standard being 60% of GNP. The Banque Nationale partly converted its gold reserves into foreign currencies investments and transferred this income to the state, thus contributing to reducing the budget deficit to the 3 % standard. Through gold arbitrages against foreign currencies, the central bank helped also to reduce the foreign public debt by half. Meanwhile, through domestic monetary policy and the management of public debt, the so-called "snowball effect" of public debt servicing was broken<sup>78</sup>. Although Belgium did not reach the public debt standard stipulated by the Maastricht Treaty, the spectacular recovery of its budgetary policy was recognized and it was admitted in the European Monetary Union in 1998. In this process, the Banque Nationale had played a leading part and the modernization of its monetary policy during the 1990s successfully prepared Belgian integration in EMU.

## **Conclusion**

The Banque Nationale's role in Belgian economic policy during the XXth century has evolved under the double characteristics of continuity and disruption. The First World War triggered a major disruption foreign exchange policy at the top of the central bank's concerns, while its activity had been centred before on supplying the needs of the domestic market.

<sup>78</sup> Janssens, *De beheerders...*, p. 262 ff. Verplaetse, "Van devaluatie...", pp.11 ff.

Without repeating comments on the prewar period, we shall point the factors of continuity and disruption from the end of World War I to Belgian entry to the EMU.

In the long run, monetary orthodoxy has prevailed in the leadership of the Banque Nationale, with a lasting devotion to the gold standard and traditional monetary instruments. Stability thus prevailed in the central bank's policy. Deeply aware of the dangers of cost-push inflation in a small open economy, the Banque Nationale defended strongly foreign-exchange stability. During the foreign exchange crisis, the board rejected devaluation and supported deflationary policies. Thus, despite changing circumstances, it is revealing that the devaluations of 1926, 1935 and 1982 were decided and implemented outside the central bank, but with the help of some experts or managers belonging to it. The monetary reform of 1944 was a similar case.

The failure of its deflationary policy always resulted in a lasting loss of influence of the Banque Nationale. However, devaluation was followed every time by a policy defending foreign exchange stability in order to avoid any further devaluation, thus giving rise to new criticism of the deflationary results of the bank's monetary policy.

Devotion to stable foreign-exchange systems and distrust of floating exchange rates are long-lasting features of the bank's policy. It participated in the *Bloc or*, supported the Bretton Woods system and contributed actively to European monetary integration.

Finally, despite major fluctuations in its relations with the State, the budget deficit and the public debt have been a permanent concern for the central bank since World War I.

Disruptions in the Banque Nationale's role occurred both under foreign and domestic circumstances. The two World Wars and the world crisis played a leading part.

These disruptions concerned mainly the balance of power between the central bank, the commercial banks and the State, but also the relationship of the central bank with enterprises.

During the interwar period, the influence of private banks prevailed on the financial market. The banking reform of 1935 limited

the bankers' power, increased state intervention without strengthening the Banque Nationale, which was side-lined when the Banking Commission was founded. Meanwhile the competition from private bankers had significantly reduced the central bank's operations with business firms.

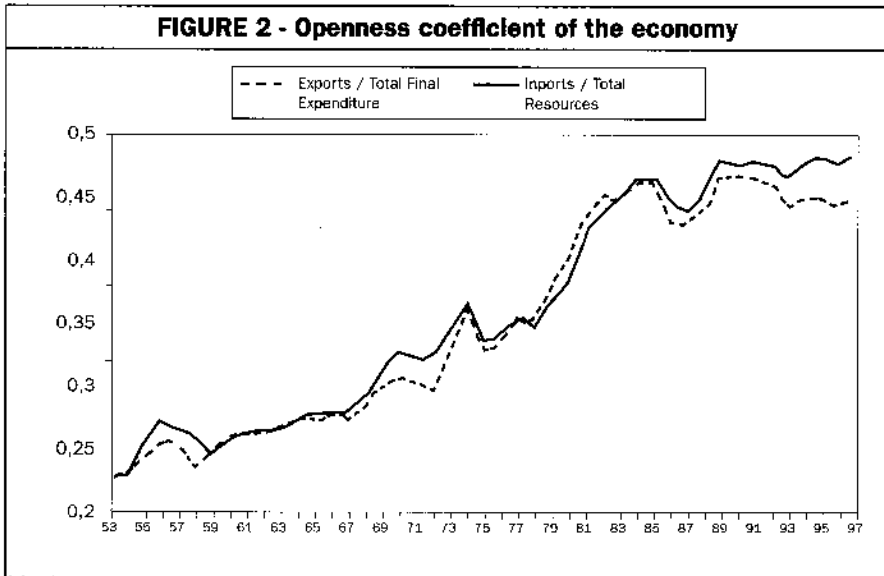
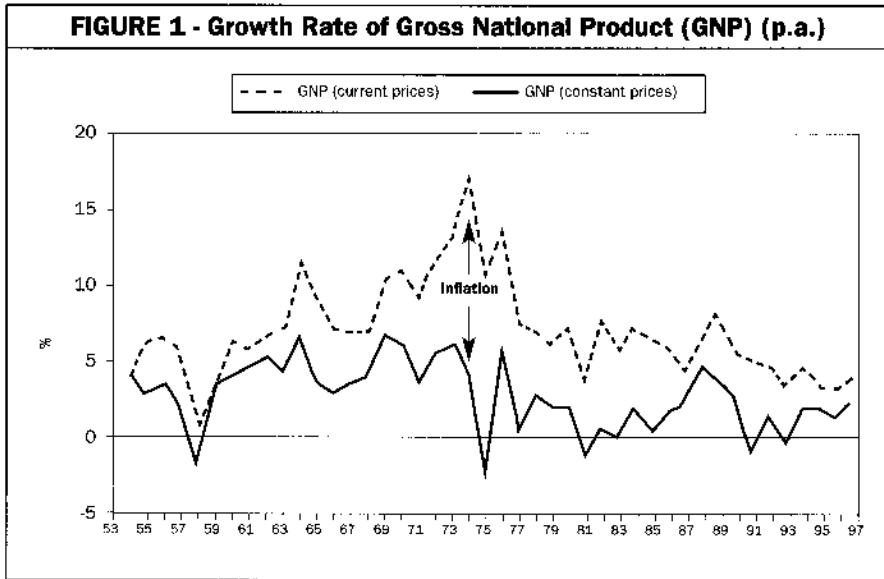
World War II benefited to the recovery of the Banque Nationale's influence on the financial market. While the private banks kept a lower profile in the mixed economy regime established in Belgium, the main issue was now to save the central bank's autonomy versus the government. Until the 1960s the Banque Nationale was able to maintain its policy of a strong Belgian franc. Afterwards, it lost its grip on monetary policy both for external and domestic reasons, mainly because of growing government intervention.

According to A. Verplaetse, the central bank's influence depends largely on the personal relationship between the governor and the Finance Minister. This is confirmed when analyzing this relationship during the past. The former governor also stresses that the central bank's power is limited to monetary policy ; it can only advise government on budgetary and incomes policy, which are central for economic prosperity. Economists, who are concerned about the European Central Bank and the member states' responsibilities in EU economic policy, share Verplaetse's acknowledgment of the central bank's limited role in growth and his opinion that central bankers should not intervene in incomes and budgetary policy. According to their opinion, the best contribution a central bank can make to long-run economic performance is a medium-term monetary policy oriented to price stability<sup>79</sup>.

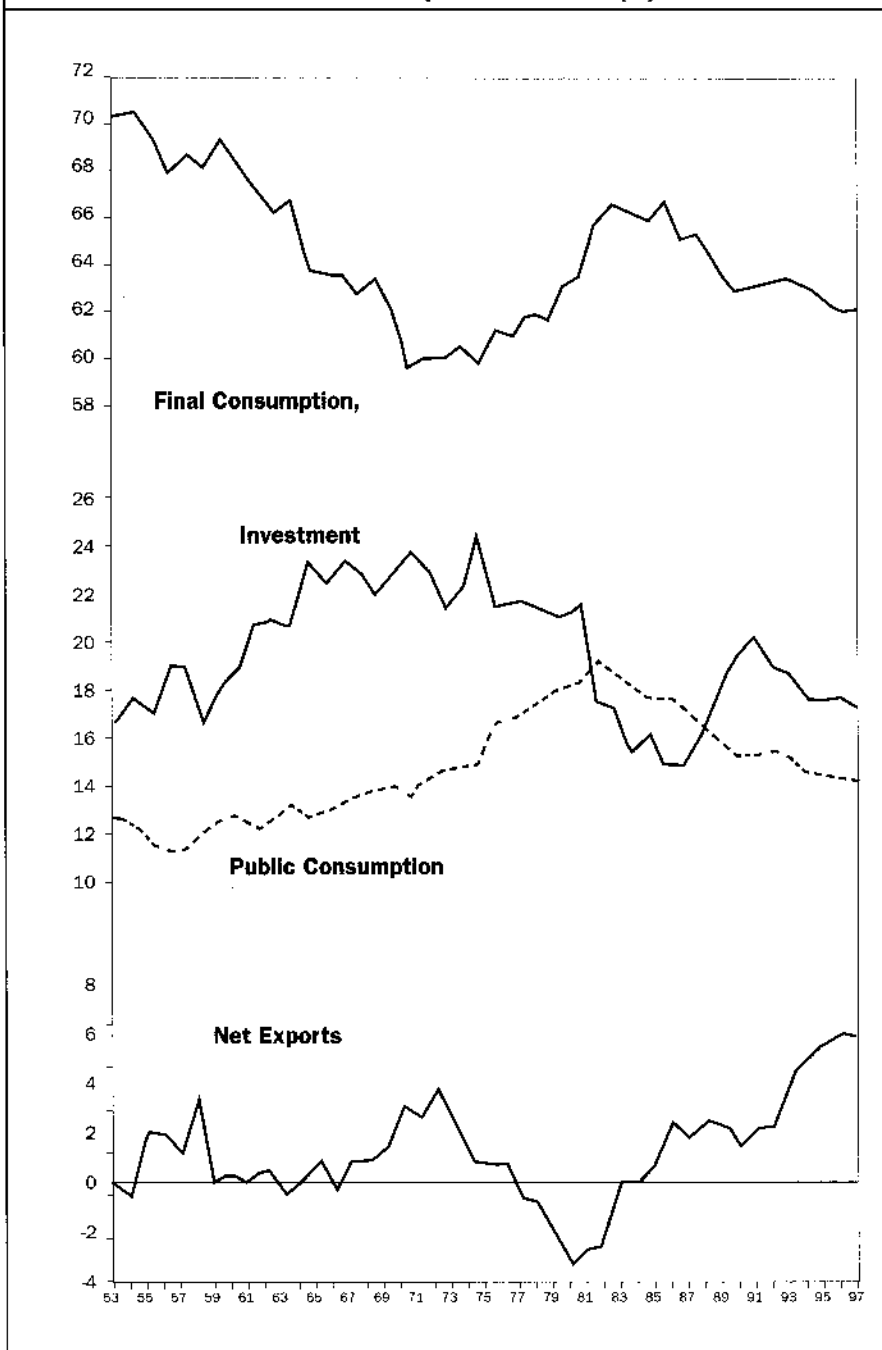
<sup>79</sup> O. Missing, "How to promote growth in the euro area : the contribution of monetary policy", paper delivered at the Conference of the National Bank of Belgium, 12 May 2000.

APPENDIX

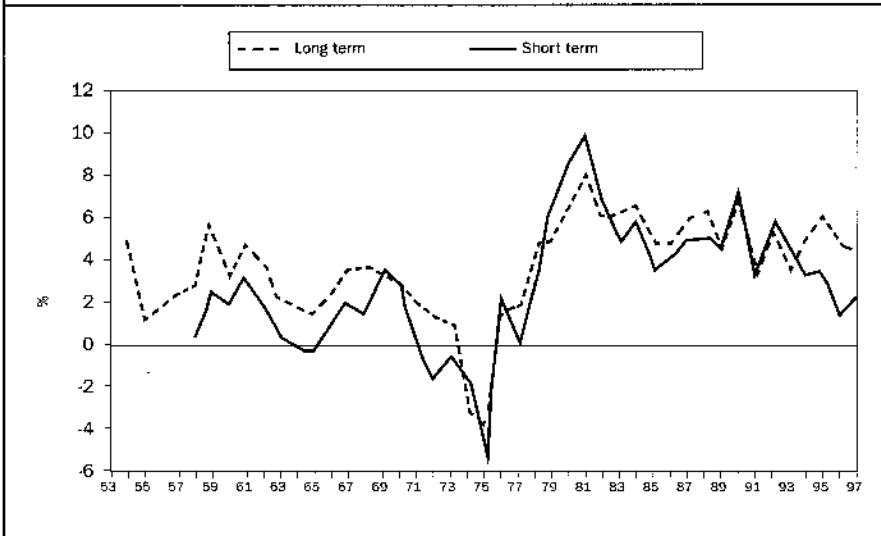
The following graphs are extracted from I. Cassiers and A. Durré, "Les tendances longues en graphiques", in I. Cassiers (ed.) *Que nous est-il arrivé? Un demi-siècle d'évolution de l'économie belge, Reflets et perspectives de la vie économique*, (XXXIX, 2000), n°1, pp. 155-169.



**FIGURE 3 - Components of GNP (%)**



**FIGURE 4 - Real Interest Rates (%)**



**FIGURE 5 - Unemployment rate (% of active population)**

