

Maes, Ivo

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A century of macroeconomic and monetary thought at the National Bank of Belgium

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A century of macroeconomic and monetary thought at the National Bank of Belgium



Working Paper Research

by Ivo Maes

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Jan Smets, Member of the Board of Directors of the National Bank of Belgium

Editorial

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Abstract

"A century of macroeconomic and monetary thought at the National Bank of Belgium" traces the history of economic research at the National Bank of Belgium, from the early decades of the 20th century to its present functioning in the Eurosystem. The study also goes into the major economic policy debates, as well as the specific lines of macroeconomic and monetary thinking at the National Bank of Belgium. The focus is very much on the role of the Research Department in policy-making and its dialogue (and debates) with the academic community.

Key words: National Bank of Belgium, central banking, monetary theory, economic research

JEL codes: A11, B22, E42, E58, N10

Corresponding author:

Ivo Maes, Research Department, NBB, Robert Triffin Chair, Université catholique de Louvain, HUBrussel and ICHEC Brussels Management School. E-mail: ivo.maes@nbb.be

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The views expressed in this paper are those of the author and do not necessarily reflect the views of the National Bank of Belgium or those of the institutions to which he is affiliated.

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1. INTRODUCTION

Economic research plays an important role in central banking. There are two key elements to any central bank's research department and those are contributing to monetary policy-making and sustaining a dialogue with the academic community. Research departments largely fulfil a bridging function between monetary policy-making and the academic world. This is more or less a constant in the history of the Research Department of the National Bank of Belgium as well as other central banks.

This study takes a look at how this analysis and research function has been developing over the years at the National Bank of Belgium. Throughout the study, the emphasis will be on the major policy debates and the specific lines of macroeconomic and monetary thinking at the National Bank of Belgium. The focus is very much on the role of its Research Department in policy-making and its interaction with the academic community.

The second section of this study looks back at the establishment and early decades of the National Bank of Belgium, which was founded in 1850 as both an issuing and discount bank. The monetary expertise then lay in the Board of Directors. It was only at the beginning of the twentieth century that a nucleus of an Economic Service started to emerge at the Bank.

In the third section, we analyse the interwar period. The monetary chaos after the First World War led to the formal establishment of an Economic Service at the National Bank in 1921. We further focus on the stabilisation plans for the Belgian franc in 1926 and the Great Depression of the 1930s, especially the 1935 currency devaluation and the fundamental reforms of the financial system.

The fourth section discusses the postwar period, extending to the end of the 20th century. The early postwar period saw the establishment of a fully-fledged Research Department at the NBB. In its early decades, it played an important role, not only in monetary and credit policy, but also in setting up business surveys and preparing the ground for major reforms of the financial system. The world-wide economic crisis of the 1970s hit the Belgian economy heavily. During the ensuing decades, the exchange rate of the Belgian franc became a major issue of economic policy debate.

With the advent of EMU and the introduction of the euro, the National Bank of Belgium entered a new era. This will be the topic of the fifth section. We will discuss how this has affected economic analysis and research at the National Bank of Belgium.

In the conclusions, we will present an overview of the Bank's research function. The overall assessment will focus in particular on the Economic Service's influence on economic and monetary policy-making in Belgium and its reputation in the academic world.

2 THE ORIGINS OF THE ECONOMIC SERVICE

In Belgium, as in other countries, financial crises highlighted that the stability of the monetary system was a matter of public interest. The banking crises of 1838 and 1848 gave Walthère Frère-Orban, the then Minister of Finance, the impetus to draw up a plan to establish an issuing and discount bank (Buyst, Maes et al., 2005). The law founding the National Bank was signed on 5 May 1850. It gave the National Bank three important missions, typical for an issuing and discount institute: the issue of banknotes, the organisation of short-term commercial credit, in particular the rediscounting of commercial paper, and the function of State cashier.

The National Bank took off quickly. Its activities are brought to the fore in its balance sheet. Two main items dominated the assets side, namely precious metals and discount credit. The liabilities side is dominated by banknotes in circulation.

Table 2.1 Balance sheet of the National Bank of Belgium in 1910
(in millions of Belgian francs)

Assets		Liabilities	
Gold and silver reserves	376.8	Banknotes in circulation	904.5
Discount credit and bills for collection	524.5	Current accounts	105.1
Public funds	94.8	Nominal capital	50.0
Advances on public funds	88.4	Reserves, depreciation and non-distributed profits	54.6
Sundry	41.7	Sundry	12.0
Total	1 126.2	Total	1 126.2

Source: Annual Report of the National Bank of Belgium, 1910.

Originally, banknotes represented claims on metal standard money and were intended mainly to facilitate large-value payments. At the end of the 19th century, banknotes became more widely established as payment instruments. The large-scale replacement of coins by notes also led to a growing concentration of the country's stock of precious metal at the National Bank. Thus, the National Bank played an ever-growing role in settling the balance of payments, and became the custodian of the country's international payment instruments. As noted by A.-E. Janssen, this contributed to the growing importance of the "*monetary*" function of the National Bank, as

compared to its "*credit*" function of providing discount credit (A.-E. Janssen, *Comment par une lente évolution la fonction monétaire de l'Institut d'émission est devenu dominante*, AEJA).

In the early decades, the National Bank's monetary expertise lay almost exclusively with the Board of Directors, with eminent specialists like François Depouhon, Jonathan-Raphaël Bischoffsheim and Eudore Pirmez. The National Bank also gradually built up a statistical capacity. This was, at least initially, very much focused on its own activities and boosted by the Bank's obligation to publish an Annual Report.

The origins of the Economic Service at the National Bank of Belgium can be traced back to the establishment of the library in the beginning of the 20th century (Maes and Buyst, 2005a). When the National Bank was founded in 1850, the need for documentation was limited and involved more or less exclusively the Board of Directors, where the monetary expertise of the Bank lay. It concerned mostly legal publications as well as monetary studies, especially ones related to the Latin Monetary Union (Maes, 1953, p. 471).

A key role in setting up the library, as well as the Economic Service, was played by Albert-Edouard Janssen. Janssen was a student of Victor Brants at the University of Louvain, where he obtained degrees in Law, in 1907, and in Political and Diplomatic Sciences, in 1909.

Janssen's doctoral dissertation, "*Les conventions monétaires*" (Monetary unions, Janssen, 1911), discussed international monetary relations, from both a legal and an economic perspective. The main body of the book contained a detailed analysis of the German, Scandinavian and, in particular, Latin Monetary Unions.

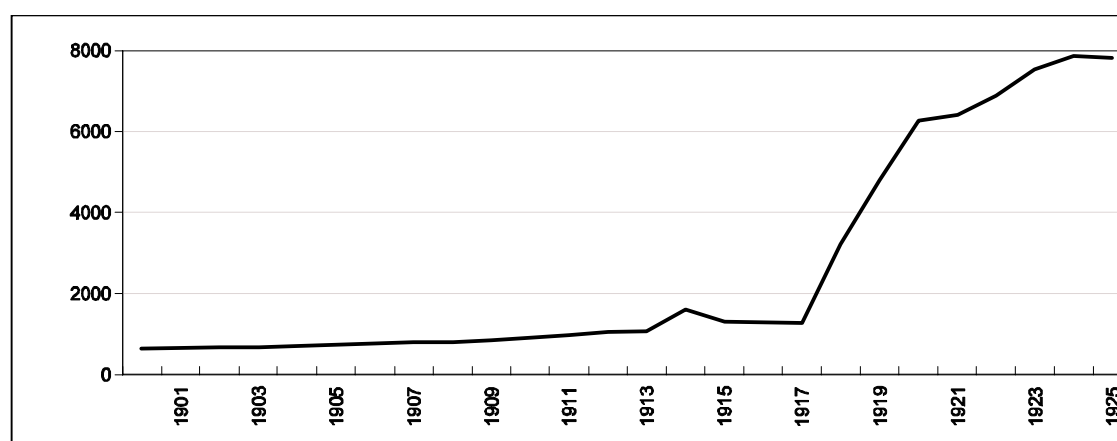
Recruited by the National Bank in 1908, Janssen made a quick career, becoming Secretary of the Bank in 1914 and Director in 1919. Describing his role in the first part of the history of the National Bank of Belgium, Pierre Kauch wrote:

"The Bank only extracted itself from its apathy after bringing into the Legal Unit a young man with a doctorate in Law, very curious about everything to do with currency and credit: A.E. Janssen ... He soon became a rising star, thanks to his analyses that stimulated Board members, even those less open to new ideas, into reconsidering conventional and outdated concepts. He also took on the role of a mentor ... and created a dynamism which eventually gave the Bank back the vitality that one might have thought to have been exhausted" (Kauch, 1950, p. 255).

3 THE FORMAL ESTABLISHMENT AND FIRST DECADES OF THE ECONOMIC SERVICE

The First World War marked a break in the economic and social order. The war was also a catastrophe for the Belgian economy. Manufacturing activity came to an almost complete standstill. Meanwhile, the heavy war levies had been largely financed by money creation. The increase in the money supply received a new and even bigger impetus when the German authorities started paying in marks for their purchases in Belgium at a compulsory, overvalued, exchange rate. As a consequence of the war, the money supply rose by a factor of six, which created severe inflationary pressures (Buyst and Maes, 2007).

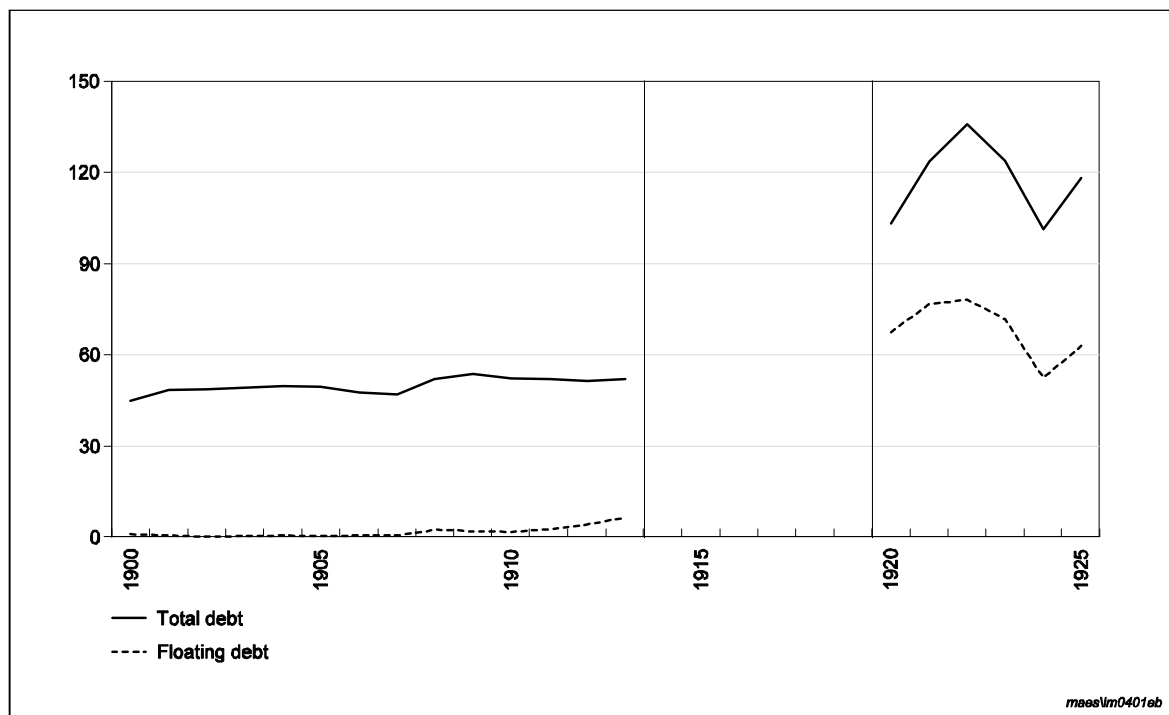
Chart 3.1 - Banknotes in circulation, 1900-1925
(millions of Belgian francs)



Source: NBB.

The expectation of German war reparations tempted the Belgian government into a lax budgetary policy. As a result, both the budget deficit and public debt skyrocketed. Moreover, the composition of public debt changed dramatically after the First World War. Continuous price increases eroded investors' confidence in long-term loans, so that the government increasingly had to rely on short-term credit. Moreover, the public sector's borrowing requirements could no longer be placed on the domestic market. Short-term foreign credits were thus indispensable. Consequently, Belgium's public finances became extremely vulnerable to financial crises. These lax budgetary and monetary policies also affected the balance of payments. The Belgian current account recorded deficits of 8 to 10% of GNP per year in the early 1920s (Buyst, 1997). All these imbalances only served to undermine confidence in the Belgian franc.

Chart 3.2 - Belgium's public debt, 1900-1925
(as a % of GNP)



Note: central government only.

Source: Pirard, 1999 and Buyst, 1997.

So, after the First World War and the ensuing economic problems, the need to reinforce economic analysis at the National Bank became paramount. During discussions in the Board of Directors, Janssen argued strongly in favour of formally establishing an Economic Service (Van der Wee and Tavernier, 1975). He also had a brilliant student at the University of Louvain, in the name of Paul van Zeeland, who he had been steering towards the leadership of this new Economic Service.

Like Janssen, Paul van Zeeland had studied Law and Political and Diplomatic Sciences at the University of Leuven/Louvain. In 1920, along with the first group of "*CRB fellows*", he went to Princeton University to study Economics (Report by Paul van Zeeland, BAEFA). As advised by Janssen, van Zeeland followed several courses by Professor Edward Kemmerer, a famous "*Money Doctor*". Moreover, during the winter break, he effected a stage at the New York Federal Reserve Bank. He also wrote a paper on "*The Financial and Monetary Crisis in Belgium*" (Report by Paul van Zeeland, PUA).

So, by the time van Zeeland returned to Belgium in 1921, he had acquired a profound knowledge not only of monetary economics but also of how economic research at a central bank should be organised. So, it came as no surprise that Paul van Zeeland was recruited as an advisor to the Economic Service at the National Bank of Belgium on 1 October 1921 (Dujardin and Dumoulin, 1997).

During the following years, the Service expanded (Maes and Buyst, 2005a), with Jean-Jacques Vincent being appointed Deputy Head in December 1922. In 1924, the year that van Zeeland became Secretary, Louis Mahieu joined the group. Then, in 1925, two brilliant young economists were recruited, namely Léon-H. Dupriez and Robert Lemoine.

The formal organisation of the Economic Service gradually began to take shape. According to the 1928 Internal Rules of Procedure of the National Bank, the Economic Service was made up of five sections: Library, Documentation, Statistics, Research and Publishing.

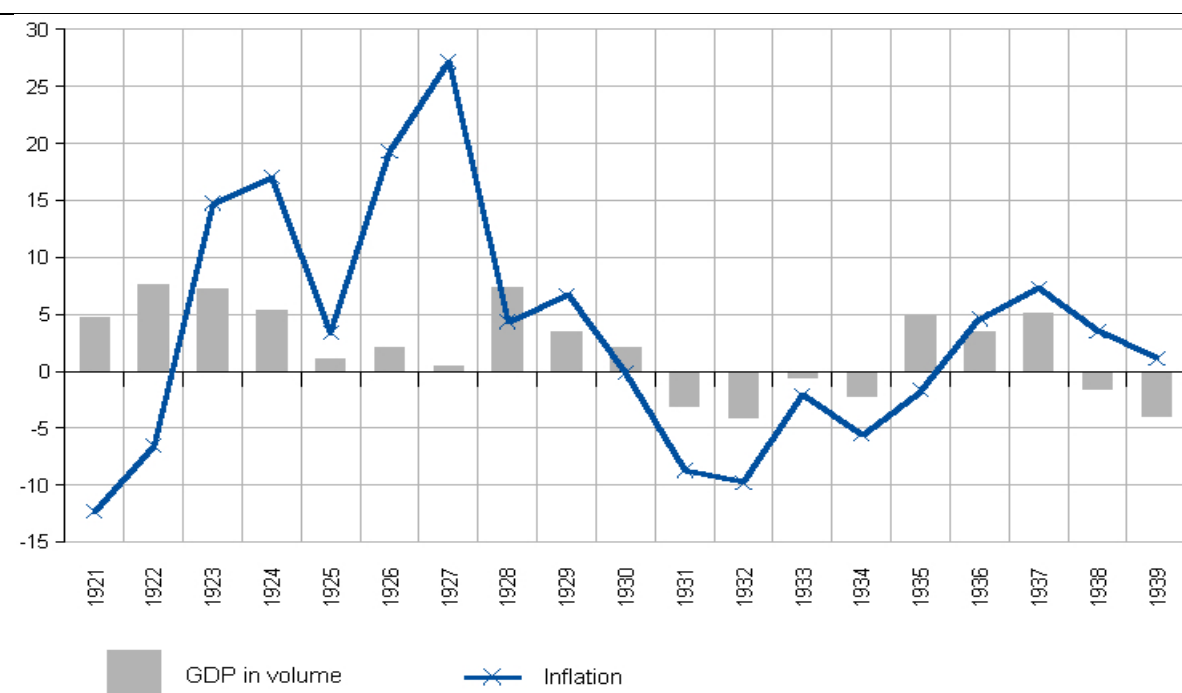
An important step in the development of the Economic Service was the creation, in June 1926, of the *"Information and Documentation Bulletin"*, now known as the *"Economic Review"*. Fernand Baudhuin (1946), considered it as Belgium's first economics journal. Initially, the Bulletin was divided into three parts: financial issues, industrial, commercial and agricultural issues, and statistics.

Meanwhile, different Belgian governments struggled to get the monetary chaos under control. In June 1925, there was a radical shift of power on the Belgian political scene with the Poulet-Vandervelde government. The new government was supported by the Socialists and the Labour wing of the Catholic Party. Albert-Edouard Janssen became Finance Minister, with the responsibility for drawing up a stabilisation plan. It was a very delicate operation, with Janssen himself describing it as having to *"carry out surgery on a train travelling at 150 kilometres an hour"* (Vanthemsche, 1978, p. 169).

Janssen's plan contained three key elements: stabilising the Belgian currency at a rate of 100 francs to the pound sterling, issuing a long-term foreign loan of 150 million dollars and raising tax to cover the budget deficit. However, the consolidation of the floating debt would only be tackled after the stabilisation of the franc. It would prove to be a major weakness of the plan.

As the government failed to obtain a loan on the international financial markets, the stabilisation plan derailed and Janssen had to resign in April 1926. It would remain a major trauma for the centre-left in Belgium. Only in October 1926 did a new government of national union, with Emile Francqui of the Société Générale as the dominant force, succeed in stabilising the Belgian franc, albeit at a parity of 175 francs to the pound sterling, a much lower exchange rate than the National Bank would have liked. The undervalued exchange rate led to a strong recovery, but also an upsurge in inflation, surpassing 25% in 1927 (Heremans and Tavernier, 1980, p. 129).

Chart 3.3 - Economic growth and inflation in Belgium, 1921-1939
(percentages)



Source: NBB.

A few years later, Belgium, as a small and open economy, was badly hit by the Great Depression of the 1930s and especially by the sharply contracting world trade and plummeting international prices. Yet, in Belgium, there was unanimous support for maintaining the existing gold parity, even after the devaluation of the British pound in September 1931 (Buyst, Maes et al, 2005). The difficulty in stabilising the franc in 1926 was still too fresh in everyone's memory.

There was thus no real alternative to a deflationary policy, under which domestic prices had to be adjusted to the lower world market price level by cutting costs. However, implementation of this deflationary policy came up against stiff resistance. Company closures and restructuring led to a further rise in unemployment. The Belgian economy went straight into a downward spiral. The financial system was also hard hit and a few banks even went bankrupt.

The deflation prompted major debates within the Bank's Economic Service. Gradually, the advocates of devaluation gained ground (Van der Wee and Tavernier, 1975, p. 279). So, in a memorandum dated 15 March 1935, Lemoine, who was earlier against devaluing the franc, put up a case for an immediate and official devaluation. However, the opinions of Vice-Governor van Zeeland and the Economic Service were rejected by Governor Franck. The 1926 gold franc remained his top priority and the National Bank's gold reserves were, in his view, amply sufficient to ward off an attack on the Belgian franc.

In March 1935, the political cards in Belgium were radically reshuffled. Paul van Zeeland was instructed by King Leopold III to form a government of national unity. As soon as van Zeeland was appointed Prime Minister, he wanted to devalue the franc immediately. This led to an embarrassing confrontation between the former Vice-Governor of the Bank and Governor Franck. By Royal Decree dated 31 March 1935, the franc was devalued by 28%.

The van Zeeland government also brought in important reform measures in the financial system. Earlier, whilst a minister in the de Broqueville government in 1934, van Zeeland had played an active role in the preparation of the Royal Decrees splitting up the mixed banks into deposit banks and holding companies (Van der Wee and Tavernier, 1975, p. 275). The van Zeeland government, with Hendrik de Man, took the view that the banking sector performed a function in the public interest. So it was perfectly reasonable for the State to have some control over the banks' activities. This was set out in the Royal Decree No. 185 of 9 July 1935. Preliminary drafts of this Royal Decree were prepared by Léon-H. Dupriez and Robert Lemoine, who were then detached from the NBB's Economic Service (Van der Wee and Tavernier, 1975, p. 297). At the heart of the new financial system was the Banking Commission. This institution had the power, among other things, to require the banks to maintain a liquidity ratio and a solvency ratio.

The Royal Decree of 9 July 1935 also led to the creation of a new service in the National Bank for the analysis of banks' financial statements, entitled "*Contrôle des Situations Bancaires*" (Control of Banks' Financial Statements) (Internal Regulation, 1940, NBBA B309). This service became responsible for activities relating to statistics, control and analysis of banks' accounts and balance sheets. In a major internal reform in 1948, the service was merged with the Economic Service, thus creating a new "*Research Department*".

4 THE SECOND HALF OF THE 20TH CENTURY

In Belgium, the neo-classical tradition in economics remained strong, in the early postwar period as well (Maes and Buyst, 2005b). Postwar economic policy in Belgium was also very closely in line with the classical orthodoxy. At the heart of policy-making was the so-called "*Gutt operation*" of September 1944, named after the then Belgian Finance Minister Camille Gutt (Cassiers and Ledent, 2005). The basic challenge was the enormous increase in the volume of banknotes in circulation, due to the war financing. The monetary and financial chaos after the First World War was a major trauma for policy-makers. So, the crucial aim was to avoid a repetition of such monetary turmoil.

In the early postwar period, under the governorship of Maurice Frère, the National Bank of Belgium strongly adhered to orthodox monetary views. Frère's ideas on the nature of monetary and budgetary policy were summed up in his remarks to Albert-Edouard Janssen, who was Finance Minister from 1952 to 1954: "*if you keep a firm hand on the State expenditure tap and I do the same for credit, nothing can go basically wrong*" (as quoted in Janssens 1997, p. 265).

However, Keynesian ideas were gaining influence at the National Bank of Belgium too. An important role here was played by Franz De Voghel, who became Director in November 1944 and was responsible for the Research Department. A blueprint of De Voghel's ideas can be found in a presentation dating from December 1943, entitled *"Les conditions préalables d'une politique du crédit en fonction d'une politique économique en Belgique"* (Preconditions for a credit policy appropriate to economic policy in Belgium) (NBBA, E588). De Voghel's ideas were quite eclectic, combining very Keynesian and interventionist ideas with a profound preoccupation for monetary stability. In his view, *"economic policy must aim to ensure stable prosperity for the country"*. He further elaborated on the notion of stability and stressed its importance, *"The notion of stability is an essential concept because we know that it is relatively easy to bring about short-lived prosperity. Devaluation is one of these extremely easy means which we have already used improperly. But stability is quite another thing. I would go even further to say that this is the real problem"* (a thinly veiled criticism of Francqui's devaluation in 1926).

For De Voghel, an essential function of the State was the organisation of a structural economic policy. At the heart of this policy was the determination of investment, not only public but also private investment. In line with ideas on indicative planning, like in France in the postwar period, he considered that the State also had a role to play in the sectoral allocation of investment.

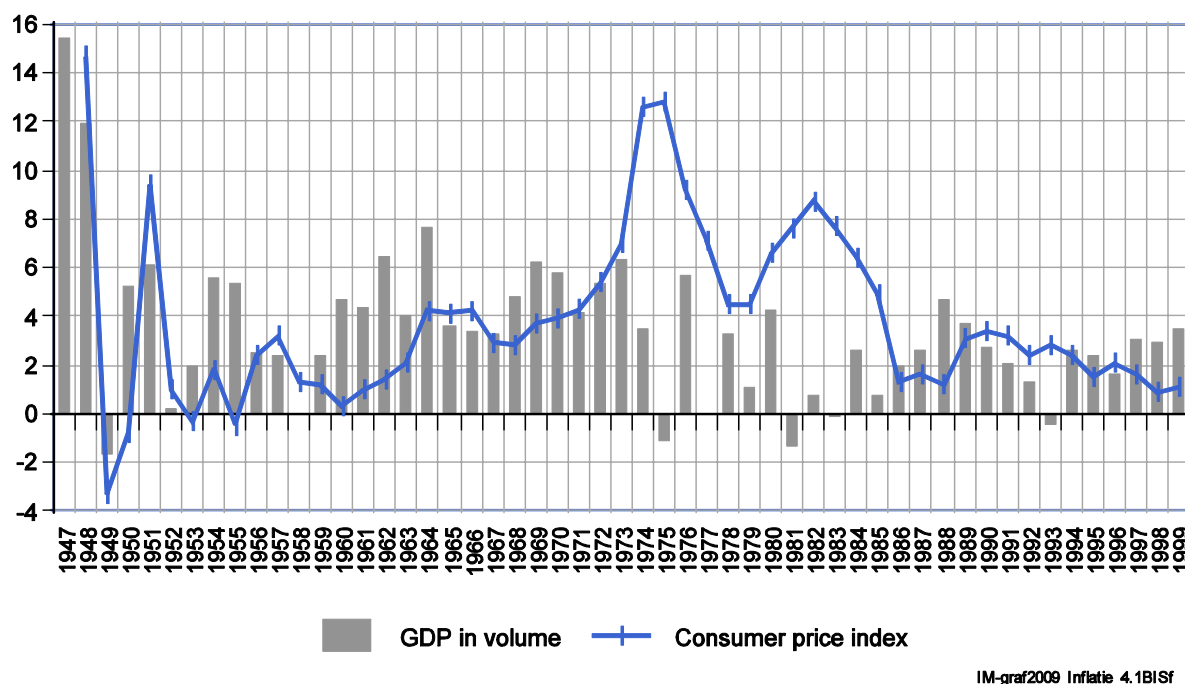
So, notwithstanding a different philosophical approach, in De Voghel's view, just as in Frère's opinion, credit policy had a crucial role to play in Belgian economic policy. In the decades following the war, times of limited capital mobility, monetary policy in Belgium became to a large extent credit policy, whereby quantitative control instruments had a significant role to play. Given the importance of credit policy, De Voghel radically reorganised the National Bank's economic research function. In 1948, a Research Department was established. Within it, there were three services: Studies and Documentation (the old Economic Service, but without the Statistics Division), Statistics, and Bank Credit. The establishment of an autonomous Statistics Service, earlier part of the Economic Service, pointed up the growing importance of statistical data. The Bank Credit Service was the Control of Banks' Financial Statements Service in charge of controlling banks' accounts. With this reform, De Voghel gave the Research Department an important role in the formulation of monetary and credit policy.

In the early postwar period, business cycle analysis became one of the focal points of the economics profession. It was, as early as the interwar period, also one of the strong points of economic research at the National Bank of Belgium, under the influence of Léon-H. Dupriez. In a meeting of the Board of Directors of 16 September 1949, De Voghel complained that the data for economic analysis (balance sheet data of firms) were only available with significant time lags. The Research Department, probably under the impulse of Pierre Kauch, therefore intended to contact the most important firms directly to get better information on current economic developments.

When, in 1950, the *Institut für Wirtschaftsforschung*, the Munich-based institute for economic research, launched a new system of business cycle surveys, this also attracted economists from

the National Bank's Research Department (Pluym and Boehme, 2005). From 1952, the National Bank's Research Department started work on trial surveys. This provided the basis for the business cycle surveys which are still a well-known product of the National Bank of Belgium.

Chart 4.1 - Growth and inflation in Belgium, 1947-1999
(percentages)



Source: NBB

In the Golden Sixties, economic growth, and also planning, took centre stage, in line with the dominant Keynesian ideas at the time. It applied to the financial area, too. As in other countries, successive governments set up study groups to develop blueprints for reforms of the financial system. Via these reforms, the key objective was to stimulate investment, and, along with it, economic growth. In Belgium, there were three important committees, which were all chaired by Vice-Governor Franz De Voghel. The Bank's Research Department played a crucial role in these committees and the reports that they prepared. The De Voghel reports would lay the basis for the modernisation of the Belgian financial system in the 1960s and 1970s.

In this period, for almost three whole decades, the Bretton Woods system was the main guideline for monetary and exchange rate policy in the Western world. For Belgium, too, the Bretton Woods Accords formed the linchpin of monetary and exchange rate policy.

Until the 1970s, Belgium was not confronted with major external imbalances and the Belgian franc did not come under significant pressure. The parity of the Belgian franc remained unchanged, with

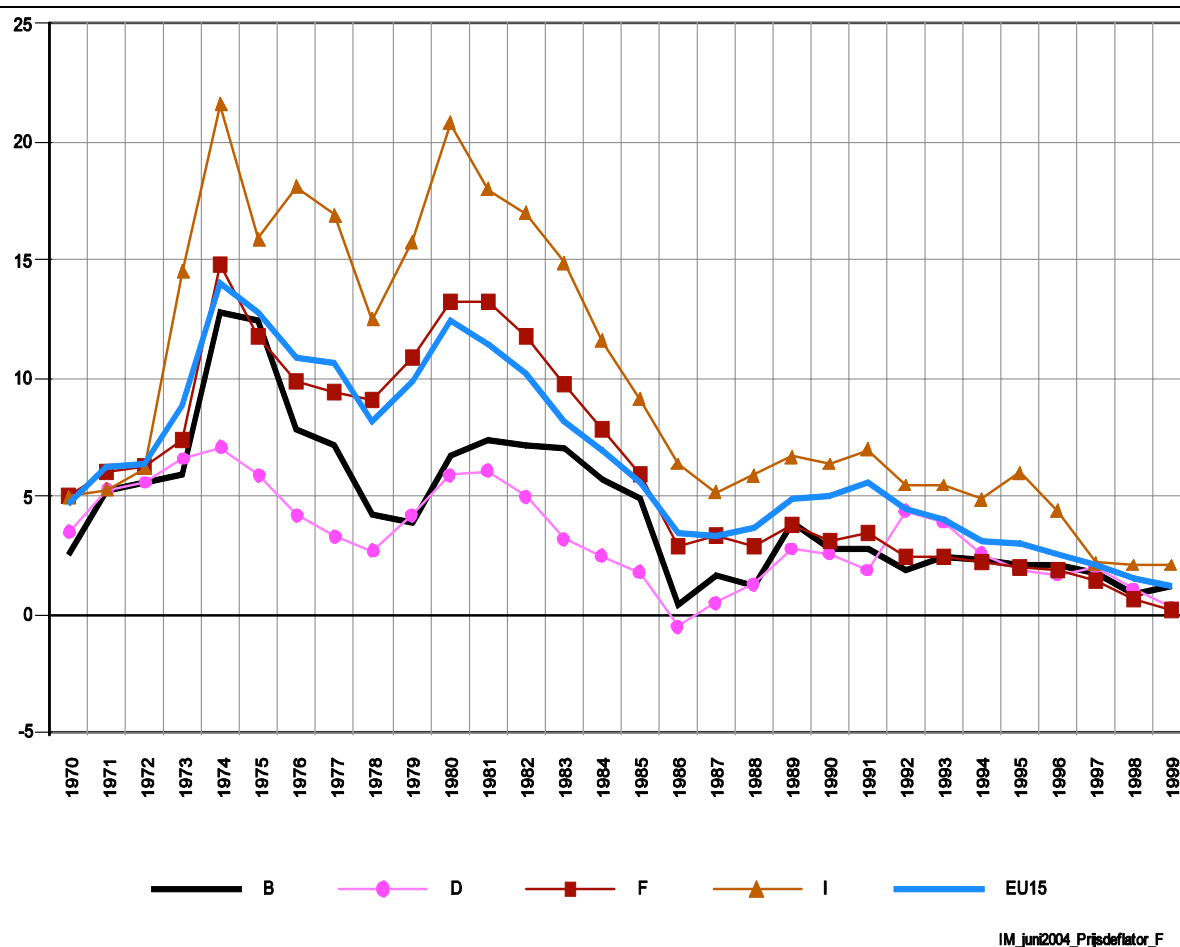
one exception. In September 1949, during a general realignment of parities, the franc was devalued by 12.345% against the dollar, contrary to the ideas of Governor Frère. According to Gaston Eyskens (1993, p. 268), then Prime Minister, Frère was in favour of letting the Belgian franc float. However, there were certain divergences at the National Bank, as De Voghel was in favour of a significant devaluation (more than 20%). In the end, as other currencies were devalued by much more, this realignment constituted an effective appreciation of the Belgian franc.

After the breakdown of the Bretton Woods system, in the period from 1970 to 1998, a stable exchange rate for the Belgian franc, first in the European currency snake and then in the European Monetary System, remained the primary objective of monetary policy.

The early 1970s were a turbulent period for the world economy, with rapidly rising inflation and turmoil on the foreign exchange markets. The end of the fixed exchange rate system and the first oil crisis in October 1973 created confusion and uncertainty. The oil shock not only drove up inflation, but also had repercussions on economic activity. The ensuing years were characterised by "*stagflation*". As remarked by the Bank in its 1974 Annual Report: "*The myth of 'inflation as a factor of growth' has been destroyed*" (p. XXI).

The Belgian economy was harder hit by the international economic crisis than some other countries (Buyst, Maes et al., 2005, p. 216). By 1974, inflation in Belgium had reached almost 13%, which was significantly higher than the rates at the time in the Netherlands and Germany, namely 10 and 7% respectively. The Bank was concerned about this, and the May 1975 edition of its Bulletin contained a study devoted to the topic.

Chart 4.2 - Inflation in Europe, 1970-1999
(change in the private consumption deflator, percentages)



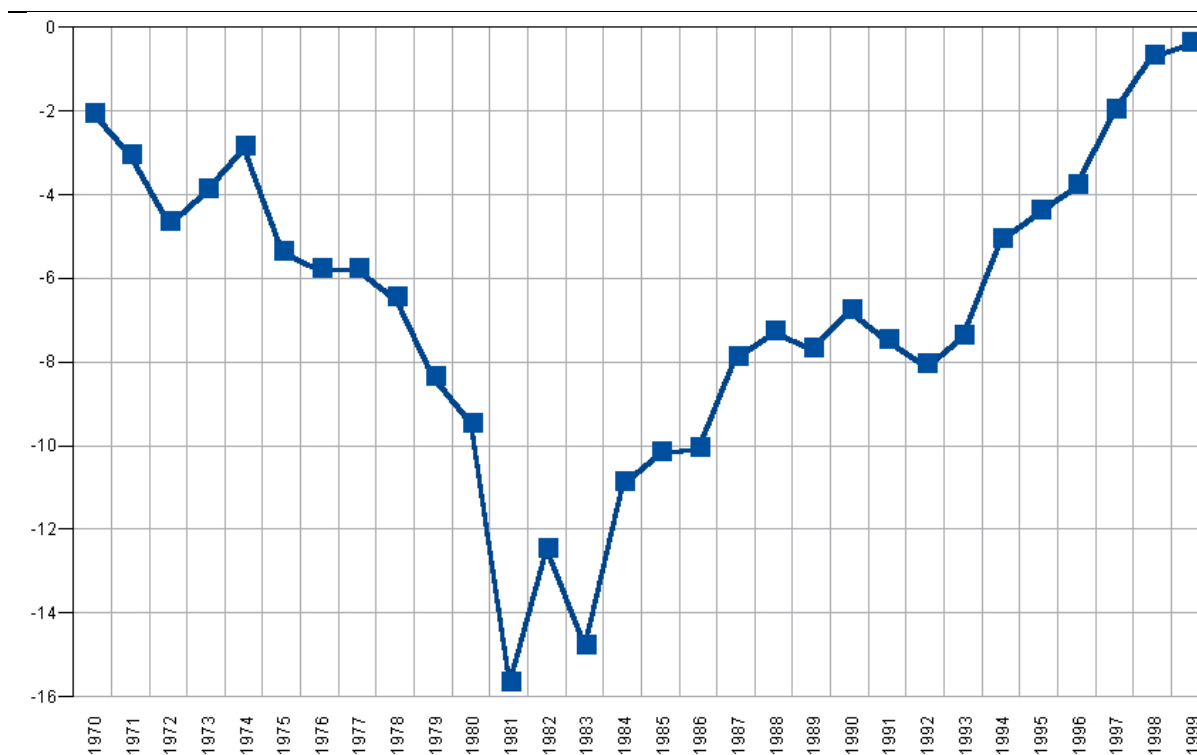
Note: 1970-1991: West Germany
Source: European Commission

The Research Department considered that Belgium's higher inflation rate was due to certain structural characteristics of the Belgian economy combined with the failure of economic policy. Two characteristics of the economy were important: Belgium's heavy external dependence, especially with regard to energy, and the close interaction between prices and wages. Belgium's weak structural position was further exacerbated by an inappropriate economic policy.

Fiscal policy was getting out of hand. In 1975, the budget deficit rose to 5.4%, against 2.9% in 1974. In the light of this sharp deterioration in public finances, Finance Minister De Clercq set up a technical working group "to formulate proposals with a view to the immediate curtailment of the State's borrowing requirement". The group was chaired by the former Prime Minister Jean Van Houtte. Much of the analysis was done by the NBB's Research Department. The Van Houtte Report remarked that an excessive increase in public spending inhibited economic growth and fuelled inflation, "which in turn inevitably leads to a crisis, ultimately also threatening employment".

Unemployment will, in turn, lead to higher public spending and lower tax revenues, *“thus creating a vicious circle which is bound to spiral out of control”*.

Chart 4.3 - Budget balance in Belgium, 1970-1999
(percentage of GDP)



Source: National Accounts Institute.

However, the Van Houtte Report had little impact. In the 1970s, the political agenda in Belgium was dominated by the problems concerning the various Regions and Communities, which meant that the policy-makers were paying little attention to the economic challenges of the moment. Political instability also prevented an effective economic policy. Furthermore, interest rates were rising, placing further strain on public finances. In 1981, a disastrous year for the Belgian economy, the public deficit totalled more than 15% of GDP.

In the second half of the 1970s, Belgium's competitive position became a crucial concern for policy-makers (Buyst, Maes et al., 2005, p. 221). The National Bank was highly sceptical that a devaluation could improve competitiveness. It feared that the price advantage of a devaluation would soon be eroded, in view of the high degree of openness of the Belgian economy and of the indexation and price-setting processes. The Bank was extremely afraid of a vicious circle, namely a devaluation followed by inflation and further devaluations, as had happened in the United Kingdom and Italy.

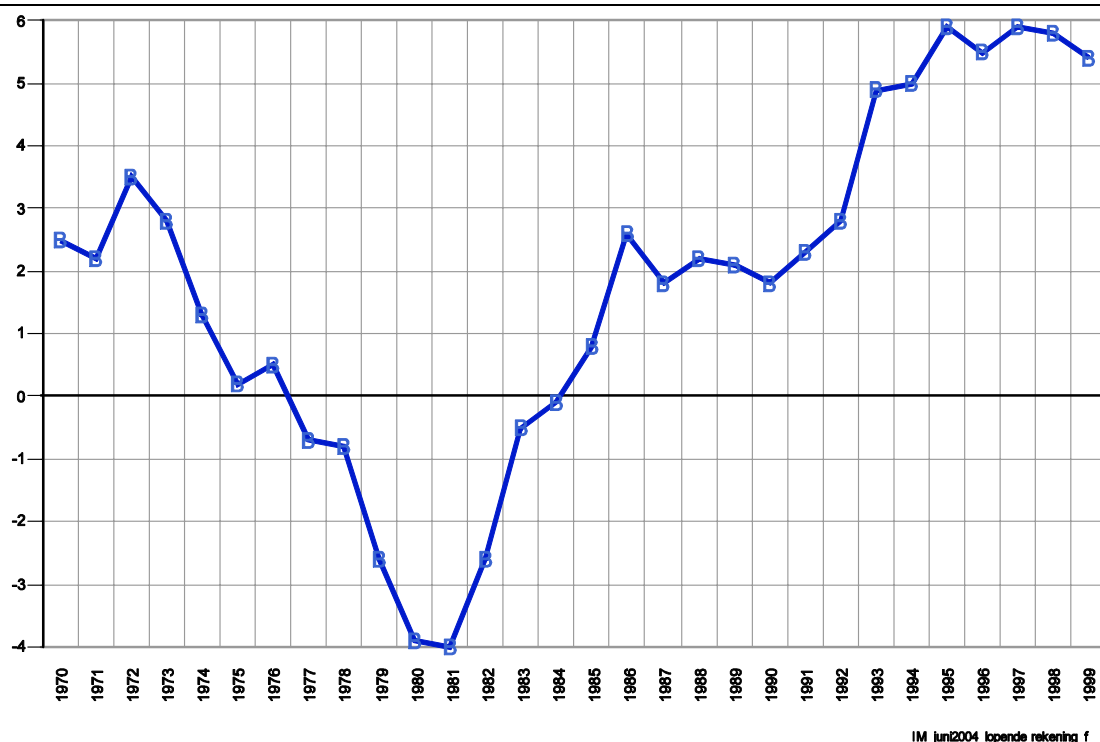
In 1979, the Belgian economy was hit by the second oil shock. In a speech prepared by the Research Department, Governor de Strycker remarked: *“In accordance with the recommendations*

of the international institutions, we must not repeat the error committed in 1974-1975, which consisted in transferring from households to businesses, and also to the State, the inevitable impoverishment that results from higher prices of imported energy. Such an approach is bound to mean further excessive increases in the level of prices and costs, lower investment and yet more unemployment” (de Strycker, 1980). It was wishful thinking.

At the end of the 1970s, the balance of payments current account went deep into the red. The deficit grew from 1% of GDP in 1978 to 4% in 1980. Key factors here were, of course, the second oil shock and the increase in energy prices, but other elements also played a role.

In an all-important study entitled *“The Belgian economy’s loss of vitality in the past decade”*, the NBB analysed the deterioration in the balance of payments on current account. This study, which ran to 272 pages, was published between September 1980 and July 1981 in four issues of the Bank’s Bulletin. The Bank argued that Belgian industry had to contend with two major handicaps. The first concerned the structure of exports. Belgium was too highly specialised in *“regressive”* products, that is, products for which world demand was growing only slowly. Furthermore, in comparison with its competitors, Belgium had little presence in geographical regions producing strong growth. The second, even more serious handicap, was the weakening of industry’s competitiveness. The primary reason for this was the increase in labour costs, which had compressed profit margins. As a result, manufacturing industry was obliged to drive up productivity, and that also entailed closing down plants. The outcome was a *“de-industrialisation”* of the Belgian economy. In addition, the erosion of profitability damaged investment and employment. The unemployment rate in Belgium rose from 2% in the early 1970s to 11% in 1982.

Chart 4.4 - Balance of payments on current account of the Belgium-Luxembourg Economic Union, 1970-1999
(percentage of GDP)



Sources: National Accounts Institute, European Commission for Luxembourg's GDP.

At the March 1981 European summit, the then German Chancellor Helmut Schmidt raised the issue of the Belgian franc and asked Belgium to take action, especially in regard to the indexation mechanism (Buyst, Maes et al., 2005, p. 224).

Over the next few days, the foreign exchange markets were extremely turbulent and the National Bank was forced to provide strong support for the franc. The NBB prepared an economic adjustment plan, engineered by Roland Beauvois, the Director of the Research Department. Crucial measures were a 5% cut in all incomes, and a suspension of the index-linking until 31 December 1981.

Governor de Strycker discussed the adjustment plan on Saturday 28 March with Finance Minister Mark Eyskens. After hearing of these measures and the accompanying commentary, Eyskens is reported to have said, half jokingly, half seriously: *"To do something like this, special powers will not suffice, you will have to put tanks on all corners of the streets"* (De Ridder, 1986, p. 48).

While the official line of the National Bank and its Research Department was strongly against any devaluation, there were also dissenters within the Bank. A key role was played by Alfons Verplaetse, then an advisor in the Bank's Research Department. He was a member of a

confidential Christian-Democratic group and was subsequently to become involved in implementing the new policy, including the devaluation, as assistant *chef de cabinet* to Prime Minister Martens.

Over the weekend of 20 February 1982, the Belgian franc was devalued by 8.5%. The Government did not consult the National Bank of Belgium before taking the decision. The devaluation was clearly designed as a one-off operation. It was accompanied by a series of measures to prevent inflation from getting out of hand (Verplaetse, 2000).

With the devaluation, the government triggered a psychological shock which enabled it to introduce tough measures, particularly the suspension of index-linking. The NBB had always regarded the indexation mechanism as a reason to advocate a hard currency policy. One might therefore argue that the devaluation was "*the measure accompanying the accompanying measures*".

In the second half of the 1980s, European monetary union was back on the agenda (Padoa-Schioppa, 1994). This was clearly linked to the success of the Internal Market programme and stable exchange rates in the European Monetary System.

In the periodic exchange rate realignments in the EMS in the mid-1980s, the Belgian franc generally took a middle-of-the-road position, in between the stronger and the weaker currencies. Thanks to the better performance of the Belgian economy, especially as far as the balance of payments was concerned, a more ambitious exchange rate policy could gradually be pursued. So, the Belgian franc began to lose less and less ground against the German mark. In June 1990, it was officially anchored to the mark.

The 1970s and 1980s saw a widening gap between the National Bank of Belgium and the academic world. This was apparent, for instance, in the decline in the number of articles in the Bulletin of the Bank. It also extended to the methods of analysis used. The academic world, along with other policy-making institutions, was moving over to the construction of econometric models. However, the Bank did not go in this direction. It was not until 1990, under the impetus of Alfons Verplaetse, that a "*Model group*" was formed in the National Bank of Belgium's Research Department.

5 ECONOMIC ANALYSIS AND RESEARCH IN THE NEW WORLD OF THE EUROSISTEM

On 1 June 1998, the central banks of the then fifteen Member States of the European Union became members of the European System of Central Banks, together with the newly-established Frankfurt-based European Central Bank (ECB). Six months later, on 1 January 1999, eleven Member States of the European Union, including Belgium, adopted the euro as their single currency and began to conduct a common monetary policy. Together, these countries make up the euro area. Along with the ECB, their central banks form the Eurosystem. Since then, five more countries have joined the euro area.

The primary objective of the Eurosystem is to maintain price stability in the euro area. Decisions on the common monetary policy are centralised and most of them are taken by the Governing Council of the European Central Bank. The National Bank of Belgium's Governor attends the meetings in a personal capacity. In performing those duties, the Governor is strictly independent. Yet it can be said that Belgium actually has more influence over monetary policy now than before the introduction of the euro, when the Belgian franc was pegged to the German mark and Belgium had no say in the interest rate decisions made by the Bundesbank. National autonomy has thus been exchanged for a share in the supranational decision-making power. This is a practical illustration of how European integration can actually have the effect of restoring the power of decision, certainly for a small country like Belgium.

EMU naturally implies that some exchange rates no longer exist, like the rate of the Belgian franc against the German mark or the Italian lira, for instance. In the past, the volatility of these exchange rates was most harmful to the Belgian economy and the functioning of the European Single Market. With the introduction of the euro, this form of monetary instability has been entirely wiped out once and for all. One can only imagine the situation the Belgian economy would have been in if it had been hurt in 2008-2009 by a *"twin crisis"*, affecting not only the financial sector, but also the exchange rate of the Belgian franc.

An important feature of economic and monetary union is its asymmetrical nature (Maes, 2002). In EMU, monetary policy is centralised and falls under the responsibility of the Governing Council of the European Central Bank. Responsibility for other economic policy instruments, such as budgetary policy, remains basically decentralised, remaining in the hands of the national authorities. Member States are nevertheless required to view their economic policies as a matter of common concern and to coordinate them accordingly.

Economic and monetary union, and its asymmetric nature, has also had important consequences for the National Bank of Belgium and its Research Department. EMU made the National Bank a kind of a hybrid institution, with both a European and a Belgian dimension (Maes and Verdun, 2009). On the one hand, the NBB and its Research Department are involved in the preparation of the supranational, single monetary policy. On the other hand, they have an important role to play in the coherence of the *"policy mix"*, to ensure that economic policy in Belgium is compatible with the single monetary policy. This is naturally even more important as a loss of competitiveness can no longer be offset by a devaluation within the euro area. Central banks have further developed strategies to adapt to the new environment of the euro and the Eurosystem.

In the area of research, strengthening the dialogue with the academic community became a common theme among central banks, not only in Europe. It was part of a more general process of international convergence towards a more research-based monetary policy. As noted by one eminent observer, *"Central banks look more alike - even if not exactly the same - on such dimensions as their independence, collective internal decision-making structures, monetary policy strategies that target inflation, stress on transparency, and 'knowledge-based' operation"* (Dyson,

2009, pp. 18-19). This went together with a growing tendency for economics professors to become central bankers.

In the Eurosystem, an important impulse to strengthen the dialogue with the academic community came from the ECB, where Professor Otmar Issing had been made responsible for the ECB's Directorates General Economics and Research. Issing emphasised the importance of academic research for monetary policy-making. A crucial reason for this was that EMU presented an unprecedented challenge, a unique event without historical parallel. From an economic analysis perspective, the key issue was that EMU implied a *"regime shift"*, as elaborated in the work of Nobel laureate Robert Lucas (1976). Issing argued that economic research was crucial to handle this uncertainty: *"There was no blueprint for the introduction of a new currency under these special circumstances. The obvious first step was to take stock of current economic thinking. Zero hour for the ECB as a new central bank was the hour of economics. What insights were relevant, and had they been put to the test in central bank experience?"* (Issing, 2008, p. 184).

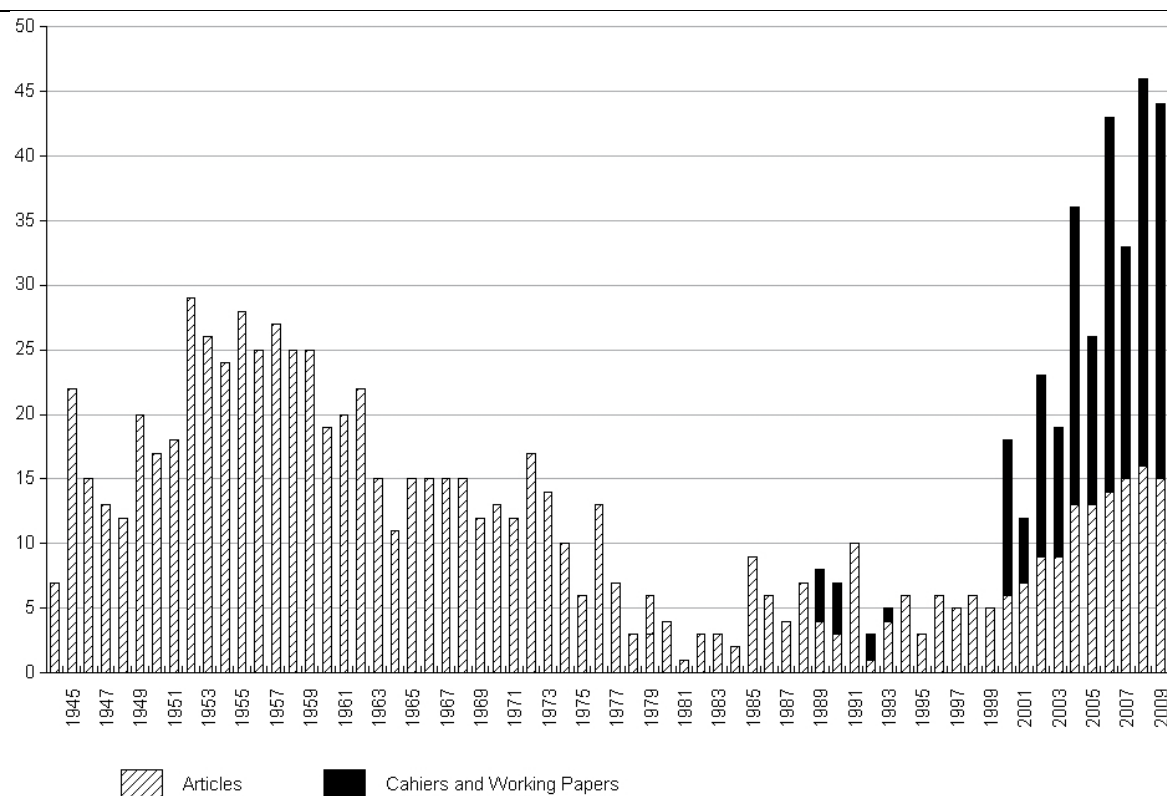
So, right from the beginning, the ECB sought to keep in close contact with the academic world. It set up an intensive dialogue via a wide range of initiatives such as conferences, visitor programmes and seminars. Publications, especially in the ECB's Working Paper series, were also encouraged. The establishment of the ECB, and the importance it attached to economic research, was also a spur to other central banks to reinforce their research capacities, too. Furthermore, the academic world also became interested in the European central banks' research performance.

At the National Bank of Belgium, a few months after the introduction of the euro, there was an important renewal of the Executive Board, including the Governor and the Director responsible for the Research Department. It decided to undertake a deep-going strategic exercise. In the new environment of growing interaction (and competition) between academics and researchers at central banks, the National Bank of Belgium also decided to strengthen its research capacity and its contacts with the academic world. This not only concerned the Research Department. Two new departments were set up as well, namely Microeconomic Information and Financial Stability.

The new approach to research came clearly to the fore in 2000, when the National Bank of Belgium celebrated its 150th anniversary. The various events which commemorated this anniversary were inaugurated by an international conference on the theme *"How to promote economic growth in the euro area?"* (Smets and Dombrecht, 2001). In his introduction to the conference, Governor Quaden (2001) emphasised that central bank independence also implies greater accountability and that a dialogue with the academic community has an important role here.

The National Bank's publications policy was also revamped. Also on the occasion of its 150th anniversary, the Bank decided to target a wider audience with its economic publications and started publishing *"Working Papers"*. Since then, the publications of the National Bank, both in the form of articles in its Economic Review and in its Working Papers, have expanded significantly.

Chart 5.1. - Articles published in the Bulletin, Cahiers and Working Papers, 1944-2009



There were also other reforms at the NBB's Research Department, with a view to strengthening links with the academic world. The key objectives have always been to ensure that the NBB is kept constantly informed of the latest state of scientific research and to stimulate academic research in the monetary area. The NBB therefore recruits Ph.D. economists for temporary jobs of up to two years and offers internships ranging from three to six months for young researchers. Furthermore, the NBB arranges periodic seminars, in collaboration with the Katholieke Universiteit Leuven, the Université catholique de Louvain and the Université Libre de Bruxelles, where prominent economists are invited to present their research work.

Contrary to other central banks, like the ECB, which cover a very wide-ranging research agenda, the NBB is following a "*niche*" strategy, both from a geographical and thematic point of view. In geographical terms, the NBB's focus is largely on strengthening contacts with the Belgian academic world. In terms of research themes, there is a focus on analysis of microeconomic databases concerning pricing, wage-setting and international trade, business cycle analysis and dynamic stochastic general equilibrium (DSGE) models.

6. CONCLUSION

A research department is now a core element of any modern central bank. The growth of research departments in central banks is closely related to their transformation from issuing banks, with more commercial tasks mainly relating to discount credit, into modern monetary authorities. It is also related to the need for management of the monetary system, especially after the demise of the Gold Standard. Moreover, the growth of research departments, not only in central banks, is also an expression of the growing importance of a more systematic and scientific approach in modern society.

At the beginning of the 20th century, the concept of an Economic Service was still vague. However, different elements may be observed at the National Bank of Belgium, like a library, statistical documentation and an eminent economist. It allowed Albert-Edouard Janssen, who was recruited by the National Bank to set up a library, to claim, as early as 1911, that the National Bank had created its own "*Economic Service*".

World War I led to the general collapse of the Gold Standard. The war destroyed the Belgian economy and led to a huge increase in the supply of money. Consequently, in the early interwar period, Belgium was confronted with severe problems of inflation, budget deficits and a large government debt. As there was no longer an automatic pilot, the need for accurate economic analysis became paramount. So, in 1921, under the initiative of A.-E. Janssen, the National Bank officially established an Economic Service to analyse the policy problems with which the country was confronted. This initiative further illustrates that economic analysis at policy-making institutions is mainly a demand-led process, and driven in particular by concrete policy problems.

The National Bank's Economic Service gradually expanded over the years. In the early postwar period, it became one of the Bank's first two departments, under the name of "*Research Department*". Over time, while certain activities, like Statistics or the Risk Office, were transferred to other departments of the Bank, the number of economists in the Research Department steadily increased and the department increasingly focused on its core functions of economic analysis and research.

How can the performance of the NBB's Research Department be further assessed? As a central bank research department, it basically inhabits two worlds: the policy-making and academic ones. So, it is necessary to trace both its influence on policy-making and its reputation in the academic world.

The fundamental monetary policy objective of Belgium, as a small, open economy, vulnerable to external shocks, was the development of a stable and open international monetary system. This aim was fulfilled with the advent of European Economic and Monetary Union. When the National

Bank of Belgium joined the Eurosystem as one of the founding members, it marked the start of a new era.

Before the arrival of the euro, the National Bank traditionally defended a stable exchange rate as an anchor and as a factor encouraging discipline in the Belgian economy. It was mainly when external shocks hit the Belgian economy and there was no coherent domestic policy that the exchange rate became the subject of debate and controversy. Sometimes, devaluations proved unavoidable. These were painful times for the National Bank.

This attachment to monetary stability, especially exchange rate stability, was a constant feature in economic and monetary thinking at the National Bank of Belgium, not only in the more monetarist periods, like under Governor Frère in the immediate postwar period, but also in Keynesian periods, like the 1960s or 1970s. This is certainly not unnatural for a central bank, where safeguarding monetary stability is always a fundamental aim.

The interwar period was difficult because both the political and economic order had been shaken in their very foundations. However, with sharp economic analyses, the National Bank's Economic Service quickly acquired a strong reputation. Moreover, the Bank's Bulletin established itself as an authoritative economic review.

The influence of the Economic Service on economic policy-making in the interwar period is much more difficult to assess and varies significantly from one period to another. It played a major role in A.-E. Janssen's stabilisation project in 1926, yet the failure of this plan was a major trauma for the National Bank and its nascent economic research department.

The Great Depression led to major policy debates, within the National Bank and its Economic Service too. The 1935 devaluation of the Belgian franc was largely the work of van Zeeland (the first Head of the Economic Service and former Vice-Governor). However, it was very much against the conviction of Governor Franck. Van Zeeland also played a key role in the financial system reforms, like the splitting-up of the mixed banks and the setting-up of the Banking Commission, which would mark the Belgian financial landscape for decades. Dupriez and Lemoine, detached from the Economic Service, played a role here, too.

The decades after the Second World War were a golden age for the National Bank's Economic Service. Under the leadership of Franz De Voghel, it was merged with the Bank Credit Service and transformed into a fully-fledged Research Department. It took on a key role in monetary and credit policy and contributed significantly to economic policy-making in Belgium, especially when it came to the modernisation of the Belgian financial system in the 1960s and 1970s. With contributions from many eminent foreign economists, the National Bank's Bulletin also played a significant role in the propagation of new ideas in the economics profession in Belgium, both among policy-makers and academics.

The 1970s and 1980s were a more difficult period for the National Bank and its Research Department. The 1973 oil shock contributed significantly to a derailment of the Belgian economy. The NBB's analyses did not succeed in bringing about the necessary policy adjustment. The Bank became more and more isolated in its defence of the exchange rate of the Belgian franc, which was finally devalued in 1982. Moreover, the Research Department's relationship with the academic world also suffered from its rejection of modern economic methodologies, like econometric modelling, and from the decline in the publications of the NBB.

From the mid-1980s, the NBB and its Research Department gradually reinforced their reputation in economic policy-making. Over time, a more ambitious exchange rate policy was pursued, which culminated in the Belgian franc being anchored to the German mark in June 1990. The advent of EMU was a crucial factor in this process. Moreover, EMU greatly contributed to a convergence in central banking practices. It encouraged the NBB to undertake a strategic exercise, in 2000, to position itself in the new world of the euro and the Eurosystem.

In terms of research strategy, the NBB and its Research Department developed a niche strategy, to affirm their presence both in the Eurosystem and in the academic world. There is a strong focus on analyses of microeconomic databases concerning pricing, wage-setting and international trade, business cycle analysis and dynamic stochastic general equilibrium models.

As regards economic policy-making, the NBB's Research Department basically has a twofold objective. On the one hand, it contributes to the single monetary policy, for instance in the briefings which it prepares for the Governor. On the other hand, it has to follow attentively the "*policy mix*", to check whether policies in Belgium are compatible with the single monetary policy. The monetary history of Belgium has clearly shown that problems in the compatibility of the policy mix, like in the 1930s, 1950s or 1970s, can lead to periods of slow economic growth and rising unemployment. As a devaluation is no longer an option, preventive policy choices become ever more important. The financial crisis of 2008-2009, like that of the 1930s, has further illustrated the importance of the interrelationship between monetary and financial stability. Macro-prudential stability will in future become an increasingly important topic of analysis and research.

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BAEFA: Belgian American Educational Foundation, Brussels

NBBA: National Bank of Belgium, Brussels

PUA: Princeton University, Princeton

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