L. 5. 2. RFD. 192

Board of Governors of the Federal Reserve System

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

May 6, 1952

The Postwar Business Cycle in Belgium
Robert Solomon 12 pages

NOT FOR PUBLICATION

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THE POSTWAR BUSINESS CYCLE IN BELGIUM

Robert Solomon

Belgium was liberated from German occupation in September 1944. The six year period from that date until the outbreak of the Korean war in June 1950 was marked not only by the recovery of the economy from the effects of war and occupation but also by a combination of cyclical fluctuations of a type not treated in business cycle literature.

In addition, Belgian economic policies during this period gave rise to a considerable amount of controversy in other countries. Belgium has been highly praised as the country which used "the classical medicine" and achieved a rapid recovery with a minimum of inflation. The "hardness" of the Belgian franc, the political stability of the country, and the relatively high living standards have all been pointed to by adherents of this view as proof of the soundness of the economic and financial policies of the Belgian Government. On the other hand, Belgian policies have been severely criticized by other observers on the grounds that they imparted a deflationary bias to the economy. Belgium's persistent balance of payments surplus in Europe and its relatively high level of unemployment have been cited by these critics as evidence of the short-sightedness of the policies followed.

Various aspects of these issues have been touched upon in the course of the study of which this article is a summary.1/ Its primary purpose, however, is to focus upon cyclical developments in Belgium during the postwar period. It is surprising to observe that, as far as can be discovered, no previous attempt has been made to treat systematically the cyclical fluctuations in Belgium since the war.

Two possible explanations may be advanced for this lack of analysis. In the first place, Belgium experienced two separate cycles, one in metals and the other in textiles. While both cycles were of significant amplitude, they tended largely to offset each other. As a result, the aggregate indices, such as gross national product and employment, reflected only slightly the cyclical developments. In the second place, statistical material concerning the Belgian economy is very inadequate. Many of the series upon which modern business cycle theory is based are either absent or fragmentary. Nevertheless, it appears that even the material which is available has not been exploited.

Economic developments, 1944-50

Favored by an early liberation and relatively little damage to its industrial plant, Belgium achieved a rapid recovery of production during the early postwar years. The policy of heavy imports of raw

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1/ This article constitutes, in slightly revised form, the final chapter of a study submitted to Harvard University as a Ph.D. thesis.

materials and consumer goods facilitated the rapid expansion of output and permitted the early elimination of direct controls. From the end of the war to the end of 1947, overall industrial output rose rapidly, to 110 per cent of the 1936-38 average by the last quarter of 1947. Rising exports, a growing level of investment, including increasing inventories, and the deferred demand of consumers all combined to present Belgian industry with a growing level of demand. The only exception during this period was the wool industry, which began to reduce its output in early 1947.

Recession in textiles -- This tendency spread to the cotton branch in 1948 and by the end of that year aggregate textile production had fallen by 23 per cent from the peak level, attained in April 1947. It has been shown that, contrary to common belief, none of the decline in wool output and only one-fifth of the decline in cotton output were attributable to a reduction in exports.

It seems reasonable to assume that the recession in wool production, and beginning in 1948 in cotton production also, was caused not only by the satisfaction of deferred demand but also by the rapid rise in food prices after mid-1947 which forced many consumers to curtail their purchases of non-food items. Despite the system of compensatory allocations, the average worker's real earnings ceased rising in 1947 and declined in 1948. For many in the other one-half of the population which did not receive these allocations, the rise in food prices must have entailed a still greater reduction of real income. Even for those whose earnings rose as rapidly as the cost of living index, the increase of food prices relative to non-food prices was likely to lead to a reduction of clothing and other textile purchases.

It must be admitted that the available data on consumer purchases do not completely support this hypothesis. There is some evidence of a decline in clothing purchases in 1948 in those stores which are probably patronized mainly by the lower income groups. But the large decline in these purchases occurred in 1949, when it was probably the result mainly of the decline in employment.

It is likely that in addition to the decline in consumer takings of wool and cotton products in 1948, which may have been minor, there occurred a reduction in the rate of inventory accumulation, if not a reversal. The sharp reduction in 1947 in the rate of increase of sales to consumers was sufficient to affect the inventory policies of fabricators and distributors of wool and cotton products and to cause a decline in the production of wool and cotton cloth even in the absence of a reduction in consumption. The "inventory accelerator" 1/

1/ See Lloyd Metzler, "The Nature and Stability of Inventory Cycles", Review of Economic Statistics, Aug. 1941.

could easily be adapted to explain such a development by restricting it to a particular segment of the economy and by introducing an autonomous change in the rate of change of consumption of the output of this sector.

Expansion in metals -- While textile production declined sharply in 1948, the output of iron and steel, non-ferrous metals, and metal products continued to expand, primarily to satisfy export orders. In fact, it may be said that the export of these products, which accounted for the entire increase in exports in 1948, was the major expansionary force acting on the Belgian economy during 1948; although there occurred also a significant increase in fixed investment during 1948, this was probably offset, at least in part, by a reduction in the rate of inventory accumulation.

The continued expansion of output by the metal producing and using industries was sufficient to compensate for the decline in textile output. Industrial production rose about 7 per cent from 1947 to 1948 although there was little increase during 1948. The increase in gross national product from 1947 to 1948 (12 per cent) was less than the rise in retail prices (15 per cent) and in the cost of living index (20 per cent) but more than the increase in the wholesale price index (10 per cent). Since it is likely that both the retail price and the cost of living indexes weight food more heavily than its share of the gross national product would call for, there is no reason to assume a decline in the real gross national product in 1948; on the other hand, the increase was apparently not very great.

It may also be noted that employment began to decline during the second half of 1948 and in December of that year was 3.6 per cent below the level of a year earlier. In view of the fact that productivity in the textile industries (where output was falling) is lower than in steel and metal fabrication, (where output was rising) there is nothing inconsistent about the decline in employment unaccompanied by a decline in total output. In addition, the disappearance of the sellers market in most fields may well have led to efforts to produce more efficiently in order to reduce unit costs.

Recession in metals -- The expansion of output in the metal industries came to an abrupt end in March 1949. The precipitous decline in steel production in Belgium-Luxembourg (32 per cent from March to November) was apparently initially associated with the fall in exports to the United States, but after mid-1949, other countries also reduced their purchases of Belgian steel and other metal products. The decline in exports, which in turn was due to the recession in the United States and the recovery of production in Germany, France, and the United Kingdom, was the main reason for the reduction in steel output after March 1949, but it appears likely that a decumulation of inventories also contributed to the fall in demand.

While the cycle in metal production reached its peak during the first quarter of 1949, the textile industries had passed through their trough during the fourth quarter of 1948. Their output began to rise in early 1949, because of increased export demand, and by the fourth quarter of that year was up 13 per cent from the level of a year earlier. Textile production and exports increased even more rapidly during the first half of 1950, as the Dutch market was opened up in keeping with the Benelux agreement.

Thus during the period after 1948, the fluctuations in output in the two principal groups of industries tended partially to offset one another. During 1948 the continued rapid rise of steel and associated output served to offset the effects of declining output of textile products on the national income, although not completely on employment. During 1949 rising textile output served as a partial offset to the decline in activity in the metal producing industries. While industrial output and real gross national product were no lower in 1949 than in 1948, output and employment during the fourth quarter of 1949 were lower than during the fourth quarter of 1948.

In addition to the decline in steel and engineering exports during 1949, there occurred a fall in total gross investment. While fixed investment remained unchanged, inventories were reduced; unfortunately the lack of data makes it impossible to form a judgement as to the magnitude of this factor.

Recovery in 1950 -- Finally, it may be noted that, as was the case in the United States, Belgium was experiencing a rapid revival of economic activity during the half-year before the outbreak of hostilities in Korea. During April and May of 1950, over-all production was only 3 per cent below the peak level previously reached. Textile production had surpassed the previous peak of April 1947, and steel production had recovered about one-fourth of the loss in output of 1949. The main explanation for this revival was the lifting of trade barriers by The Netherlands and other OEEC countries against Belgian exports. In addition, however, the public works program and the subsidization of private housing appear to have contributed, judging from the large increase in employment among construction workers.

Unemployment -- During the postwar period, when Belgium was experiencing two major sectional cycles in economic activity, the level of unemployment increased almost steadily, except for seasonal variations. Many observers in Belgium and elsewhere have argued that the high level of unemployment is explained by Belgium's liberal unemployment insurance system, which contains on its rolls (so it is argued) many who are not involuntarily unemployed.

Although the available data do not permit a complete explanation of the growth of unemployment, the major portion of it resulted from a decline in employment, which in turn was associated with reductions in production. Nevertheless when employment began to rise again after mid-1949, unemployment failed to decline significantly. In March 1951, when industrial production reached its postwar peak of 133 (1936 - 38=100), total unemployment still amounted to 186 thousand. Of these, 33 thousand were in branches of activity which experienced subsequent reductions in unemployment; these reductions were offset by rising unemployment in the textile industries as textile production declined again after the first quarter of 1951. Taking account of these 33 thousand, there still remains a hard core of 153 thousand of complete plus partial unemployed at the peak level of output. We have no assurance, however, that this level of output, though a postwar record, represented capacity output. Furthermore, even if it did represent capacity output, the creation of new productive capacity would probably have permitted unemployment to be reduced further. Finally, the fact that in November 1950 only 20 per cent1/ of those completely unemployed (153 thousand) had been out of work for more than 1 year indicates that the number of voluntarily unemployed could not be much over 30 thousand; in particular, this fact minimizes the force of the argument concerning the liberal unemployment insurance system, since that argument is based on the absence of a time limit on the drawing of unemployment benefits.

Belgian policies during the postwar period

Even before the liberation in 1944, the Belgian Government-in-Exile had been making plans for the postwar period and had prepared the famous currency reform. The need to prevent inflation was given a very high priority from the very beginning. Emphasis on anti-inflationary policy plus a strong anti-dirigisme were the basic tenets of Belgian policy-makers, including apparently the Socialist Party which dominated the government until August 1949.

Anti-inflationary policies -- Acting on the basis of these beliefs, the Government carried out the monetary reform and adopted a policy of large-scale imports of raw materials and consumer goods. The latter policy permitted the early elimination of bottlenecks and succeeded in absorbing a good deal of the liquidity which was created in 1945 when military activities gave rise to a large and unexpected amount of expenditure in Belgium. As a result retail prices declined as early as the last months of 1945. After 1945 the only large increases in Belgian prices recurred as a result of the elimination of subsidies (in early 1947, mid-1947, and early 1948).

There is no doubt that there were elements of good fortune involved in Belgium's success in the early elimination of inflation. Not only were Belgium's gold and foreign exchange reserves not depleted during the war, but they were increased during 1945. At the end of 1945, Belgium's gold and foreign exchange reserves were almost twice those of the Netherlands, whose population is slightly larger than Belgium's; about one-half those of France, whose population is 5 times

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1/ Bulletin de Statistique, Feb. 1951, p. 271.

Belgium's; and about one-third those of the United Kingdom, which holds reserves for the entire sterling area. These ample reserves permitted Belgium to undertake the policy of large-scale imports, a policy which may have been denied other countries which had smaller reserves. Secondly, the relatively small amount of damage to plant and equipment (and the partial repair of the railroad system and ports by Allied Armies) made it unnecessary for Belgium to put aside its reserves for the purpose of financing capital goods imports, as was the case for The Netherlands. Thirdly, Belgium's wealthy colony remained securely under its control as an important earning asset and source of raw materials.

Thus Belgium entered the postwar period in a more fortunate position than most of its neighbors. At the same time, Belgian policies made the most of this good fortune. In contrast to most other countries, the Belgian people at an early stage enjoyed a relatively stable price level and did not have to put up with shortages for very long.

In addition to the currency reform and the import policy, Belgium's success in preventing inflation must also be ascribed, on the one hand, to the absence of a large-scale publicly-fostered investment program and, on the other, to the budgetary and monetary policy pursued from 1946 on. Belgium's failure to adopt an investment program is no doubt partly due to the fact that there was little war damage to capital equipment. In addition, however, the antipathy to government "interference" or "planning", which appear to have been shared by most policy-makers, must also be mentioned.

Perhaps largely because an investment program was not adopted but also as a result of the government importation and sale of large quantities of foreign supplies, the budget was very nearly in balance in 1946. It may be noted that the distaste for government "interference" with the market did not prevent the organization of a large scale and highly successful government import program at the time of liberation.

While it is extremely difficult to judge the effects of a given set of credit controls, it may be safely said that the monetary policy inaugurated in 1946 appears to have restricted the availability of credit relative to the demand for it. Thus from the point of view of the maintenance of internal financial stability, Belgian policies must be termed highly successful, even though the adoption of some of these policies was permitted to Belgium because of its good fortune.

Furthermore there is evident in Belgian policies a directness of approach which reflects agreement and determination as to the objectives of those policies. In contrast to the wavering and attempts to attain contradictory objectives in a number of other countries, Belgium exhibited a singleness of purpose in its effort to attain monetary stability and balance of payments equilibrium without direct controls. Whether one agrees or not with the judgment of Belgian policy-makers as to the priority accorded to these objectives as compared with others, it must be admitted that they saw clearly what their goals were and took effective steps to attain them. This approach led Belgium to pioneer in the introduction of a number of measures which were later widely adopted by other countries in Western Europe. Among these measures may be included the currency reform, the revival of monetary policy including the particular form of the credit controls (a security reserve requirement), and the substitution of direct payments to lower-income families for general price subsidies.

Belgium's success in preventing inflation constitutes one of the important explanations for its early balance of payments recovery and for the "hardness" of the Belgian franc. In addition it made possible, at an early stage, the removal of import and exchange restrictions. Here too, however, an element of good fortune played a role. The large steel industry of Belgium-Luxembourg, the output of which was in great demand by a war-shattered Europe, gave them very favorable terms of trade which contributed greatly to their foreign exchange earnings.

Belgian policies and the business recessions -- Given the success of these various policies in preventing inflation, can it be said that they were in any sense responsible for the recessions in economic activity which occurred during the post-war period? It has been observed that the reduction of price subsidies on imported food products in July 1947 and February 1948 led to a brusque rise in food prices, and that, given the inelastic demand for food products, this may have been partly responsible for a decline in consumer takings of textile products. Although textile exports continued to rise, except for a small decline in cotton cloth which accounts for less than one-fourth of the decline in cotton production in 1948, the export market did not offset completely the decline in internal demand.

Thus the point can be made that the policy of subsidy elimination, whatever its general merits, had the effect of contributing to the recession in textile production which began in 1947 for wool and affected the entire industry in 1948. Now it can certainly be argued that this policy had the favorable effect of improving the balance of payments, by reducing the demand for imports and by forcing Belgian producers to seek export markets. It is only intended here to indicate that a price, in the form of idle manpower and productive capacity, was paid for that improvement.

Perhaps more important than the reduction of consumer takings of textile products was the reduction in inventory accumulation in 1947 and 1948. While this development was probably associated with the reduction in the rate of growth of consumer expenditures, and also with the reduction in the rate of increase of exports, can it be attributed in a more direct sense to economic policy?

It has been shown that credit conditions were relatively stringent after 1946. The fact that credit was expensive and borrowing was not easy may have discouraged inventory accumulation. But there is no evidence that credit was ever so tight as to cause a liquidation of inventories. Aside from the sharp reduction in the rate of growth of consumption, which in itself is sufficient to explain the inventory cycle, a more general explanation may be offered. After 1947, it is now evident, the Belgian economy became relatively stagnant except for the foreign demand for steel products, which was temporarily inflated as a result of the effect of the war on both the demand and the supply in other countries. Aside from this factor, there were no important expansive elements in Belgium and the general psychological atmosphere was not that of an expanding economy; in fact, fears of depression contributed to these attitudes. Thus as early as 1947 the National Bank was warning the business community about the possibility of a world recession and cautioning that business firms not over-commit themselves. Furthermore, the Belgian population, especially those who were responsible for investment decisions, had no reason to expect vigorous government action to counteract a future depression.

Investment in Belgium -- This brings us to the problem of investment in Belgium. While gross fixed investment increased sharply in 1947 and somewhat less in 1948, it was considerably smaller than in other countries, as measured by the ratio of gross investment to gross national product. It can be argued that a more vigorous government investment program, for which the need appears to be generally admitted, and greater encouragement of private investment would have been in order in Belgium in 1948 and later.

While there is no evidence as yet that there was insufficient private investment to permit Belgian firms to maintain their competitive positions, there are several reasons why a greater volume of government and private investment would not have been amiss. In the first place, it would have led to a greater use of Belgian resources which were being wasted in unemployment. Secondly, Belgium was offered, under the European Recovery Program, foreign resources for a period of four years, in order that it might improve its productive plant and raise its standard of living. Not only did Belgium fail to take full advantage of this offer of American resources, but it developed a balance of payments surplus itself in late 1948. While it is strange to find fault with the attainment of over-all foreign balance, it can be argued that Belgium was sacrificing the future in order to achieve that balance. Thirdly, the nature of the unemployment problem discussed earlier indicates that, while many of the unemployed might have found jobs if only effective demand had been greater, it also appears that to some extent the unemployment may be structural; that is, there may be a shortage of capital equipment relative to the labor supply. Thus more private investment was needed not only to stimulate effective demand but also to provide more capital equipment.

Finally, it is quite likely that Belgium like other European countries relies too heavily on textile exports. The difficulties of the United Kingdom in this respect are so well known that there is no need to repeat the arguments. For this reason also, it can be argued, steps should have been taken to encourage the development of industries which would employ idle labor and which would be more adapted to present and probable future world demand.

Now it certainly would have been possible for the Belgian Government to have encouraged a higher level of investment and to have attempted to influence the direction of that investment, without interfering with the working of the free economy. There are a number of fiscal measures which might have been adopted for these pruposes. Furthermore, a program of government loans to private industry on favorable terms might also have contributed. Finally, a greater amount of government investment to improve highways, ports, canals, and so on, would have helped to make the economy more expansive and therefore might have had a favorable effect on private investment decisions.

Investment financing -- In regard to the financing of private investment, reference should be made to the Banking Law of 1935 and its possible effects in this connection. As happened in the United States, the Belgian banks found themselves in the early thirties with portfolios which could not be liquidated in the face of demands by depositors for withdrawal. These demands for withdrawal originated partly because of bank failures, but mainly because of the desire for speculative capital flight in anticipation of a devaluation of the Belgian franc. In any case it led to a banking crisis and to demands that the banking system be reformed in a way that would require the banks to remain more liquid and thus, it was argued, to be able to meet the withdrawals of depositors.1/

During the entire period of Belgium's industrial development, its mixed banking system had played an intimate and important part in the financing of industrial investment. The banks had promoted new firms, had supplied the initial capital, were represented on boards of directors, and frequently continued to hold securities of affiliated firms. Whatever the arguments, political, social, and economic, for and against such an institutional arrangement, it is important to recognize that it was an essential element in Belgium's industrial development.2/

In 1935, the system was abrubptly changed. The banks were required to divest themselves of their security holdings and, under the supervision of the Banking Commission, had to maintain their assets in "liquid" form. While an intimate relationship undoubtedly continues

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1/ This episode is well summarized in B.S. Chlepner, Belgian Banking and Banking Theory (Washington, 1943) pp. 69-81.
2/ Roland Durviaux, La Banque Mixte (Brussels, 1947) passim.

to exist, with the industrial groups now controlling the banks rather than the banks controlling the industrial firms,1/ the important fact, from our point of view, is that the banks can no longer freely finance industrial expansion.

It is not intended to argue here that the Banking Reform of 1935 was ill-advised. It can be said, however, that the commercial loan theory appears to have been overstressed since 1935. The extensive questioning in American literature of the validity of the commercial loan theory as a guarantor of stability, the meaning of bank liquidity under modern conditions, and the role of the central bank in assuring the "shiftability" of commercial bank assets, does not appear to have made any impact in Belgium.

Perhaps more important, the Banking Reform of 1935, in abrubptly severing a network of institutional relationships within which Belgium's industrial expansion had been carried out, may have failed to make adequate provison for the continued financing of industrial investment. Belgian business firms were not as accustomed as firms in other countries to raising funds in the capital market, which is not as highly developed in Belgium as in many other industrial countries. New firms, in particular, were almost always promoted by banks before 1935. Under the present regulations, a bank may help to underwrite a new issue if it holds the securities for no longer than six months. But, especially when considered with another requirement of the Banking Law of 1935 prohibiting the listing on the stock exchange of securities of a company less than two years old, this provision may not encourage banks to engage in underwriting new firms.2/

Thus it appears reasonable to conclude that a share of the responsibility for the failure of the Belgian economy to be more dynamic and buoyant during the post-war period must be attributed to the Banking Law of 1935; or, at least, to the failure of the Belgian Government to establish a means by which the dependence of industry on bank credit for the financing of investment was replaced in a way which would permit a greater volume of private investment. It seems clear that during the period after 1947 Belgium could have absorbed a higher level of investment without seriously comprising its firmly-held desire to prevent inflation.

As far as public investment is concerned, it has been observed that a public works program was adopted in late 1949, and it began to have its effects only during 1950. It can be said that such a program should have been initiated at an earlier stage, but, it must be admitted, Belgium is probably not the only country where administrative and other delays are likely to occur in this regard. The tax reduction of 1949,

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1/ _Ibid._, p. 218.
2/ See Chlepner, _op. cit._, pp. 91-92.

although of minor importance in quantitative terms, should also be mentioned as a step in the right direction. Finally, the policy of encouraging private construction appears to have had a significant effect.

With regard to monetary policy, it appears that the central bank was rather too cautious. While it is impossible to determine whether a more expansionary monetary policy would have had any significant effects during 1948 and 1949, conditions appeared to call for some relaxation, if only for its psychological effect, of the policy established in 1947 when inflationary dangers were present.

With regard to economic policies, it may be concluded that, whereas some European countries may have underrated the gravity of the inflationary effects of their investment programs, Belgian policies tended to sacrifice economic progress by their preoccupation with the maintenance of monetary stability.

Theoretical implications of the Belgian experience

This study has made no attempt to test business cycle theories against the data provided by cyclical developments in Belgium. Rather it has attempted to supply the groundwork for such a testing. Because the facts and their relationships are so little known, it was first necessary to assemble them in an effort simply to learn what happened in Belgium during the postwar period. Before concluding this study, two theoretical points suggested by the previous analysis may be mentioned.

1. The cyclical fluctuations in the Belgian economy during the postwar period were of a type not ordinarily treated in business cycle literature. Normally the business cycle is envisaged as involving more or less simultaneous upward and downward movements in the output of the various industries. In Belgium, however, there occurred cycles in the two major industries which moved in opposite directions and tended to offset each other.

The impulses which acted on the economy may have been the product of the special circumstances of the postwar period. Nevertheless the reaction of the economy to these impulses -- that is, the offsetting sectional cycles -- may be of general significance for business cycle theory. In fact at the present time a number of countries, including Belgium, are apparently experiencing a somewhat similar phenomenon, with capital goods output expanding while consumer goods output is contracting by more than is necessary to permit the increase armament production.

2. In open industrialized economies, one must take account not only of the interaction of consumption and investment but also of the interaction of exports with consumption and investment.

The concept of the foreign trade multiplier is well embodied in business cycle literature. It expresses the positive stimulus of a change in exports on domestic consumption. One could also develop a foreign trade accelerator, which would express a positive relation between a change in exports and a resultant change in investment.

But there is another relationship between foreign trade and domestic spending which is not so well integrated into business cycle theory. When the level of domestic spending declines, producers tend to seek foreign markets for their output. Thus exports rise, not because of a net increase in foreign demand (a shift to the right of foreign demand curves) but because a more aggressive sales policy on the part of exporters permits them to fill previously unsatisfied demand in foreign countries as well as to displace other sellers.1/ This effect could not occur in many countries at the same time, because foreign demand would then be shrinking also. In a single country, however, it may occur and would serve to offset in part the decline in domestic spending. Just as the propensity to import implies a positive relationship between domestic spending and imports, this concept implies a negative relationship between domestic spending and exports.

In treating this effect, it becomes necessary to distinguish, if possible, between an increase in exports resulting from an increase in foreign demand and an increase in exports resulting from a decline in domestic demand. In the first case, the usual analysis involving the foreign trade multiplier indicates how domestic expansion results from the rise in exports. In the second case, however the rise in exports serves usually only to cushion the effects of the decline in domestic demand.

In Belgium the increase in exports during the postwar period was due primarily to rising foreign demand. However, it is very likely that the declining level of domestic demand after 1947 was also responsible for the expanding exports, as well as the declining imports, which resulted in Belgium's favorable balance of payments.

1/ Thus this approach involves the application of the theory of monopolistic competition to international trade.