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Belgian Progress Toward Convertibility
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Belgian Progress Toward Convertibility

July 20, 1954
Elinor Harris

The 1954 Annual Report of the National Bank of Belgium states that a country cannot "introduce and maintain genuine convertibility, which essentially implies freedom of capital movements, unless its internal conditions . . . ensure that its balance of payments will be kept in equilibrium . . . without restrictions or artificial interventions . . . Convertibility calls for strict financial discipline. Within the limits of its competence, the Bank thinks it has succeeded . . . in creating the preliminary conditions essential for the establishment, on the basis of a fixed rate of exchange, of genuine convertibility of the Belgian franc, implying the liberalization and consequently the expansion of international trade."

Belgian External Progress Toward Convertibility

Belgian financial officials envisage establishment, if possible, of full -- as contrasted with limited -- convertibility of the Belgian franc; that is, establishment of freedom of capital movement as well as current account payments and of freedom from major restraints on trade as well as on exchange. In contrast with the British concept, it thus embraces the right of domestic residents to convert at will their domestic currency holdings into foreign currencies at the official (presumably fixed) rates of exchange. The Belgian concept implies progress in the removal of both trade and exchange restrictions simultaneously, rather than any "dash" in one direction or the other.

Removal of trade restrictions and dollar discrimination

Accordingly, since 1952, Belgium has gradually removed trade restrictions (a) on all Belgian imports on a global basis and (b) on dollar imports, especially those implying discriminatory treatment of dollar goods. Such progress in the relaxation of trade restrictions has been especially rapid this spring. First, in March 1954, with removal of forty items from formal dollar import licensing requirements, dollar discrimination was reported to have been almost entirely removed on an administrative basis, although a few special quotas still remained on the books as a precautionary measure in the event of rapid deterioration in Belgium's external balance. Also in March, a common list for liberalized OEEC imports was established between the Benelux nations (Belgium, the Netherlands, and Luxembourg) while in April a common Benelux list for liberalized dollar imports was set up.

Finally, in May 1954 all remaining discrimination against dollar imports was abolished. All goods on the free list now may be imported without restriction from dollar as well as from non-dollar sources. In

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the case of commodities whose import is still subject to official authorization, there is no discrimination against the dollar area; that is, Belgian importers may choose freely between dollar and non-dollar goods within the limits of the quota of the particular item. Governmental officials further maintain that, for a great number even of these so-called "restricted" goods, licenses in actual administrative practice will be granted freely.

The establishment of common Benelux commercial policy, with respect both to dollar and OEEC imports, is intended to strengthen the bargaining power of both the Netherlands and Belgium vis-a-vis third countries; to reduce the chance of discriminatory action against Benelux by non-convertible countries in the event of full convertibility; to increase the effectiveness of the area's gold and dollar reserves and thus to reduce the risks of inadequate reserves and the need for outside stabilization loans; and to lessen the danger of speculative capital outflows in the event of convertibility. The elimination of dollar discrimination, as a first step, should normalize the pattern of trade and indicate whether a drain on gold and dollar reserves would result from trade transactions in the event of establishment of full convertibility.

Relaxation of exchange restrictions

Significant developments in the freeing of exchanges and the Belgian capital market have occurred simultaneously this spring with the freeing of trade.

The Benelux capital market — The Governments of Belgium, Luxembourg and the Netherlands announced in July the opening of a common Benelux capital market, whereby all Benelux capital transactions will be permitted to take place outside the European Payments Union and at a freely fluctuating exchange rate. All movements of capital between the three countries will be liberalized, including investment or repatriation of equities, bonds, or bank or other short-term credit. Belgium and Luxembourg, but not the Netherlands, also will establish special capital accounts for residents of EPU countries into which may be deposited all Belgian franc proceeds from capital or securities transactions. Such accounts will be freely transferable between all residents of EPU countries, can be used for all capital and other non-trade payments to Belgium and Luxembourg and can be sold in a free exchange market at a free rate.

Inauguration of the common Benelux capital market is an important first step towards closer economic union. Since public and private bond yields as well as money market rates are higher in Belgium than in the Netherlands, it may be presumed that capital (especially in the form of bank credit or debentures) will be more likely to move from the Netherlands

into Belgium; however, consideration of greater prospective growth in certain Netherlands industrial firms might conceivably outweigh the interest rate factor and induce increased Belgian participation in Netherlands share capital.

To some extent, the new arrangements give formal sanction to a freedom of capital movement which already existed in actual practice. Belgian nationals, in most cases, have been permitted to transfer capital to residents both to the EPU and the dollar area, and have obtained foreign currencies with which to make the transaction at free rates in the free exchange market. An indication of the desire of Belgian residents to make such out-payments has been the relationship between the official and the free rates of exchange of the Belgian franc. Recently, the discount between official and free rates (used mainly for these capital transactions) has been narrowed until by the end of May it was only about one-half of one per cent. Consequently, the effect was to reduce the penalty imposed upon outward capital transfers from Belgium and to achieve two of the essential requirements for convertibility: a full-valued currency and effective freedom of capital movements.

It may be presumed that the new BLEU capital arrangements with OEEC countries will not affect the existing system with respect to capital transfers to the dollar and other non-OEEC areas. At present, Belgian nationals may purchase United States securities or "export" other forms of capital under license, virtually always granted by the Government, at the "free" Belgian-dollar rate of exchange. Recently there has been little demand by Belgian citizens to transfer their franc assets abroad either to OEEC countries or into dollars or dollar securities: an indication of the growing strength or "hardness" of the Belgian franc.

To what extent would restoration of formal convertibility change the present situation in which freedom of BLEU capital movement in fact exists? The Belgian authorities would lose their present administrative control over capital flight which might occur in unusual circumstances, such as major political upheaval or outbreak of war in Europe, and which would, in this case, threaten rapid loss of gold or hard currency reserves. Dollar exchange for capital transactions could presumably be purchased at the official rather than the free market rate, removing whatever small penalty on such transactions still now exists. On the other hand, official announcement of Belgian franc convertibility might conceivably induce an inflow -- rather than an outflow -- of foreign funds; this would both strengthen the Belgian currency and the official gold and dollar reserve position but, at the same time, might possibly have unstabilizing effects upon the banks' reserve position and the domestic supply of money.

The Brussels gold market -- Other indications of external progress toward convertibility include (1) the narrowed differential between free and official gold prices in Brussels, currently the

smallest since 1949; and (2) the somewhat greater trading freedom permitted in the gold market iself. Prior to March 1954, even those individuals authorized to deal in gold were forbidden to buy or sell gold at prices which differed from the official gold prices by more than one-quarter per cent. This rigid price-fixing system was removed last March but, as hitherto, individual gold tranactions still are subject to prior approval of the National Bank. Such approval is normally granted only for gold purchases for industrial or other non-speculative uses; moreover, gold imports and exports from the country still remain the exclusive monopoly of the Belgian National Bank, which greatly limits the practical effect of new official gold policy.

Exchange regulations — Finally, in May the Belgian-Luxembourg Exchange Office completely revised its foreign exchange regulations for purposes of simplification and elimination of needless restrictions. Effective June 1, moreover, the new regulations provide for an increase from BF 25,000 to BF 50,000 in the amount of Belgian banknotes which may be taken abroad.

Growth in Belgian gold and dollar reserves

The rise through March 1954 in Belgian gold and dollar reserves to the highest level since the end of the war reflects, in part, the strengthened Belgian external position and should be an aid both to convertibility and Benelux economic union; some declines have occurred in the second quarter of 1954 as a result of a worsened BLEU trade position. Existing gold and dollar reserves (about $900 million at the end of June) are equal to more than one-third of all annual imports. Continued growth would probably further increase confidence in the franc and might induce some repatriation of Belgian capital from the United States or Switzerland, thereby further strengthening official reserves and making more funds available for domestic private investment.

However, since Belgian financial policy has been directed consciously toward increasing reserves, the extent of the reserves may be a somewhat spurious guide to strength or weakness in the economy. Sufficient external loans were negotiated last year with Switzerland, the BIS, and the Netherlands to maintain a reasonably constant ratio (about 40 per cent) of gold reserves to note and deposit liabilities of the National Bank. Last year's growth in Belgian gold and dollar balances also reflects sale of Belgian Treasury bills to the Congo, which sustains a dollar suplus as a result of sale of uranium and other strategic materials to the dollar area, in exchange for dollar balances; and rising United States off-shore military purchases in Belgium.

The paramount question of whether existing gold and dollar reserves are adequate for convertibility cannot be answered without knowledge of the nature of any convertibility move. Holdings would need to be greater in the event of a single venture by Belgium than in a joint venture by a

group of European nations; or if convertibility on capital as well as on current account was contemplated. Other questions pertaining to the structure of trade would also be important. Belgium's reserve position would be worsened if non-convertible currency countries tended to introduce the same import restrictions against Belgian goods as they presently maintain against dollar imports. Obviously, the greater the number of countries which simultaneously embarked upon the venture and the greater and more effective the degree of "policing" by international or regional organizations -- such as OEEC or GATT -- the less would be the danger of loss of reserves from this type of discrimination.

Internal Progress Toward Convertibility

According to the National Bank's definition, convertibility requires not only balance-of-payments equilibrium without trade or exchange restrictions, which implies a strong Belgian competitive position in the world market and thus an adequate level of domestic investment; it also demands continued confidence in the domestic currency so as to avoid any capital flight, which implies maintenance of sound internal financial policies. The main problem appears to be whether present Belgian fiscal and monetary policies are contributing successfully and without internal contradictions to attainment of both the goals of internal stability and an adequate investment level.

Fiscal policies

Present fiscal policies try to integrate relatively high and virtually irreducible expenditure needs with equally inflexible revenue and loan sources. On the expenditure side, there are, on the one hand, high and fairly rigid defense requirements and fixed social charges which cannot be cut either for military or for political reasons; and, on the other hand, high public investment needs, which are essential for reducing pockets of unemployment and at the same time putting Belgian industries on a competitive basis. Belgian firms are presently handicapped by the greater degree of public and private postwar investment in competing German and Dutch firms, which are consequently able to underprice them in world markets.

Present tax revenues, too, are somewhat rigid as a result of heavy reliance upon cyclically insensitive sources such as excise and production taxes. These taxes are burdensome on industrial costs and on the exporters' ability to compete externally. The alternative source of funds -- governmental borrowing -- is blocked by monetary policies

which have generally restricted the banks' ability to purchase Treasury issues other than those necessary to meet legal reserve requirements.

If anything, the Treasury's budgetary problem has recently appeared to be worsening. The estimated budget deficit (for both the ordinary and extraordinary budget accounts) rose from 15 billion francs in 1952 to 17 billion in 1953. On a cash basis ordinary budget revenues declined somewhat in 1953 although ordinary expenditures continued to rise slightly. The Treasury was able to reduce its actual 1953 cash drain by slowing the rate of Treasury spending of certain appropriated funds and by cutting other appropriations, especially those for defense; it also managed to obtain a record peacetime level of loan funds from all sources, both domestic and foreign. 1/

Prospective changes in fiscal policy and debt management

Heavy foreign borrowing on a short-term basis in 1953 has further aggravated debt management problems during 1954, since the effect was to shift a part of last year's budgetary problem to this year as repayment falls due. This year, the most likely loan sources continue to be the Belgian Congo, the Swiss private banks, the B.I.S., and the Netherlands; the New York money market appears not to be a prospective source of Belgian Treasury funds, given the reluctance of the National Bank to put up gold collateral. In fact, in June 1954 the Belgian Treasury contracted a $40 million loan with a group of Swiss banks at a 1/2 per cent interest rate reduction and without gold collateral, in order to pay off in advance a loan of that amount from the Export-Import Bank and private New York banks.

In view of the ambitious social and investment expenditures of the new government (in conjunction with its reluctance to levy new taxes), it appears likely that Belgian postwar debt management policies will somewhat be altered and especially that the policy of keeping the constant ratio of gold reserves to National Bank deposits and note liabilities may be abandoned. 2/ Moreover, the commercial banks will probably have to take a larger proportion of the new Treasury issues for financing budget deficits as well as foreign surpluses.

1/ In May 1953, the Treasury obtained a one-year loan of about 0.7 billion francs from two Netherlands commercial banks; subsequently, Treasury bills were placed with the Bank for International Settlements in Switzerland and one loan was obtained from a Swiss commercial banking group, probably yielding an additional 1 billion francs. The Belgian Treasury also derived the dollar equivalent of about 3 billion francs of the Congo's dollar resources through sale of dollar-denominated Belgian Treasury 90-day bills to the Congo Treasury and the Congo Central Bank. In addition, an arrangement was concluded with the Netherlands for early repayment of a government-to-government loan, yielding about 1 billion francs.
2/ Rigid application of such a gold reserve rule appears to be undesirable. For one thing, Treasury deficit financing through foreign borrowing increases the domestic quantity of money to fully the same extent as commercial bank

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Monetary policies

The problem of meeting the chronic budgetary deficits has been further aggravated by Belgian monetary policies, which require that Treasury domestic borrowing be limited insofar as possible to "genuine savings" of the non-banking public. These policies have, until recently, contributed to the high cost and general scarcity of both public and private credit. Savings of private individuals and institutions (despite some recent increase) continue to be fairly low and the capital market remains inactive by American standards. Nevertheless, the National Bank has been generally reluctant to permit deficit financing through commercial bank purchase of government issues, except as required reserve cover against bank deposit increases -- an unpredictable source of Treasury financing. Deficit financing through National Bank purchases of Treasury bills -- directly or indirectly through open-market operations -- is permissible only insofar as the Bank's legal ceiling on such Treasury advances is not exceeded by such transactions.

However, it seems that this rigidity of postwar Belgian monetary policy is now being somewhat relaxed. Since 1953, there appears to have been some easing in the Belgian monetary and capital markets arising, at first, from an unforeseen combination of technical factors and, more recently, from conscious policy measures in this direction.

The money market in 1953 -- A combination of technical and cyclical factors since mid-1952 has tended to ease monetary reserves and the quantity of available short-term bank credit and, to some extent, of long-term investment financing; and, correspondingly, to force down money market rates and long-term public and private bond yields.

The disappearance of the large EPU surplus, which has provided a steady increase in the reserve base and in bank liquidity during 1951 and early 1952, was offset by the increased use of foreign loan operations to finance the budget deficit. The supply of investment funds was increased also by a small rise in personal saving and the consequent growth of personal and institutional investment funds, while private demand for bank credit was reduced by liquidation in business stocks.

Finally, the National Bank reduced its discount rate by one-quarter per cent each in December 1952 and October 1953 to 2-3/4 per cent. A further reduction occurred in early 1954 in Belgian private money market rates and bond yields. These declines reduced the formerly great differential in interest rates between the two prospective partners in the Benelux, and were in line with similar developments in the United Kingdom and Western Germany.

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borrowing would have done; while, in addition, it raises the banks' cash reserves permitting, in Belgium, (where the average reserve requirement is 60 per cent) a further domestic loan expansion to somewhat less than the original amount. Moreover, since such loans are generally of short maturity, Treasury debt management problems are increased greatly from a technical point of view. Past application of this rule is discussed in the author's paper on "Government Debt Management and the Capital Market in Belgium" (April 21, 1953).

Recent changes in monetary policy — Until recently, the Treasury has opposed participation of the commercial banks in EPU surplus financing, in part, to minimize monetary expansion and, in part, to augment the market for short-term Treasury paper. Partial blocking of foreign currency proceeds from Belgian exports to EPU nations was ended in April 1954, and all funds blocked at that time are being repaid over a six months' period. The National Bank is obtaining funds for repayment through sale to the commercial banks of 2,050 million francs of EPU Special Treasury Certificates, with maturities from 6 to 24 months and yields of 2.5 to 3.5 per cent, to which each bank must subscribe in an amount equal to the blocked balances on its books in April. Further, the banks will subscribe to additional amounts of these Certificates to a maximum of 300 million Belgian francs to form a fund for financing the credit half of future EPU monthly surpluses.

In view of the present and prospective ample supply of short-term credit at declining rates, the Treasury apparently does not fear that additional short-term public credit demands upon the banks will impinge upon the Treasury's ability to obtain short-term credit. Moreover, the arrangement does provide that, in order to guarantee sufficient reserves to the banks, the banks may discount 50 per cent (or 1,175 million francs) with the National Bank at the interest rate of this issue; and that the 6 and 12 month Certificates are eligible for use as cover ratio, or legal reserves, to the extent of 60 per cent of a bank's holdings of such Certificates. The arrangement also contributes to monetary ease in the sense that unblocked funds released to exporters will constitute, in effect, an addition to net business investment funds, which might further reduce long-term private rates and stimulate investment expenditures.

Conclusion

Externally, Belgian progress toward convertibility, with respect to removal both of trade and exchange restrictions, has been impressive and amounts for all practical purposes to almost full attainment of the goal. As pointed out in the 1954 Annual Report of the National Bank, Belgium's monetary and fiscal policies have contributed greatly to this development by creating sound internal conditions and confidence in the Belgian franc. It appears, however, that in view of the growing external competitive disadvantage, partially caused by continued underinvestment in many economic sectors, some relaxation in Belgium's traditional strict rules of debt management and monetary policy is taking place. Fiscal reform, including some shift to direct revenue sources which would bear less heavily upon industrial costs and Belgian export prices, also has been promised by the new government. These changes should not endanger internal financial stability nor impede progress toward convertibility; on the contrary, they should help Belgium to realize the opportunities created by such progress for increasing its domestic investment and national income.