During the post-war years, inflation and balance of payments deficit and closely related problems were persistent in Western European countries. The excess of effective demands over the volume of available goods and services increased imports and reduced exports, bringing about an immediate payments problem. The import-surpluses were not sufficient to absorb fully the excess-demand; further, domestic price and cost also rose, tending to make the payments-problems chronic. Thus circumstances were favourable for the application of a monetary policy to improve both the inflation and the payments-deficits. But, surprisingly enough, with few exceptions no country in Western Europe, faced with the twin problems of inflation and payments-deficits, used any monetary policy to meet these problems prior to the Korean War. Of course, in recent years different monetary measures have been adopted in European countries.

In the next few pages an attempt will be made to study critically both the quantitative and qualitative measures adopted in these countries in recent years.
Monetary policy in France

Since the outbreak of World War II inflation has been more pronounced and persistent in France than in any other country. During the war, the payment of occupation costs and financing of net exports to Germany which led to a considerable increase in bank deposits and currency circulation, were responsible for inflationary pressure in France. And although production declined considerably, this increased in bank deposits and currency circulation did not cause a proportionate rise in prices, because controls worked with some success during that period.

During the post-war years, the inflationary potential that had accumulated between 1939 and 1944 became open. So in this period prices, wages, and bank credit increased very sharply in an environment of persistent and large budget deficits, political instability and social tensions.

After the liberation of France in September 1944, when the total money supply in France was more than five times that of 1938, the French government, unlike Belgium and Netherlands, did not embark on a monetary purge to get rid of the surplus money. Moreover, government securities held by the commercial banks accorded for a much larger share of the banks' total assets that in prewar days and, consequently, the scope for the expansion of bank-credit was greater than before.
One of the causes of the postwar inflationary process was the government budget deficits which amounted to 12 to 14 per cent of the national income during 1946-48. There was also an increase of 600 per cent in bank credit to the private sector between 1945 and 1948. During the same period, the money supply was more than doubled and prices rose to 4½ times and wages to nearly 4 times the previous level. These will be evident from the figures given below.

Selected Economic Data for France. 1

<table>
<thead>
<tr>
<th>Date</th>
<th>Money Supply (In Million Francs)</th>
<th>Wholesale Prices (Paris) Base 1948 - 100</th>
<th>Wages (Base 1948 = 100)</th>
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</thead>
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<tr>
<td>1948</td>
<td>1,128</td>
<td>58</td>
<td>63</td>
</tr>
<tr>
<td>1945</td>
<td>1,013</td>
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<td>1,349</td>
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<td>1947</td>
<td>1,578</td>
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</tr>
<tr>
<td>1950</td>
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</tr>
<tr>
<td>1952</td>
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<td>163</td>
<td></td>
</tr>
<tr>
<td>1953</td>
<td>4,330</td>
<td>154</td>
<td></td>
</tr>
</tbody>
</table>

1. International Financial Statistics, I.M.F.
Domestic Loans and Investments of Banks in France.1

In billions of Frenchs.

<table>
<thead>
<tr>
<th>Date</th>
<th>Bank of France</th>
<th>Other banks</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Government</td>
<td>Business &amp; individuals</td>
</tr>
<tr>
<td>1938</td>
<td>33</td>
<td>13</td>
</tr>
<tr>
<td>1945</td>
<td>463</td>
<td>30</td>
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</tr>
<tr>
<td>1953</td>
<td>1,252</td>
<td>890</td>
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Qualitative credit controls

In the face of these inflationary pressures, the chief aim of the French monetary authorities was to use extensively the quantitative and qualitative methods of credit controls to combat inflation. In December, 1945 a banking legislation was passed, by which an effort was made to reform the French credit and banking conditions. Under the

1. International Financial Statistics, I.M.F.
provisions of the Act, in the first place, the Bank of France and the largest four deposit banks were nationalised and secondly, the National Credit-Council (Conseil National du credit) was established as the paramount banking and credit agency in France. One of its powers was to issue orders or recommendations to banks about the type of credit they should encourage or discourage. 1

Recognising the paradox confronting credit control during a period of reconstruction and inflation, the National Credit Council, in 1947, preferred qualitative methods to quantitative credit control. In its own words, "the National Credit Council recognises that the risk of an excessive development of credit is grave..., but the council also recognises the danger which would result from an excessive limitation of credit." Placing these two opposite risks on the same level of importance, it declared "any available resources which it is physically possible to put into operation - raw materials, power, labour, transportation, foreign exchanges - should not remain unused for lack of credit." Therefore in order to check inflation, the council first relied solely on qualitative controls. In the council’s judgement the distribution of credit was to be "discriminatory but not systematically restrictive." 2

Measures for qualitative credit control were taken along two lines: First, the Council gave the banks general instruction for restricting credit, and Second, it referred the approval of large credits to the Bank of France. In 1946, it was made obligatory for


banks to report all extensions of credit in excess of 5 million Francs to a newly created credit department of the Bank of France. In January 1947, the banks were asked not to give advances exceeding 30 million Francs (raised in February 1948 to 50 millions) without the previous approval of the Bank of France.

At the same time, the National Credit Council directed the banks not to grant credit for non-essential purposes and to firms which could obtain funds by speeding up sales, or by liquidating extraneous assets, or by recourse to personal resources or to the capital markets.

These measures of new controls did not include the commercial bills discounted by banks on the assumption that such credit represented the flow of goods through the process of production and distribution and thus, was noninflationary. But since a major portion of bank credit to commerce and industry consisted of discounting commercial bills, a large area of credit remained uncontrolled. The ratio of commercial bills to all bank loans increased from 43 per cent at the end of 1945 to 60 per cent at the end of 1948. Therefore, it was difficult to ensure implementation of the qualitative controls with success. Moreover, the Bank of France found it difficult to apply the criterion of screening the types of loans to be granted to borrowers. It failed to examine properly the solvency

1. Federal Reserve Bulletin, August 1948, P.953
of the borrower, the quality of the collateral supplied and other technical credit matters. It is significant to observe that the number and amount of rejections of application for loans sharply decreased while the number of requests considerably increased from 1947 to 1948.

Such increase was due to the fact that, when taken singly, each loan applicant appeared to be in pressing need of funds as a result of inflation. It was also impossible for the commercial bank and difficult even for the Bank of France to relate each single case to the total volume of credit or to the national investment programme.

Finally it was held that without some quantitative control, it was impossible for the commercial banks or the Bank of France to reject less deserving borrowers who placed strong arguments for special consideration. Therefore, before the monetary reform of September 1948, some bankers began to feel that quantitative rather than qualitative controls would have been quicker and more effective in curbing credit-expansion.

1. Ibid
When qualitative credit-measures proved inadequate and inflation resumed its course again in the summer of 1948 under the impact of a renewed treasury-deficit, continued bank credit-expansion and a prolonged political crisis, a more comprehensive system of quantitative control was set up in September 1948. The Bank of France prepared a series of new measures in the field of credit control which were finally approved by the National Credit Council. These measures, consisting of new quantitative and strengthened qualitative controls, became an integral part of the stabilization programme of the coalition government headed by M. Queuille.

The rise in interest rates.

After January 1947, the discount rate of the Bank of France was raised in various stages to 4 per cent in 1943, to 3% in September 1948, the increase by one point from 2½ and 3 per cent, to 3½ and 4 per cent respectively, was mainly due to psychological reasons during the period of political instability arising from a succession of governmental crises. With the increase of the discount rate, the rates of interest on government securities, call-money-rate and treasury-bill top-rate were also allowed to move up. Changes in interest rates in France in the postwar period will be evident from the figures given on the next page.
<table>
<thead>
<tr>
<th>Year</th>
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<th>Treasury Bill Rate</th>
<th>Call Money Rate</th>
<th>Government Bond Yield</th>
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<td>2.60</td>
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<td>4.04</td>
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<tr>
<td></td>
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<td>1.625</td>
<td>1.50</td>
<td>1.38</td>
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</tr>
<tr>
<td>1947</td>
<td>{ 1.75-2.25</td>
<td>1.625</td>
<td>1.57</td>
<td>3.91</td>
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<tr>
<td></td>
<td>2.50-3.00</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>1948</td>
<td>( 3.50 - 4.00</td>
<td>2.00</td>
<td>2.09</td>
<td>4.62</td>
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<td></td>
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<td>1949</td>
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<td>2.26</td>
<td>4.78</td>
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<td>1951</td>
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<td>( 4.00</td>
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</tr>
<tr>
<td>1952</td>
<td>4.00</td>
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<td>3.79</td>
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<td>1953</td>
<td>Sep. 5.50</td>
<td>3.00</td>
<td>4.18</td>
<td>5.52 (August '53)</td>
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<tr>
<td></td>
<td></td>
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<td>(August '53)</td>
<td></td>
</tr>
</tbody>
</table>

Reserve of Government Securities,

New monetary measures of quantitative control which were adopted in September 1948 by the French monetary authorities, provided for control over bank reserves and set ceilings to a bank's rediscount facilities.

1. International Financial Statistics I.M.F
In France, as in most other countries, the danger of expansion of private credit by the selling of government securities to the Bank of France by the Commercial Banks was real. And in fact in 1946 and 1947 commercial banks caused considerable difficulty by selling government securities for the purpose of expanding private credit. To stop this practice, the Bank of France had attempted to make "gentlemen's agreements" with the important commercial banks whereby the latter undertook to hold government securities, except when there was a net withdrawal of deposits. This voluntary measure had worked well, on the whole, but the regulation passed in September, 1948, formalised these agreements. From October 1948, banks were legally required to maintain their minimum holdings of government papers at 95 per cent of the volume held on September 30, 1948.

Also, at least 20 percent of any addition to their deposits had to be kept in cash on short term government paper. This was the first formal reserve requirement of any type, in French banking history.

Since the great depression and more particularly since World War II the governments of western countries attempted to control credit by extending control over commercial bank portfolios. By imposing reserve requirements to be met by government securities, the liquidity of commercial banks was reduced and consequently, their capacity for loan expansion was made immediately dependent upon and responsive to the central bank's discount policies. Besides France commercial bank reserve requirements to be met in part or in whole in the form of government-securities have been established in Belgium, Italy, the Netherlands, Sweden, Switzerland, Brazil, Mexico etc.
Rediscounting Ceilings.

The new measures regarding bank holdings of government-securities were not sufficient to prevent the expansion of private credit. They were therefore supplemented by the establishment of rediscount ceilings for all commercial banks. This action might well prove effective in preventing a general expansion of credit by banks. Before the regulation of September 1948, rediscount ceilings were imposed by the Bank of France upon many smaller banks operating in the Paris money market. After September 1948, they were applied to all banks. These ceilings were fixed individually for each bank and were held in strict confidence.

The most important significance of the imposition of rediscount ceilings was that commercial bills would not be treated as self-liquidating paper. If a bank reached its rediscount ceilings, a high class commercial bill brought by that bank for rediscount was ineligible for rediscount at the Bank of France. The rediscount ceilings could in this way bring pressure on the banks to keep an increasing percentage in the form of cash or short term government-securities. Therefore, they might be a more substantial restraint on credit expansion than are the reserve requirements. But the restraining effect of the ceiling was not absolute because certain types of bills, such as acceptances of the credit National, bills drawn on the Caisse Nationale du Credit Agricole in connection with the financing of the wheat harvest, and bills drawn by the Treasury were exempted from the ceilings. Such
exemptions for certain types of bills exerted pressures upon the Bank of France for rediscounting, which were evident within a few weeks after the ceilings were imposed.1

As a result of the credit controls introduced in September 1949, the pace of inflation slowed down considerably during 1949 and most of 1950. The deficit in the government budget was smaller in relation to national income than in the preceding three or four years. Price and wages rose by 20 percent and the balance of payments deficits was reduced.2 The money supply and bank credit increased by about 45 percent; production continued to increase and unemployment remained low.

During this period of comparative stability, the French authorities relaxed the restraints on credit. In April 1950, the limit beyond which bank advances could not be given to a customer without the approval of the Bank of France was raised from 50 million to 100 million francs. Rediscount ceilings were also raised. In June 1950, the discount rate was reduced from 3 to 2½ percent and the rate on advances against securities from 4 to 3½ percent. As a consequence, the rates on bank credit also were reduced.

2. International Financial Statistics, I.M.F.
Monetary policy after the outbreak of the Korean War.

Like the United Kingdom, France felt the inflationary impact of the Korean War some-what later than most countries of Western Europe. Notwithstanding budget deficits and the rise in prices following the Korean War, the French monetary authorities, instead of adopting restrictive measures, allowed credit to expand in order to meet the military expenditure of the Government. The effects of this inflation were obviously a sharp rise in prices and the attendant fall in the purchasing power of money. The wholesale price index rose by 177 per cent (base 1948-100) between 1945 and the middle of 1951. The Balance of payments showed an alarming deficit. It rose from 200 million in 1950 to 1,000 million U.S. dollars in 1951.

In the face of this serious inflationary authorities alarming payments deficits, the French monetary authorities renewed monetary controls. The Bank of France restored its discount rate in October, 1951 from 2½ per cent to 3 per cent and about a month later raised it further to 4 per cent. The treasury-bill-top-rate was raised, for the first time in four years, from 2 to 3 per cent. The government bond rate was allowed to find its own level and it continued its upward movement. The rediscount ceilings for each bank were raised upward in most cases. The total of rediscount ceilings were raised from 290 billion to 500 billion francs. The compulsory reserve
requirement provisions were also revised. Previously, banks had been
required to attain the required ratios in their assets only once a
month, with the result that a practice of window dressing developed. But
since October 1951, these ratios were to be maintained on a daily basis.

Insipite of these monetary measures credit continued to expand,
one of the factors responsible for credit expansion was the raising of
the limit of bank advances to a customer without the approval of the Bank
of France, from 100 million to 500 million francs. Consequently bank
credit continued to increase during the last quarter of 1951 and the
first quarter of 1952. The average monthly deficit with the European Ex-
change Payments Union rose from U.S. $36 million in the third quarter of 1951
to $95 million in the fourth quarter and the 129 million in February
1952. Only after March 1952, there were some signs of an abatement
of inflationary pressures in France. Wholesale prices fell slightly
and bank credit increased a little. The foreign trade deficit declined
from a monthly average of U.S. $172 million during the first quarter of
1952 to U.S. $65 million during the third quarter of the same year.
It should be noted that this improvement was the outcome of different
policies and circumstances unrelated to the monetary reform of 1951.
Despite the monetary reform, France failed to achieve economic prosperity
and stability as her increasing military expenditure absorbed a large
portion of the national resources.

1. International Financial Statistics: I.M.F
Monetary policy in Western Germany.

The foundation of an active monetary policy in Western Germany was laid in June 1948, when a drastic currency reform was undertaken. Since the occupation of Germany by the Allied Powers, the problems of rehabilitation of banking and credit drew their attention. Early in 1947, somewhat on the model of the Federal Reserve System in the United States, a central banking system was established in Germany, with four Lender Central Banks in the U.S. Zone, four in the French Zone and five in the Russian Zone, mainly, to regulate monetary circulation and credit supply, to secure the solvency of the credit institution and to facilitate payments relations with other lender and foreign countries. These banks were subordinate to the main central bank, namely the Bank Deutscher Central Bank. It was started on first March 1948, to replace the old Reichs Bank. In the Russian Zone a similar Central Bank was established in June 1948. The Bank Deutscher Lander responded quickly to the opportunity offered by the far-reaching monetary reforms introduced in the middle of 1948.

Monetary reform of 1948.

As in Belgium and the Netherlands, the most important feature of the currency reform introduced in Germany, was to embark on a drastic monetary purge which permanently wiped out more than nine-tenths of the money in circulation. In June 1948, the unit of currency was changed from
from the old Reichsmark to a new Deutsche Mark. The Reichsmark holdings, including bank balances, of all individuals other than banks, government agencies and a few other institutions were converted into Deutsche Mark at the ratio of RM 100 to DM 6. This conversion was gradual and it was completed by the middle of 1949.

The currency reform provided also for the conversion of most of the monetary claims in the ratio of RM 10 to DM 1. The entire internal debt of the old Reich was declared worthless. This, along with the money supply, the liquid assets were curtailed.

A Banking reform of far-reaching importance was undertaken to reorganize the banking system in Germany. Banks had suffered very seriously as a result of war-time destruction, the loss of their assets outside Germany and the confiscation of their holdings of foreign exchange. Their entire holdings of notes and coins of the Reichsmark period, their claims against the Reich, and their balances with other banks were declared worthless. Therefore, it was necessary to compensate them if they were to resume their normal activities. This was done, first, by giving them an initial quota of balances with the Central Bank and secondly, by giving them certain amounts of equalization-claims. These claims were similar to funded government debt, but, unlike government securities, their negotiability was restricted and they could be transferred only between banks at par. The result of this reorganization of bank assets was to restore their usefulness on the one hand and to bring banks under the control of the central bank on the other.
All the government agencies were helped with an initial quota of Deutsche Marks to carry on their normal functions. Under the provisions of the currency laws, budget deficits were forbidden in principle and short-term borrowing was allowed only in anticipation of future receipts. At the same time, under the central bank laws, limits were put on borrowings by the public authorities from the Lender Central Banks and the Bank Deutscher Lender. From the above, it becomes clear that the Bank Deutscher Lender started its career with sufficient safeguards against the frustration of its monetary policy by the budgetary impudence of the government.

Monetary policy before the Korean War.

The immediate effects of the monetary reform were satisfactory. Confidence in the currency began to revive in Germany. It was possible there to start the work of economic reconstruction, while the reconstitution programmes depended heavily on bank-credit, at the same time, the volume of the means of payment was reduced by over 90 per cent by the monetary reform of June 1948. In the absence of a capital-market, this produced a need for a large expansion of credit by the commercial banks in Germany. They were responsible for providing accommodation, medium and at long term as well as short term credits rising from DM 1244 million, in July to 3550 million, in October 1948. This being a sign of an incipient inflationary rise in prices, the Bank Deutscher Lender began to use gradually the techniques of control over

2. Ibid. P. 200
bank credit. The discount rate was initially set at 6 per cent and banks were subject to minimum reserve requirements. Instructions were also issued to commercial banks regarding the type of bills and acceptances which would be discounted by the Bank Deutscher Lander and the conditions under which they would buy and lend against equalization claims.

After October 1948, there was a considerable increase of bank credit and an inflationary rise in prices. Apprehending a further inflationary rise in prices due to increase in bank-credit, the Bank Deutscher Lander raised the minimum reserve requirements from 10 to 15 per cent against sight deposits. Commercial banks were persuaded not to increase the total amount of their credits beyond the level of October 31, 1948, without consultation with the appropriate Lander Central Banks and at the same time the conditions concerning the central bank rediscount were stiffened. As a result of these measures, from November 1948, wholesale prices began to decline and in early 1949, they fell a little and the rate of credit-expansion slowed down. At that time, the influx of refugees continued to swell the ranks of the unemployed and, therefore, the need to create further employment was felt.

This change in the trend allowed the central bank of Western Germany too reverse the tighter credit policy and the Bank Deutscher Lander followed a policy of encouraging credit expansion.

In March 1949, so far as commercial banks were concerned, the condition of keeping their credits below the level of October 1948,
was relaxed. In June 1949, the minimum reserve requirements were re-
duced: the reserve ratio was lowered from 5 to 4 per cent against
time deposits, from 15 to 10 per cent or from 10 to 8 per cent against
sight deposits according to the category of the bank concerned. In
July 1949 the discount rate was reduced first from 5 to 4 1/2 per cent
and then to 4 per cent.

In August 1949, the Bank Deutscher Länder laid a liberal pro-
cedure under which commercial banks could make use of their equaliza-
tion-claims in order to expand credit for long term export orders or
for investment purposes. Banks could get total help of DM 300 million
by selling their equalization to the Bank Deutscher Länder if they
could satisfy the central bank that the funds were needed for export
orders or investment purposes. Thus the central bank bought at par
some of the bonds held by commercial banks, Despite these steps to lib-
eralise credit during 1949, the monetary authorities followed a
cautious policy due to the balance of payments difficulty.

Throughout 1949 and in early 1950, the number of unemployed
continued to increase enormously. So in order to procure employment
for these unemployed persons, the central bank took certain steps to
ease credit conditions. The Bank Deutscher Länder decided to expand
credit finance to export industries and the construction of houses. It
decided to help in the programme of building of houses to the extent
of nearly DM 900 million. The government credit limit at the central
bank was raised from DM 500 to 1000 million and then it was raised

1. Ibid P. 200
Thus only a part of the credit promised by the central bank was utilised before the outbreak of the Korean War.

As a result of easing credit conditions, during 1949 short-term credits extended by commercial banks increased from DM 4684 million in December 1948 to DM 9849 million in December 1949 and medium and long-term credits from DM 476 to 2229 million in the same period. Commercial banks' liquidity also gradually diminished, while in 1948 Land banks held large excess reserves with the various Länder Central Banks but these reserves declined considerably in early 1950, in spite of the fact that during 1949 the minimum reserve requirements had twice been lowered.

Monetary policy after the outbreak of the Korean War.

After the outbreak of hostilities in Korea, Germany was faced with two conflicting problems: one was the fear of inflation and balance of payments difficulty, and the other was the desire to increase production and employment. The immediate crisis was the large intra-European deficits which rapidly exhausted its quota of $320 million in the European Payments Union caused by rapid increase in imports, the deterioration in the terms of trade and a speculative shift in the terms of overseas payments.

The sharp increase in the volume of fresh credits in the autumn of 1950 was responsible for increasing the purchasing power and at the same time for causing a disequilibrium in the balance of payments. In

1. Ibid P. 201 2. Ibid P. 201 3. Ibid P. 201
September 1950, short-term loans granted by commercial banks to non-bank customers increased by DM 685 million. This expansion was possible because an equally large amount was refinanced by the central banking system. 

Under this circumstance, in October and November 1950, an attempt was made to rectify this crisis in the balance of payments by introducing restrictive monetary measures which were quickly supplemented by a direct restriction of imports.

From October 1, 1950, the minimum reserve requirements for commercial banks were raised from 10 to 15 percent against demand deposits and from 4 to 8 percent against time deposits. As a result of this, the legal minimum requirements against deposits kept by commercial banks with the Central banking system rose from an average of DM 1141 million in September 1950 to an average of DM 1716 million in October, 1950, i.e., by 575 million. But this was offset by an increase of credits by DM 648 million granted by the Central banking system to commercial banks in the month of October. Therefore, it was decided that bank acceptances would be rediscounted at Lander Central Banks at the level of 12th October with some exceptions for export credits and harvest financing. Although the decrease in the volume of acceptance credit had been more than counterbalanced by increases in other forms of short term lending by the banks, the fact that acceptances were reduced, undoubtedly helped to improve the quality of the bank credit-outstanding. In October 20, 1950, the discount rate was raised from 4 to 6 percent. The Lander Central Banks were requested by the Bank Deutscher

1. The twentyfirst Annual Report, B.I.S. P.48
2. Ibid P.49
3. Ibid P.49
to reduce their credits to commercial banks by 20 per cent before
January 31, 1951, with certain exceptions. But the success of this
policy fell short of expectations, because between October 1950, and of
January, 1951, the percentage-decrease in the amount of bills rediscounted
worked out at 5.4 instead of 10 per cent.1

To make the financing of imports still more difficult, a new
regulation was adopted to the effect that import permits could be grant-
ed or prolonged only if 50 per cent of the value of the permits were
first deposited in cash at a Lender Central Bank. The important signifi-
cance of this regulation was not only to impose a certain restriction
on the individual firms which applied for import licences, but also to
reduce the liquidity of commercial banks and at the same time to sterilize
corresponding amount of bank credit. Of the increase of short term cre-
dits by DM 1500 million by commercial banks to business and other private
customers, about DM 860 million were sterilized through the operation of
the cash-deposit provision.2

These monetary measures were mainly taken to redress the
balance of payments crisis. But the success of the policy fell short
of expectations. By the end of February 1951, Germany had almost exhaus-
ted its special credit with the European Payments Union and had to
resort to severe import-restrictions. The dear money policy slowed
down the rate of expansion of bank-credit. But on account of the urgency
of the crisis and of the loopholes that manifested themselves in the
system of monetary discipline, it became difficult for the monetary
authorities to introduce additional measures. The higher discount rate

1. Ibid p.49 2. Ibid p.50
was not much of a deterrent to borrowers who expected prices to rise sharply. It was not possible to raise reserve requirements as it would impinge on the liquidity of different banks. Apart from this, the criteria established by the Bank Deutscher Lender for the rediscounting of bank-bills and acceptances left some scope for shifting to other types of credit for obtaining additional accommodation from the central banking system. The unutilized portion of the credit promised by the central bank in connection with the employment promotion-programme of the earlier period was used to feed the Post Korean expansion.

The experience with monetary policy led the central bank to adopt new measures of a somewhat permanent significance. At the end of January the Bank Deutscher Lender issued certain new guiding principles to the commercial banks according to which those banks had to adjust their balances. First, their short-term credits granted to businesses and other private customers should not be more than twenty times greater than their capital and reserves. Secondly, current credit and acceptance credits together should not exceed 70 per cent of deposits and the banks’ own resources. Thirdly, acceptance credit should not exceed seven times and three times in the case of foreign trade and harvesting financing respectively to the banks’ own resources. Lastly, the ratio of liquid assets to deposits should be at least one to five. Such principles could not be compulsorily established. But the idea was to develop certain uniform practices during the period by utilizing the powers of suasion and supervision.

1. Ibid p.51
These measures did not prove sufficient to reverse the market trend in the conditions obtaining in the early months of 1951. Therefore, the German Government imposed import restrictions by issuing no further import licences. At the end of February 1951, the Board of Directors of the Bank Deutscher Länder decided that the outstanding volume of credits which had been granted by commercial banks to business and other private customers should be reduced within two or three months by at least DM 1000 million below the level recorded on 31st January, 1951.1 Instead of relying merely on indirect pressures, the central banks thus required the banks to follow a direct quantitative course. The scheme for reducing credits permitted different treatment for different banks, in so far as they were not subject to a uniform proportionate reduction. It also implied a selective approach to credit restrictions: long-term credits were excluded from the scheme and a certain type of short-term credits, for example credits for financing exports were exempt from the provision.

The new monetary policy was successful on the whole. By the end of May 1951, the type of bank-credit subject to reduction quotas was curbed by DM 840 million against the DM 1 million which had been intended (base period: the end of January 1951). This reduction indicated the fall in import-credits resulting from the import-restrictions, the decline in raw-material prices. It also helped to restore confidence in the financial stability of the German economy and encouraged fresh savings.

1. Ibid, P. 28
After June 1951, the central banking system eased monetary measures. In September 1951, the obligation to deposit cash at the Local Central Bank for import, was abolished. During the year 1952, German imports fell much less than those of other European countries while its exports increased steadily. It is unlikely however that the continued growth of German exports in a period of generally declining world trade would have been possible except in the context of cautious monetary policies and balanced Government Budgets. As a result of a considerable improvement of the Balance of payments position in Germany—monetary restrictions were relaxed. In April 1952, the minimum reserve requirements were lowered for the first time since October 1950 and again they were lowered in September, 1952. The discount rate was also lowered in May, 1952 from 6 to 5 per cent and again in August, 1952, to 4½ per cent. Along with these liberal measures the central banking system also refined the instruments of monetary control at its disposal. These refinements had no immediate restrictive purpose, but they were intended to add to the ability of the central bank to perform its functions adequately and efficiently.

Therefore, when the minimum reserve requirements were reduced in April, 1952, a new principle of differentiating between banks were introduced. Until then the reserve requirement had been different for different kinds of deposits and for banks in different localities; more or less on the model of the U.S. practice. But a further distinction

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1. Annual Report I.M.F. 1953 P. 12

2. In Germany, in Oct. 1950, minimum reserve requirements were 15 per cent against demand deposits of commercial banks situated in places where a Lander Central Bank had its office or branch and 12 per cent against demand deposits in other places.
was made between banks on the basis of the size of their deposits. A more favourable treatment was meted out to the smaller banks.

Another recent innovation was the determination of specific ceilings to the amount of rediscount-facilities that commercial banks could obtain from the central banking institution. A commercial bank which exhausted its quota could receive advances from the central bank against securities. The rate of interest at which such advances were available was one per cent higher than the discount rate and the conditions of their availability were more severe than those for ordinary rediscounts. And by lowering or raising ceilings to the amount of rediscount-facilities, the central bank, in Germany enforced additional influence over bank-credit.

Effects of the monetary policy

Since the currency reform of 1948, Germany has shown remarkable recovery in production. Industrial production (base: 1950 = 100) rose from 55 in 1948 to 146 in November 1952.1

Employment in industry increased by 27 per cent from 88 to 115 in December 1952. The cost of living index showed a rise by 4 points between 1949 and December 1952 while money-wages increased by 56 points.2 In 1951 the balance of payments showed a small surplus of U.S. $53 million for the first time in the post-war period and it moved up to $66 millions in June, 1952.3 The acute crisis in Germany's

1, 2 and 3 International Financial Statistics, November 1953
I.M.F. Pages 90 & 91
relations with the European Payments Union was overcome by the spring of 1951 and by the end of the year Germany was able to repay all the credits received from the European Payments Union countries. By September, 1952, it earned a net surplus of about U.S. $450 million against a deficit of the amount which was equal to it at the end of February, 1951. These economic achievements of Germany should be attributed mainly to the monetary policy of the central bank which had shown considerable ingenuity in introducing new instruments of monetary control and also in applying them suitably.

Monetary policy in Scandinavian Countries.

Norway.

As in other liberated countries, steps were taken in Norway to reduce the excess money supply which increased enormously during the German occupation. In September, 1945, all the notes in circulation (excepting the denominations of one crown and two crowns) ceased to be legal tender. The notes had to be presented and for 60 percent of the amount the owner was credited on a current banking account, while the remaining 40 percent was credited to the owner on a "state account" which could not be withdrawn by him without the permission of the Finance Department of the Norwegian Government. As a result of this operation the note circulation was reduced from N Kr 1403 million to N Kr 1136 million at the end of October 1945.1

In the post war period, monetary policy was not widely used to fight inflation. Through direct controls, subsidies and anti-inflationary fiscal policy, Norway succeeded in preventing the strong inflationary pressures.

The object of government-policy was to counteract the inflationary forces at work for restoring internal stability and for improving the external deficits. Therefore Budget-Policy was directed to maintaining a large budget surplus. A surplus on current account had already been achieved in 1946 and during 1946-49, there was an over-all surplus of N Kr 547 million. The discount rate of the Bank of Norway was lowered from 3 to 2.5 per cent in January 1946 and since July of the same year the yield on government-bonds also declined.

In Norway, there was a cut in the government-investment and both direct and indirect taxes were increased. Monetary measures were adopted to ensure that banking loans and credit facilities would be adopted according to economic policy of the government.

In Denmark, the exchange of notes was adopted in July 1945, as part of a wider measure aiming at an "economic purge". As a contraction in the note-circulation was, moreover, thought desirable, the outstanding notes were declared invalid and the result of this measure was the reduction in notes in circulation from D Kr 1124 million to D Kr 868 million on the last date of July 1945.

During 1946-48, the volume of notes in circulation and of demand deficits with the National Banks were reduced by D. Kr. 2400 million through various measures of monetary reform including special allocation of the proceeds of certain taxes. But the deflationary effect was off-set by the action of the government as it made debt-repayments in cash in order to prevent a further stiffening of interest rates. In the post-war period, regarding the policy of the National Bank, the Bank held that "the economic policy of the country, while taking account of employment, should be framed in such a way as to fulfil the requirements of balance in payments-relations with foreign countries."

In order to reduce the balance of payments-deficit (which increased from D Kr 272 million in 1949 to D Kr 229 million in 1950), the central bank raised its discount rate from 3½ to 4 per cent in July 1950.

1. The Fifteenth Annual Report, 1944-45 p.64
2. The Twentieth Annual Report, 1949-50 p.203
in 1950 and again to 5 per cent in November in the same year. The commercial and savings banks also increased their lending rates from 3 1/2 to 5 1/2 per cent. Long term rates of interest and the yield of government bonds showed an upward trend. In October 1950, the Denmark National Bank withdrew discount privileges for construction loans and such loans were not granted until September, 1951, after the central Bank had arranged with the Minister of Finance for a debt-management operation designed to prevent any consequent expansion in the money supply.

This antinflationary policy, however, improved the balance of payments position as the deficit had declined from D.Kr. 839 million in 1950 to D.Kr. 887 million in 1951, and again to D.Kr. 207 million; but it had a restrictive impact on internal activities. Industrial production, particularly, consumer-goods declined and unemployment increased faster than before.
After the World War No. II, like other Scandinavian countries, Sweden succeeded in fighting the inflationary pressures through direct controls, subsidies and an anti-inflationary fiscal policy. The monetary and credit situation in Sweden was comparatively normal as compared with other Western European countries. Therefore, in February 1945, the rediscount rate of the Riksbank was lowered from 2½ to 2 percent, at which it remained unchanged until 1950. But the treasury bill rates were raised somewhat in the years 1946-48. On the other hand, the yield of long-term government bonds was maintained practically stable around 3 percent by open market operations. When the volume of investment (public and private together) exceeded the volume of current savings in 1948, instead of making any change in the interest policy, the government took measures of direct control to curtail expenditure. By 1948 the volume of investment was reduced by about one-fifth; consequently internal balance was restored and the equilibrium was established in the balance of payments.

After the outbreak of the Korean War, there was a considerable expansion of credits by credit-institutions and this will be evident from the following figures:
Credits granted by various institutions.1

(In millions of Swedish Kroners.)

<table>
<thead>
<tr>
<th>End of month of period</th>
<th>Commercial banks</th>
<th>The 84 biggest Savings banks</th>
<th>The Postoffice Savings banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>August 1949</td>
<td>7715</td>
<td>4644</td>
<td>685</td>
</tr>
<tr>
<td>June 1950</td>
<td>8580</td>
<td>4967</td>
<td>752</td>
</tr>
<tr>
<td>Change from August 1949 to June 1950</td>
<td>+ 742</td>
<td>+ 343</td>
<td>+ 73</td>
</tr>
<tr>
<td>March 1951</td>
<td>9723</td>
<td>5201</td>
<td>823</td>
</tr>
<tr>
<td>Change from June 1950 to March 1951</td>
<td>+ 1163</td>
<td>+ 234</td>
<td>+ 130</td>
</tr>
</tbody>
</table>

This expansion of bank-credits together with the increase in import prices and in wages gave rise to inflationary tendencies.

With a view to prevent inflationary pressures, both fiscal and monetary measures were vigorously used in the second half of 1950, and at the beginning of 1951, indirect tax taxes were raised, export levies were imposed on certain commodities and the budgetary position was improved by cutting subsidies. So far the monetary measures are concerned, in the autumn of 1950, the reserve requirements for commercial banks were increased, this being the first time that the reserve provisions were used as an instrument of credit-control. From 1st October, the individual banks were to hold in liquid assets the following per-

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centages of their liabilities.

<table>
<thead>
<tr>
<th>Amount of banks</th>
<th>Reserve Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Over 50 million Kroners</td>
<td>10 per cent</td>
</tr>
<tr>
<td>10 to 5 million</td>
<td>8 per cent</td>
</tr>
<tr>
<td>Under 10 million</td>
<td>6 per cent</td>
</tr>
</tbody>
</table>

At the same time, along with the regulation of the reserve requirements, the Niki bank made request to commercial banks to exercise restraint to a greater degree than hitherto in the granting of credits, particularly for speculative and non-productive purposes and this request of the central bank was complied with.

The qualitative method of credit control was further vigorously applied by abolishing the pre-sentential rate of discounting bills to commercial and to central funds for agricultural credits, which had been ½ per cent below the official discount rate in October 1960, and by raising the discount rate from 2½ to 3 per cent in December.

The policy of maintaining a stable yield of 3 per cent of government securities through central bank purchases had long been the object of public discussion. As early as July 1960 the Niki bank withdrew its support from the bond market. Consequently, the yield on government securities, by December, rose by one-third of 1 per cent and the price of government securities fell immediately by about 2 points and
by December, 1950, the quotation of the 3 per cent, 1934 loan had fallen from par to a little over 90, its yield rising from 3.02 to 3.32 per cent. The price of short-term securities also reacted sharply, the yield of one-year govt. bonds rising from 1.8 per cent in June to 3.3 per cent in December.

Although the Riks-bank much reduced its direct support of the bond market, it none the less provided a powerful indirect support by increasing its holdings of treasury bills and bonds by 3 Kr 350 million. In the second half it increased them by 5 Kr 610 million. The reason for holding a large quantity of treasury bills by the Riks bank was to finance the over-all budget deficit.

Again in the 1st quarter, 1951 the Riks Bank again added to its holding of government securities by an increase amounting to 3 Kr 113 million, but the loss of gold and foreign exchange attained 3 Kr 113 million, and this helped to counteract the expansionary effect.

The reason for a temporary departure from the endeavour to keep the money market in a tight position on the part of the Riks Bank was that it did not like to permit a repetition of the change in the rate of interest which occurred between the summer of 1950 and November, 1950, as anticipation of such development might give rise to speculation. In fact there were certain signs of speculation in April.

This change in policy has become clear from a statement made by the Board of the Riks Bank on the 28th April, 1951, that in its
opinion a repetition of the change in the rate of interest which occurred between the summer of 1929 and November 1930 ought not to be permitted. If anticipation of such a development should give rise to speculation (and these were certain signs of this in April), the Riks Bank intended to break it, even if that involved to keep the money market in a tight position. Changes in the rate of interest should (according to the Board) be the result of decisions adopted by the responsible authorities after taking account of the tendencies in the current situation and of the probable effect of the rate of interest on the economic development as a whole. They should not be a consequence of concessions to temporary speculative factors in the market."

Monetary policy in Belgium.

Belgium was one of the first few liberated countries to return to economic liberation after the end of the World-War II. After the liberation, the first step undertaken by the monetary authorities was to get rid of the excess purchasing power accumulated during the occupation. In October 1944, the currency reform blocked 60 per cent of the currency and bank deposits (i.e. left untouched until absorbed by loans or taxes) and reduced the money-supply from B Fr. 164 billion to B Fr. 57.4 billion by the end of 1944. The main object of this reduction was that the amount that remained in circulation should be compatible with the existing prices and wages. Nearly 40 per cent of

The blocked balances were to be released gradually as production increased and the remaining blocked balances were later transformed into government-bonds.

Despite the currency reform of 1944, the money-supply increased considerably in 1945 from about B Fr. 60 billion to B Fr. 125 billion as a result of the budget-deficit which was approximately B Fr. 60 billion due to heavy expenditure on behalf of allied forces and for the reconstruction of transport facilities. Although the budgetary situation improved considerably in 1946 and 1947, the average deficit per year during 1946-49 was B Fr. 15 billion.

When the currency-reform of 1944 was in operation to reduce the excess money-supply, steps were taken by the Belgium monetary authorities to control bank-credit by putting pressure upon the banking system. As in most countries, commercial banks in Belgium acquired huge amounts of government-securities during the war and, therefore, there was the real danger of an excessive expansion of bank-credit by monetizing these bonds.

In order to avoid this danger, two important measures were taken by the authorities. First, the maturities of all government-securities falling due during the year after the currency-reform were prolonged for one year and further extension was made later on. Secondly, the commercial banks were requested to inform the National Bank of Belgium, regarding every request for loans above one million. This did not mean that prior approval of the National Bank was necessary, but it

1. International Financial Statistics I.M.F.
2. The fifteenth Annual Report, 1944-45, B.I.S. P.60
obviously carried a degree of moral suasion. In early 1946, these measures were withdrawn and reserve requirements were introduced. Like banks in many countries, the banks in Belgium were required to maintain 50 to 65 per cent of their demand deposits. Of the 50 to 65 reserve requirement, four fifths were in the form of a special issue of short term treasury bills bearing 1-15/16 per cent interest. Of course, the proportion of percentage varied for different classes of banks.  

By enforcing compulsory reserve requirements, it was possible to curb the elasticity of credit-supply and, therefore, the way was cleared for the use of discount rate as an instrument of credit-control. The discount rate, which was lowered in January, 1945, was raised to 2½ per cent in November, 1946, 3 per cent in December, 1946 and 3½ per cent in August, 1947. In October, 1949, when Belgium was suffering from an economic recession, it was lowered to 3½ per cent. The discount rate was effective during these years as Belgium had to depend considerably on the National Bank of Belgium for accommodation. The central bank charged different discount rates for different types of bank paper. Certain types of bank paper which were certified in advance by the National Bank, could be rediscounted at a preferential rate while uncertified bank paper could be rediscounted at a higher rate. Even among the bank paper certified by the central bank, some bills (generally those concerning exports) got a preferential rate of ½ to ¾ per cent from time to time, depending on circumstances. Apart from this

1. P.33 (Monetary policy in France) in this book.
3. International Financial Statistics, I.M.F.
this, the National Bank of Belgium might apply different tests of the maximum currency period of the bills it would certify, thus encouraging in advance, credit for certain purposes. Thus by changing the criteria for giving its prior certificates to bank paper, the central bank could influence not only the cost of credit for different purposes, but also the duration of credit which a bank was willing to give and the ease with which a customer could get credit from banks.

It is very difficult to appraise the effectiveness of the different monetary measures taken by the authorities during 1946-49, in restoring the Belgian economy and in restraining inflation. Unlike in France, the increase in the money supply and prices during 1946-49 was moderate. Agricultural and industrial production increased beyond prewar levels. In 1949 equilibrium in the balance of payments was restored and gold and foreign exchange-reserves increased by about 10 per cent during 1946-49. But unemployment increased during this period when compared with other countries. The post-war economic development in Belgium will be evident from some selected economic dates given below.
Some selected data, Belgium.

<table>
<thead>
<tr>
<th>Date</th>
<th>End of yr.</th>
<th>Money supply in billion B Fr.</th>
<th>Wholesale prices (1948-100)</th>
<th>Industrial production (1948-100)</th>
<th>Balance of trade in million B Fr. on B Fr.</th>
<th>Unemployment per cent of insured workers</th>
</tr>
</thead>
<tbody>
<tr>
<td>1938</td>
<td></td>
<td>43.1</td>
<td>26</td>
<td>-</td>
<td>-9</td>
<td>18.8</td>
</tr>
<tr>
<td>1945</td>
<td></td>
<td>125.6</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>1946</td>
<td></td>
<td>133.1</td>
<td>35</td>
<td>77</td>
<td>-14.3</td>
<td>9.3</td>
</tr>
<tr>
<td>1947</td>
<td></td>
<td>142.6</td>
<td>91</td>
<td>90</td>
<td>-30.1</td>
<td>3.6</td>
</tr>
<tr>
<td>1948</td>
<td></td>
<td>150.1</td>
<td>100</td>
<td>100</td>
<td>-27.5</td>
<td>3.5</td>
</tr>
<tr>
<td>1949</td>
<td></td>
<td>156.9</td>
<td>95</td>
<td>99</td>
<td>-15.5</td>
<td>6.4</td>
</tr>
<tr>
<td>1950</td>
<td></td>
<td>155.2</td>
<td>100</td>
<td>104</td>
<td>-1.7</td>
<td>11.7</td>
</tr>
<tr>
<td>1951</td>
<td></td>
<td>162.8</td>
<td>121</td>
<td>119</td>
<td>-14.5</td>
<td>10.9</td>
</tr>
<tr>
<td>1952</td>
<td></td>
<td>171.0 (Sep.)</td>
<td>123</td>
<td>113 (Dec)</td>
<td>-6.6</td>
<td>9.8</td>
</tr>
<tr>
<td>1953</td>
<td></td>
<td>179.4 (June)</td>
<td>106 (Aug.)</td>
<td>-</td>
<td>-11.1 (Dec.)</td>
<td>-13.3 (Dec.)</td>
</tr>
</tbody>
</table>

1. International Financial Statistics January 1953. I.M.F.

*Belgium and Luxembourg.
Monetary policy after the outbreak of the Korean War.

After the outbreak of the Korean War, there was the resurgence of inflationary pressures in Belgium resulting in speculative demand, a sharp rise in prices and a deterioration in the balances of payments. Immediately after the outbreak of hostilities, the National Bank of Belgium helped in expanding credits by granting adequate rediscounting facilities and therefore, these increased credits helped to finance imports directly or in any case served to strengthen the demand for them.1

Thus with a view to minimize speculative and discourage foreign imports, the National Bank felt strongly the need moderate the expansion of credit.

Therefore, the Bank took several steps to restrain the expansion of credit during the latter half of 1950. In September, 1950, the discount rate was raised from 3% to 3½ per cent. The central bank issued instructions to commercial banks to exercise restraint in granting consumer instalment credit. This type of credit had gained in importance in recent years, but unlike the United States, Belgium did not make any general attempt to modify the terms of such credit. At the same time, the National Bank of Belgium reduced by 30 days the maximum maturities that it would accept for certain import bills submitted to it.

In December, 1950, it also raised its discount rate from 3 to 3½ per cent on certified export-bills which formerly had received preference. Early in 1951, the private credit-institutions set up at the initiative of the bank adopted a programme of voluntary qualitative selection among credit applicants.

As a result of these monetary measures, stabilization was achieved to some extent, account of strong demand for its export-products, Belgium earned export surplus, as with other Western European countries. The other consequences of these monetary measures were the decline in industrial production which in July, 1951, fell by 12 per cent and the increase in unemployment by 11 per cent.

Consequently the discount rate was lowered once in July, 1951, to 3½ per cent and again in September to 3⅓ per cent, i.e., to the pre-Korean level. The discount rate on certified export-bills also was reduced to 3½ per cent in 1951, along with other rates.

In the second half of 1951, various steps were taken to reduce the export surplus with E F U countries and the import-surplus with the dollar areas by modifying the procedure guaranteeing import and export-bills. Thus the maximum maturity period of the bills relating to import from the E F U area was extended and that relating to imports from the dollar area was reduced, in deciding which bills the bank would certify.

In 1952, there was no significant change in the monetary policy. Unemployment was somewhat higher and industrial production somewhat lower than in 1951. Bank credit was slightly lower than in 1951.

The foregoing discussion of the developments in monetary policy in Belgium since the outbreak of the hostilities in Korea, shows that unlike most other countries, Belgium developed a well-integrated system of monetary control long before the Korean War and, therefore, had little to do except making minor adjustments from time to time in response to various temporary disturbances to the monetary equilibrium.

**Monetary policy in the Netherlands.**

The Netherlands was liberated in May, 1945, from the German occupation and at that time it suffered from acute latent inflation with the money supply four times that in 1938 and wholesale prices around 30 per cent higher than in prewar years. The amount of liquid assets increased during the War-period. The government borrowings also were more than five times the prewar level. The major portion of the assets of commercial banks consisted of government securities.

As in Belgium the first step taken by the monetary authorities in the Netherlands was to purge the excess money-supply and deposit money from circulation. On June 1945, all 100 guilder-notes ceased to be legal tender. Bonafide holders of such notes were allowed to open
accounts, but such accounts were blocked, for the time being, for all purposes except payment of taxes. As a result of this measure, the total note circulation was reduced from 5518 million to 2500 million guilders in early September, 1945. On the 13th September, 1945, the Finance Minister declared all Dutch Bank notes in circulation invalid and a week after all bank accounts were blocked, only 10 guilders for every being allowed per week up to 3rd October.

The purpose of this operation was: (i) To trace the profits of black marketeers, (ii) To control wages and prices, (iii) To make it possible for the government to keep the note circulation within desired limits and thus to counteract inflation, (iv) To gain an insight into the property position, preparatory to an investigation of the amount of property acquired during the War, and (v) To enable the government to supervise the amount of spending and make it subservient the welfare of the nation and its own needs. The idea was also to inject new money into the system by a gradual deblocking of old accounts in such a way that means of payment would be made available only to enable people to make their current contribution to production.

The blocked money was partly released gradually and partly was withdrawn permanently from circulation by floating long term and medium term loans and by capital levies. In 1946, 3 per cent loan with maturity of 50 years and 2½ per cent saving certificates with 5 years maturity were floated. It is difficult to say how much blocked money was absorbed this way, because these loans were subscribed to by means of free money and by the conversion of old treasury-bills as well as by the use of the blocked money.

Besides the reduction of money supply, the monetary authorities in the Netherlands attempted to block other liquid assets as a part of the Currency Rehabilitation Programme. Thus some holders of old treasury-bills had to reinvest in new treasury bills on maturity or put the proceeds in a blocked account. The long term 3 per cent government-stock floated in 1946 was not transferable until March 1949 and the savings certificates floated at that time had similar conditions attached to them.

The success of the monetary purge was of course, contingent on the control over new money creation, including that by banks. During the period 1945-49, bank-credit expanded, although not so rapidly as production. The major control over bank credit was exercised by virtue of one of the provisions of the monetary purge whereby bank credit was not to be given to any one still holding blocked accounts. The banks were left free to grant small loans, but the prior approval of the central bank was necessary for all loans over 50,000 guilders. Besides this, control over credit for nonessential purposes was exercised by the Netherland Bank by virtue of its "gentlemen's agreements with the commercial banks." The discount rate was not changed during the period; it remained at the 1941 level of 2½ per cent.
Post-Korean Monetary policy

During 1950 and in the first-half of 1951, there were in the Netherlands, a expansion of bank credit and a sharp increase in the use of privately owned liquid assets which led to the emergence of active inflationary pressures. At that time the balance of payments took an adverse turn and the deficit increased rapidly due to rise in import costs, the fall in and relatively low level of foreign exchange-reserve. Moreover, there was an increase in defence expenditure of about 50 per cent over 1950.

In order to improve the balance of payments-position and to divert investment from civilian industries to "defence" industries, monetary measures combined with fiscal and direct control-measures were adopted.

In September, 1950, the discount rate of the Netherland Bank was raised for the first time since 1941, from 2 1/2 to 3 per cent, and a further increase to 4 per cent was made in April, 1951. Unlike the increase in September, 1950, the 1951 increase was effective as it increased the cost of borrowing to banks and thus obliged them to charge higher rates to customers.

Long term rates of interest showed an upward trend in the market and they rose from the level of 3.1 to over 3 1/2 per cent in the spring of 1951.

In order to prevent commercial banks from unloading their large holdings of government-securities for the purpose of expanding credit, the Netherlands Bank introduced the quantitative reserve requirements as an instrument of credit-control in January, 1951. The required reserves were both in cash and short-term-government-securities. This was in contrast to the United States policy, but similar to the practice in Belgium. As liquidity conditions differed greatly from bank to bank, reserve requirements were different for different types of banks. In general, the banks were required to maintain at least 40 per cent of their deposits in liquid assets. (cash, money at call, balances with bankers and short-term-government-securities).

The large commercial banks whose liquidity-ratio had exceeded 40 per cent, had to keep reserves in the above stated assets to the extent of 90 per cent of the average of their assets on the 30th June and 31st December 1949, this being raised (or lowered) by two-thirds of any increase (or decrease) in their deposits.

As a result of the monetary measures outlined above, the balance of payments-position improved. In January-May 1952, the ratio of exports to imports was 94 per cent compared with 67 per cent in the corresponding period of 1951. After increasing by nearly 36 per cent between June, 1950 and May, 1951, commercial bank-credit to business and individuals declined by 6 per cent in the next twelve months.


1. Ibid P.193.
As a result of the improvement in the balance of payments situation, some steps were taken in 1952 to relax credit restrictions. The discount rate was lowered from 4 to 3⅔ per cent in January and again to 3 per cent in August, 1952. In April, the compulsory reserve requirements were withdrawn. But early in 1952 the central bank was given extensive powers to control bank credit by an act passed in early 1952. These powers included prohibiting certain loans, putting a limit to certain types of loans, prescribing reserve requirements in the form of different assets in relation to deposits. The prudence with which the dear money policy of 1950-51 was reversed in 1952, indicates the flexible character of the monetary policy of the Netherlands Bank.