The Dutch Economy between 1945 and 1967 from the Perspective of a Central Bank

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Abstract

In analyzing the Bank President's view in the annual reports of the Dutch central bank of the last 50 years a surprising consistency reveals itself. A book summarizing the reports by Zijlstra, President of the Bank between 1967 and 1980, has the title "Gematigd Monetarisme", i.e. moderate monetarism. This is a good indication of the general approach during the whole period. This paper investigates the annual reports written by Holtrop, president of the Dutch central bank between 1946 and 1966. His main problem seems to be to analyze the consequences of international inflationary pressure for Dutch economic policy.

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The annual reports by "De Nederlandsche Bank" (DNB), the Dutch central bank, provide a regular feedback about the economic history of the Netherlands. Since the Second World War the DNB only had four presidents: M.W. Holtrop (1946-1966), J.L. Zijlstra (1967-1980), W.F.M. Duisenberg (1981-1996) and J.W.E.M. Wellink (1997-). This implies constancy in the general overviews as written (mainly) by the Presidents of DNB. And the method of analysis in the general overviews is even more stable than this, because careful analysis shows that the analytical approach does not change very much over time. Even the approach of the European Central Bank (ECB) is not so much different from the

approach of the Dutch central bank (Wellink, 2002). Therefore, the reports provide a stable, well informed and more or less independent analysis of the Dutch economy using the information available in the period described.

In this article we will focus on the period between 1946 and 1966, the period where Holtrop was president of DNB. First, the analytical perspective will be characterized as "moderate monetarism". Then we will discuss the international inflationary pressures. Finally, we will investigate Holtrop's comments on the use of the main economic policies in this period: income, budgetary and monetary policy. For convenience we will refer to the annual reports by the first letter of the author, followed by the year of the report and the page numbers in the books where they have been assembled.

Moderate monetarism

The theoretical perspective in all reports can be summarized as "moderate monetarism", the title of the book with J.L. Zijlstra's reports (Zijlstra, 1985). It is monetarist, because money played a much more central role than in other countries, which had a more Keynesian approach till the 1970s. It was "moderate" because in contrast to the monetarist policies at the start of the 1980s it acknowledged a very important role to budgetary and income policies.[1] In its annual reports DNB always commented on decision-making by governments, labor unions and employers organizations (De Greef et al., 1988: 6).

In all annual reports the bank president makes clear that in equilibrium money supply should increase with real national income, and that the central bank has an important role in this. But it is not desirable to force this rule when other equilibrium conditions in the economy are not satisfied, for example when wages are rising too fast, the government budget deficit is too high, or other countries, i.e. the United States, have a policy that generates excess international liquidities. This implies that the Dutch bank presidents were more monetarist than in a lot of other countries during the Keynesian periods, and were not so monetarist as a lot of countries in the era of high monetarism at the start of the 1980s.

International developments always have been very important in the annual reports. It is obvious that the open economy of the Netherlands, exporting about 50 percent of GDP, international developments are very important. DNB always emphasized the importance of monetary discipline combined a sound government budget and when necessary income policy. Although in many cases they formulate their point as "international coordination of policy" it is obvious that

[1] De Greef et al. (1998) refer also to other differences with Friedman type monetarism. First, DNB does not assume a stable short run money demand functions. Second, DNB prefers fixed, or at least stable, exchange rates. Finally, DNB focuses more on domestic credit instead of total money supply.

in practice it implies that each country should have a sound policy, both monetary, budgetary and when possible income policy. For this reason, Holtrop and Zijlstra defended the fixed exchange rate system, or at least advocated a system of stable exchange rates.

When you accept a system of fixed exchange rates, revaluation and devaluation are only emergency measures. In most cases a devaluation or revaluation does not help, because it does not solve the fundamental problems that are behind the exchange rate problem. A devaluation or depreciation tends to increase inflation implying that the effect vanishes in a short period of time. A problem with fixed exchange rates is, that you are forced to follow the international developments in inflation (H54: 149/50).

A lot of the problems in the Netherlands, especially in the 1950s and 1960s, can be explained by a lack of monetary discipline in other countries, especially the US. DNB always criticized international policies that allowed countries to adjust for their problems at the cost of the international community by adjustments of exchange rates, providing monetary credits to solve liquidity problems, or to apply import restrictions.

International problems

The excess supply of dollars is a problem during most of Holtrop's period and has been already a problem in the 1930s with gold flowing towards the US. Although Holtrop sometimes suggests that international balance of payment disequilibria can be explained by structural changes in international demand and specialization, where adjustment may require a long period of time (H49: 57/8; H66: 418), in most of the reports excess supply of international liquidities, generated mainly by the US, is explained by a combination of incorrect monetary policy, government deficit policy and income policy in the US. Especially in the report of 1965 Holtrop argues that the interest rate in the US has been too low for a long period of time (H65: 392). He suggests that the monetary approach has been put at the background in the US and the UK to the benefit of a demand policy approach (H65: 390). Because the US, supplying the international reserve currency, could easily export excess liquidities to the rest of the world, it could easily have a large balance of payments deficit (H63: 333). This excess supply of international liquidities explains to a large extent the inflationary pressures in the world and generates a fundamental problem for the Dutch economy that cannot be solved easily.

A basic theme in most of Holtrop's annual reports is that the international problems are caused by the US, but that it is difficult to discuss this with the US. In the report of 1964 Holtrop complains that it is not of much use to discuss the causes of the international imbalances, because it would generate misunderstanding and irritation (H64: 359). And later in the same report he argues that it

is not very difficult to find solutions for the problems of the international monetary system, but it is very difficult to create international agreement about them (H64: 370).

Let us investigate the history of Holtrop's analysis of the causes of the international disequilibrium between the US and Europe. A decrease in the outflow of liquidities from the US requires that either the trade surplus of the US has to increase, or the capital exports of the US have to decrease (H61: 286). In the report of 1958 Holtrop refers to a discussion in the US about the question to what extent cost inflation can be suppressed by monetary policy (H58: 227). In 1959 DNB says that in a deficit country (i.e. the US) the increase in labor cost has to be slower than in the trade surplus countries (H59: 249). In 1960 the light recession in the US, the fast decrease in the US interest rate and the increase in the German interest rate generated a flow of capital to Europe (H60: 253). In the report of 1960 Holtrop suggests that a policy of wage and price reduction should be part of the US adjustment policy, if they do not like to bear the cost of adjustment through monetary and fiscal policy (H60: 260).

In the report of 1961 Holtrop argues that as long as the profit expectations and the interest rate in Europe are much better than in the US, it is difficult to stop the $1 billion capital export from the US to Europe. He suggests reducing capital exports by fiscal measures (H61: 289). Again, DNB suggests cost reduction for the US, because otherwise it would export its inflation to the surplus countries (H61: 290).

For 1962 Holtrop becomes more precise by talking about an "allergic resistance against an increase of interest rates in the US" (H62: 316). According to Holtrop, Europe adapted already too much to US policy, with inflation as a consequence (H62: 318). In 1963 Holtrop writes that he is not attacking the US. The cause of the balance of payment problem is not too many government expenses in the US. It may be that Europe has become too cheap after the devaluations of 1949. Furthermore, Europe is a strong competitor of the US and a safe investment area. And because finance of a balance of payment deficit could be easily done by gold and its position as a reserve currency country, the credit expansion in the US was exported (H63: 332/3). But isn't this just a polite way to say again that the interest rate in the US is too low?

In 1964 DNB poses the question to what extend internal adjustment in the US could have prevented the international problems (H64: 373). Because there has been no cost inflation in the US, this criticism on the US is not valid anymore. He argues that it is liquidity creation higher than the increase of real production that is the essence of the problem (H64: 358/9). In the report of 1965 Holtrop claims that the main instrument to correct international equilibrium problem between the US and Europe, the interest rate, has increased instead of solved the international monetary problems. Two other policy instruments, the slower increase in production cost in the US and some restrictions on international capital flows, may have worked in the correct direction (H65: 392). He argues that both the US and the UK have a tendency to put the monetary approach at the background. They focus only on expenses and determine their policy by the imprecise question if there are unused production forces without asking the question if it is cyclical or to what extend the measured surpluses in production forces are really surpluses in an economic sense (H65: 390).

Holtrop sometimes mentions politely that also Europe could do something against its inflation. In the report of 1963 he refers to autonomous local inflation sources in Europe (H63: 334), where in the report of 1965 he argues that a low interest policy (without stimulating expenses more!) and a liberal import policy of the EC may help to solve some of the international problems (H65: 396/7). But in the same report he argues that the liquidity expansion in the EC did generate a price increase of about 3.5 percent per year during the last three years (H65: 387).

Surprisingly, although during the whole period there was a problem of excess international liquidities, the international discussion focused on the creation of international liquidities when there would be a shortage of international liquidities. Holtrop argues continuously that those discussions have a tendency to hide the real international problems, i.e. the lack in discipline in (monetary) policy (H60: 258; H64; 365/8; H65: 400).

Adjustment of exchange rates has sometimes been mentioned as a solution of balance of payment problems. According to the Bretton Woods agreement, this instrument should only be used when everything else fails (H65: 392). Holtrop argues that adjustment of the exchange rates is seldom a solution to international problems, because they are generated by more fundamental problems like a lack of discipline in countries. Already in the report of 1949 Holtrop argued that the devaluation of the guilder in 1949 did not have much effect on the Dutch balance of payments problem (H49: 53). In the report of 1963 he uses the devaluations of 1949 as a possible reason that Europe did become too cheap (H63: 333). In general, devaluation has only limited consequences, because the increase in prices of imported goods stimulates local inflation compensating the effect of the devaluation in a short period of time. The revaluation of the German mark and the Dutch guilder with 5 percent in 1960 was a consequence of insufficient discipline in other parts of the world (H60: 270).

In summary, Holtrop argues that the important international monetary problems since about 1959 have been caused by the lack of monetary discipline in the US and to a lesser extent in some European countries. Although Holtrop sometimes searches for other explanations like the increase in labor cost or shifts in international demand, it is obvious that the low interest rate in the US has been the main problem. The system of fixed exchange rates requires monetary discipline and this was lacking in the country supplying the international currency.

Income policy

The Netherlands was famous for its low wage policy decided by mutual agreement between labor unions, employer's organizations and government, the so-called "guided wage policy". Holtrop always emphasized the importance of this policy. Till 1952, this policy was required to satisfy the liquidity constraint after the Second World War, where continuance of this policy since 1952 was required because of the risk of cost inflation, a deficit on the balance of payments and therefore unemployment (H62: 300). In the report of 1950 Holtrop refers to the importance of income and prices for liquidity creation. The increase of wages and prices requires more credits for the business sector and forces the central bank to increase credits. If the central bank would not accommodate, the consequence would be a recession. In this way a wage and price spiral may generate the liquidities for its own continuance (H50: 71).

In 1959 the general wage increases were differentiated per sector, where sectors with high productivity increases could increase their wages more than other sectors. It was not allowed to increase price as a compensation for a wage increase. This implied that sectors with low productivity increases like the building industry were not able to attract enough employees. But, although this policy is far from optimal, Holtrop reacts: "Without compromises, that may not be satisfactory from a logical point of view, a wage policy is not possible" (H59: 237). In the report of 1962 Holtrop remarks that this system cannot survive in the long run (H62: 301).

In 1961 the combination of revaluation, reduction of the workweek and increases in wages generated an increase in the cost price of export products of 12.5 percent (H61: 277). DNB is afraid of a loss of competitive power. You have to wait till the recession before you can perceive the loss in competitive power (H61: 278). But in 1962 the development of the Dutch economy is much better than expected (H62: 291). Nevertheless, Holtrop argues that the low wage policy should be continued. First, wages should be lower than elsewhere, because high investments must be financed to adapt to the relatively fast population growth. Second, since 1954 labor cost per unit of product increased with 50 percent, while this only 10 percent for the US. "Isn't this enough of the recipe", he asks. DNB blames excess aggregate demand for the shortages on the labor market, not wages that are too low (H63: 326-8, 444).

Holtrop pays also some attention to the benefits of wage increases. They may force productivity increases through improvements in organization, skipping of loss-generating activities, concentration of production, and faster implementation of labor saving technologies. The reduction in tension on the labor market may provide opportunities for expansion in competitive sectors that were not able to expand because of shortages on the labor market (H63: 329). Liquidity constrains may decrease investment, reducing the shortages on the balance of payments and the labor market (H63: 330).

After the so-called wage explosion of 1964, Holtrop writes that the beneficial experience in 1964 increase in wages, generated partly by temporary factors and generating price inflation, may generate new wage increases in 1965 (H64: 356). He was correct in this prediction. Also in 1965 and 1966, the wage increase was higher than the increase in labor productivity (H66: 413).

In the report of 1965 Holtrop puts into perspective the norm that wages have to increase with labor productivity, by saying that higher wage increases are possible if profits can bear it. The fact that in 1965 exports increased more than world trade seemed to be a comforting thought (H65: 351/2). In hindsight Holtrop states that the inflation till 1964 has been mainly caused by a combination of excess demand and excess liquidities, where wage increases have been an independent inflationary force only since 1965 (H65: 384). To put this into perspective: between 1954 and 1965 labor cost per unit of product increased with 67 percent! Does this imply that all warnings of excessive wage increases were not correct?

In conclusion, since the second half of the 1950s DNB has been afraid of wage increases, both because it may generate insufficient investment and because it may generate inflation and with inflation in a system of fixed exchange rates a competitive disadvantage. In hindsight, at the end of the period Holtrop the increase in labor cost did not have bad consequence for the economy, nor for employment. Combining this with the analysis about the international developments, it seems that the inflationary pressure was caused by excess international liquidities generated by the US, where it is impossible to fight those inflationary pressures by a local wage policy.

The government budget and monetary policy

Next to income policy, the government budget and monetary policy were seen as instruments to stabilize the economy. Till 1949 a government budget deficit was difficult to avoid, although some expenses should have been lower (H47: 19-21). Without equilibrium in government finance there is no monetary equilibrium and without monetary equilibrium there is no balance of payments equilibrium (H48: 41). The Marshall help made it possible to bear the burden (H50: 72). In 1952 the Netherlands has a surplus on the current account.

Till 1961, Holtrop has not much to complain about the government budget. Although he mentions the theoretical possibility of correcting international inflationary pressures by reducing the government budget deficit, this is not a practical solution in the short run, and is impossible in the long run (H54: 144; H63: 338/9). In 1956 and 1957 Holtrop complains about inflationary impulses by all levels of government (H56: 167; H57: 184), but the problem was solved very fast and during 1959 and 1960 the public sector gave deflationary monetary impulses (H59: 240; H60: 266). During the period 1962-66 the government budget has been inflationary (H62: 307; H64: 354; H65: 378-84; H66: 405-8). This stimulated inflation in an already inflationary environment.

Between 1 January 1951 and April 1952 DNB tries to limit liquidity creation by credit controls (H50: 67; H52: 114) and increases in the bank rate (H51: 79). But the power of the central bank is limited. If wages rise too much, an extremely tight monetary policy would generate a recession (H50: 70).

Since 1954 DNB refers regularly to international inflationary pressures (H53: 113/4; H54: 145; H56: 174), although sometimes DNB also blames its own credit policy for some inflation (H54: 145). In 1955 Holtrop argues that a small country like the Netherlands has to focus on its external equilibrium and is not able to stabilize its local business cycle independently (H55: 156). Nevertheless DNB tries to limit credit expansion a little bit by some credit restrictions and an increase in the bank rate in 1956 (H55: 157; H56: 172). During the recession of 1958 the credit restrictions are released and the bank rate decreased (H58: 222).

In the report of 1963 Holtrop is very explicit about monetary policy: The purpose of Dutch monetary policy is the restriction of liquidity creation to the expected increase in real national income. This implies that the interest rate increases with the shortage on the balance of payments (H63: 341); this happened in 1964 (H64: 354). In 1965 Holtrop refers again to the limited power of monetary policy. A lot of liquidities can be generated outside the direct control of the bank. Excess liquidities may be generated by capital imports, current account surpluses, or inflationary government finance. The private sector may increase the speed of money circulation (H65: 385). If monetary policy tries to restrict liquidity increases when government is financing its budget monetary, then the consequence is a decrease in private investment (H65: 395) with bad consequences for unemployment in the long run.

In summary, inflationary finance of the government deficit has been a problem since 1962. The extreme shortages on the labor market and excess demand generated by the international conditions did not need extra liquidity creation by government. DNB tried to regulate liquidity creation by credit restrictions and manipulation of the bank rate, but attributed its inability to restrict liquidity creation to the expected increase in real national income to liquidity creation through the balance of payments, increases in wages and in some periods also liquidity creation by government.

Conclusion

The reports by Holtrop show that he recognized the international inflationary pressures already in a very early stage and attributed them to a large extend to excessive liquidity creation in the US. In a system with fixed exchange rates a local monetary policy cannot cure this problem. Also the low wage policy did not cure the problem, because it made the Netherlands extremely cheap compared to other countries without creating the opportunity to generate a lower inflation rate in the long run. The wage increases in the first half of the 1960s did not generate the expected loss of competitive position, because inflation was not higher than in other countries. The wage increases did also not decrease employment creation through investment, indicating that well-informed people like Holtrop did not have a good indication about the level of wages that generated equilibrium.

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Land, Money, and Capital Formation

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Abstract

What service, if any, do landowners perform for the rents they collect? Even some fervent defenders of private ownership of land and collection of rent give feeble answers. A sounder answer is that landowners, like owners of capital goods, stocks, and bonds, are performing the service of waiting (as Gustav Cassel notably called it). Instead of selling their assets and spending the proceeds on consumption or other current purposes (and instead of never accumulating savings in these forms in the first place), the owners are tying up wealth over time and are waiting for the incomes that their assets yield. So doing, they are freeing resources otherwise allocated to consumption for construction and maintenance of machines, buildings, and other capital goods; they are thereby contributing to productivity and economic growth. Annual net rents, expressed as percentages of land values, are closely analogous to interest on bonds: landowners are performing essentially the same service as is remunerated by interest in the strict sense of the term.

On the other hand, the rise of land values over time, although a real increment in wealth from the private point of view, is a rather fictitious increment from the social point of view. Yet it helps satisfy people's propensity to save and possess wealth, making consumption out of income greater than it would be in the absence of that fictitious wealth. Paradoxically, or not so paradoxically, as analogies help to show, private landownership tends both to promote and to deter real capital formation.

The argument is illuminated by parallels with collectibles (Old Masters and so forth) and money (with the real-balance or Pigou effect entering the discussion). The article draws on and interprets ideas of Maurice Allais. While also