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BELGIAN BANKING

AND

BANKING THEORY

BY
B. S. CHLEPNER



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THE BROOKINGS INSTITUTION
WASHINGTON, D.C.



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Since the 1929 crisis banking and credit problems have played a prominent role in public discussions. In the United States, as well as in most European countries, banking organization underwent important changes. Commercial banking has been separated more or less completely from investment banking, government supervision of banking has been introduced in a number of countries, the number and the sphere of operations of financial organizations owned or controlled by governments have been greatly extended.

Belgium—although small in size—is one of the most industrialized countries in the world and possesses a highly developed financial organization. Belgium was first to establish so-called "mixed banking," with close relationships between banking corporations and industrial enterprises. For a century Belgian banks expanded largely in a free economy and were not subjected to any government regulation or supervision. In this period they played a prominent role in the economic expansion of the country. The depression of the 1930's and the monetary panic led to a banking crisis. In 1935 government regulation and supervision were introduced and the entire banking organization was thoroughly reorganized.

This volume contains the first comprehensive study of Belgian banking published outside of Belgium. On many points comparisons are made with American practices. The second part of the book reviews some fundamental problems relating to banking theory, particularly the significance of banking in economic evolution, the meaning of banking liquidity, and the regulation of banking by law.

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FOREWORD

The author of this volume has been Professor of Banking and Finance at the University of Brussels since 1918. For some years he was also Director of the Department of Economic Research and Information of one of the leading Belgian banks. Following the *banking reform* of 1935, he became "supervisor" of two large banking institutions. When the invasion necessitated his emigration, I was immediately interested in having him join the staff of the Brookings Institution.

The Belgian banking reform is of no little interest to American students of banking and credit, because the Belgian reform movement designed to introduce a purely commercial banking system in place of mixed banking was similar in purpose to the American banking legislation of 1933. The author shows that the alleged evils were much less serious than was popularly assumed and that the reforms did not, for practical reasons, go so far as to establish a complete separation of commercial from investment banking. This study is not only the first study in English of Belgian banking reform but it is the only comprehensive study of Belgian banking published outside of Belgium.

Although Belgium is a very small country possessed of distinctive economic characteristics, the evolution of the Belgian banking system has been similar in some respects to that of the United States. Although the banking structures and the methods of conducting operations were very different, it appears that Belgian banking played a part in the economic expansion of the country analogous to that played by American banks. Moreover,

Belgian experience with respect to the maintenance of liquidity and the regulation of banking operations has been fairly similar to that in the United States.

American readers will be interested in the conclusions of the author concerning the "personnel" or "human" factor in banking, the significance of business ethics, the role of public opinion, and the importance of putting the right man in the right place.

The Consulting Committee of the Institution consisted of Edwin G. Nourse, Meyer Jacobstein, and Charles O. Hardy.

HAROLD G. MOULTON,
President

AUTHOR'S PREFACE

Until about 30 or 40 years ago the principle of non-interference of government in economic life was closely observed in Belgium. The official doctrine relied exclusively on private initiative, or in some measure on spontaneous collective organizations such as co-operatives, mutual aid societies, and so on. The administrative apparatus was very meager. Strictest economy was the fundamental rule of government finance and even such activities as gathering facts and statistics were neglected. Furthermore, there were no important private organizations or foundations engaged in assembling statistical and historical data. Since the First World War the situation has improved considerably, but even now it is far from being completely satisfactory.

For this reason the statistical material used in this study may appear rather meager to the American reader. He will probably be surprised by the complete lack of data on some points, for instance on banking failures.

For more than 20 years, the author, who was a pioneer in this field, devoted an important part of his time to collecting historical and contemporary materials on Belgian banking (see the bibliography at the end of the volume). He had many contacts with bankers and officials. He hopes that notwithstanding the shortage of official statistics, the present volume gives a fairly accurate picture of the evolution of Belgian banking.

The author wishes to extend his warmest thanks to the Brookings Institution which granted him hospitality when he left his country in order not to fall into the hands of the invading hordes. Not only has he been

able to continue scientific activity but he has also benefited largely from contacts with his American colleagues. Their suggestions have improved his manuscript considerably.

He also thanks the Belgian American Educational Foundation, of New York, particularly its president, Mr. P. C. Galpin, for a grant towards the publication of this book.

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INTRODUCTION

This volume has a two-fold purpose: The first is to describe the evolution of the commercial and investment banking system of Belgium; the second is to review the theory of credit and banking in the light of Belgian experience. Part I is a factual presentation of the main events in the development of Belgian banking from 1830 up to and including the banking reforms of 1935. In the light of this history, we shall ask in Part II, What light does the Belgian experience throw upon such controversial issues as: (1) the significance of banking and credit in economic evolution; (2) the importance of short-term loans in maintaining liquidity; and (3) commercial banking regulation by law.

PART I
HISTORICAL DEVELOPMENT

CHAPTER I

BEGINNINGS OF FINANCIAL EXPANSION AND OF MIXED BANKING

At the beginning of this study it will be useful to outline very briefly the outstanding characteristics of Belgium's economy. Modern Belgium emerged as a result of the national revolution of 1830 which split the Kingdom of the Low Countries into two States. In those days Belgium had a relatively prosperous agriculture, an important class of handicraftsmen, and some manufactures. Although in advance of other countries of the Continent, modern industry based on steam was still in its infancy.

Belgium is a small country but it enjoys a favorable geographical position and has good communication facilities. Moreover, in 1830, there was already a dense population, and ancient economic traditions prevailed. There were also adequate resources of raw materials, particularly of coal and iron. In the course of time most of these raw materials were exhausted, and even agricultural production became insufficient for the growing population.

At this point it is pertinent to mention the essential distinction between the economic evolution of the United States and Belgium. Both countries have become highly industrialized, but the United States developed its industries to meet the needs of a very broad internal market. America has abundant supplies of nearly all raw materials and of food. There is a domestic market capable of absorbing the increasing output of industry. Foreign trade has played a minor role in the

economic development of the United States. An exactly opposite situation has prevailed in Belgium. The resources of raw materials being almost exhausted, Belgium became a "transforming country." It imported from abroad a great part of its food and nearly all of its raw material supplies, and exported large quantities of finished and semi-finished goods.

This phenomenon had far-reaching consequences for the Belgian economy. As Belgian industry was obliged to seek industrial outlets throughout the world, it became necessary to adapt the industrial production to the various needs and changing habits of the different customer nations. It was impossible, or at least extremely difficult, to develop a large standardized production. That circumstance was one of the reasons which occasioned the slackening of the pace of industrial concentration. The typical Belgian industrial plant was either small or medium sized. Before the First World War industrial concentration was but little developed, and Belgian industry was essentially individualistic and competitive.

Industrial enterprises were often obliged to change their methods, to grant more or less prolonged credits to their customers, and even to take important risks abroad. They were in need not only of commercial short-term loans but also of loans on a long-term basis. As a result, business concerns, especially the industrial corporations, very early established close connections with banks and with the stock exchange.

At the beginning of her industrialization, there was a scarcity of investors in Belgium. Industrial concerns were obliged to rely extensively on existing banking facilities. With the economic expansion, investors multiplied. They were recruited in large part from the mid-

dle classes, and their resources could be collected only by an extensive financial machinery.

The important role played by Belgium in the early stages of modern industry was in the fields of metallurgy and engineering. The construction of steam engines and rolling stock (locomotives, trams, and so forth) was a significant contribution of the nation to industrial progress. The sale of these durable goods abroad was one of the reasons why Belgium became a capital exporting country, a fact also conducive to links between industrial corporations and banking organizations.

The extreme economic liberalism which prevailed in Belgium after 1870 is another element of importance. In so far as banking and financial operations are concerned, Belgium was one of the freest, if not the freest, country in the world. There was no governmental control of commercial and investment banking, or of stock exchanges. The corporation law was extremely liberal. This nearly complete freedom of action was one of the elements which favored the extreme development of banking and financial operations—with all the advantages and disadvantages which such a development can produce.

It remains to be pointed out that geographical position and political neutrality have enabled Belgium, especially since the end of the last century, to exercise the functions of a connecting financial link between neighboring countries, particularly between France and Germany. This circumstance, as well as the great degree of liberty enjoyed by industrial and financial corporations, plus low taxes, have brought about the location in Belgium of many financial corporations having an international character. All of these elements, some of which will be discussed later, explain the great develop-

ment of Belgian banking and finance, as well as the international character of the Brussels capital market.

I. THE BACKGROUND OF BELGIAN BANKING

Modern banking began in Belgium around 1835. In order to obtain a realistic view of its beginnings, it will be useful to describe briefly the previous situation and the immediate circumstances in which new methods started.

At the time of the National Revolution in 1830, Belgium was chiefly an agricultural country, although it was probably the most industrialized area on the Continent. As there were no big enterprises, and as business did not use loaned funds to any great extent, the financial organization was rather rudimentary.

In 1830 Belgian banking was still in its infancy. Even the monetary system was undeveloped. Bank notes were practically nonexistent. There was still a vivid recollection of French assignats, which were imposed on the population when Belgium was conquered by French revolutionary troops, and which lost all value, as is well known. Moreover, during the period of the Kingdom of the Low Countries (1814-30) bank notes were issued only in florins, the official monetary unit, whereas in the southern provinces (which later formed the Kingdom of Belgium) the monetary unit in circulation was the franc.

On the other hand, deposit banking was hardly existent. The use of the check was almost unknown. Coins were the only circulating medium. There were, it is true, several banking houses in Brussels and in some provincial towns. But their deposits were small, and their loans and discounts were limited. Their principal business was to collect money and to make payments for

their customers, especially outside of the city where they were located.¹

The most important of these houses performed some investment business. They subscribed to bonds issued by the State, by a few municipalities, or sometimes even by foreign governments. The amounts involved were very small, consisting of a few million francs, while the bonds were sold to a restricted number of investors. Small industrial enterprises were owned almost exclusively by individuals or by partnerships. There were only half a dozen small industrial corporations.

The Société Générale pour favoriser l'industrie nationale was the only banking corporation. In fact, it was the only important business corporation then existing in Belgium. The Société Générale was founded on the initiative of William I, King of the Low Countries, who became its principal shareholder. It was established in 1822 with an authorized capital of 50 million florins (more than 100 million gold francs) a tremendous amount for that day. Twenty million florins were represented by landed properties² surrendered by William I to the corporation. The remaining 30 million florins, were subscribed almost exclusively by the King, who paid them with government bonds from his private fortune. The result was, that the assets of the Société Générale consisted almost exclusively of landed properties and of public bonds.

The charter of incorporation empowered the Société

¹ What is said here about Belgian bankers can be applied to all other European countries, at least, on the Continent. It may be recalled that the idea of a bank being primarily an institution for maintaining deposits and distributing loans is a product of nineteenth century evolution. See below, p. 171.

² These properties were "domains"—estates belonging to the State—granted to the King under the Constitution.

Générale among others things, to issue bank notes. But, as has been mentioned before, people did not use them. The amount in circulation prior to 1830 never exceeded 5 million florins (10 million francs or 2 million dollars). Private deposits were very limited at the Société Générale. As the corporation was the "State's cashier" (depository of public funds), government deposits usually made up a relatively important part of the bank's liabilities.

During the first decade of its active existence, the Société Générale was engaged principally in exploiting its landed properties and in dealing in State bonds. The company also extended some commercial credit by re-discounting paper presented by private banking houses. In addition the Société Générale made some direct loans to industrialists, that is, to partnerships exploiting collieries in the basin of Borinage near Mons, province of Hainant. After the revolution of 1830, these collieries had difficulty meeting their commitments. Moreover, they needed new funds to extend and modernize their equipment. As we shall see in the next section, these collieries were transformed into joint stock companies—they were incorporated to use American terminology—and the Société Générale bought a certain amount of their shares. In these relations we can see the seeds of what later became the characteristic method of Belgian, or rather continental, banking, consisting of tight links between the banks and industrial enterprises.

The expansion of industrial corporations during 1834-38 is the background against which the first phases of banking expansion must be studied. When the conditions provoked by the revolution of 1830 became more settled, industrial progress, already manifest in the first quarter of the century, began to move at a more accelerated pace.

First, there was the desire of manufacturers to use recent technical inventions coming from England. Second, there was a special reason which gave a particular impulse to the coal and iron industries. After the outbreak of the Belgian revolution in 1830, the Dutch blocked the estuary of the Scheldt. Immediately, projects were developed for building railways in order to establish connections with the neighboring countries. In 1834 Parliament decided to construct two railways, one crossing the country from north to south and the other from east to west. At the same time, projects for railway construction were being developed in France, whose production of coal and iron was insufficient.

For these reasons Belgian coal and iron producers anticipated new and important outlets for their products. An era of extensive plant expansion and modernization began. In the field of metallurgy, particularly, the old small furnaces using wood were replaced by larger ones utilizing coke. In order to obtain new funds, many private enterprises or copartnerships were changed into corporations. Fresh capital was obtained by the issuance of additional shares.

At the time of the revolution, the corporate movement was scarcely beginning in Belgium. There were in existence only half a dozen small industrial corporations, most of which disappeared in the period following the revolution.

Between 1834 and 1839 there were more than 150 new incorporations, with an issued capital of about 300 million francs, representing a tremendous amount of investment for that period. The corporate movement was particularly important in coal and iron mining and in the metallurgical industry.

It may be recalled that the "spirit of association" (*esprit d'association*) and "industrialism" were often

acclaimed in those days by many writers, chiefly the Saint Simonians who popularized the idea of industrialism. They considered it not only as economic progress but also as a means of political liberation—as a device to supplant the remnants of feudalism.

It is true that between 1836 and 1838 there were objections, in some political circles, to a too rapid industrialization and to the growth of large corporations. They were regarded as a source of economic instability, dangerous to individual enterprises and even to political liberty. This opposition was inspired by a mixture of ideas and sentiments where one could distinguish: traces of a traditional fear of the pernicious influences of new methods of living (especially in some Catholic sections); resentment of landed interests against rising power of industrial classes; influence of Sismondi's ideas about the dangers of an extended rise of mechanization and a too rapid industrial expansion.³

At times these ideas even inspired governmental policies. Such policies were manifested in the refusal of authorizations to some industrial and financial corporations.⁴ Notwithstanding these objections and in spite of some obstacles raised by the government, the corporate movement and industrial expansion were the most remarkable economic developments during the first decade of Belgian independence.

³ The ideas of these "anti-industrialists" were somewhat analogous to the social philosophy of Jefferson, although they were expressed at the time of Andrew Jackson.

⁴ Before 1830 no corporation could be established without a special authorization of the government. During the first few years after the revolution some lawyers and businessmen claimed that the liberty of association established by the Constitution implied that business corporations no longer required any government consent. Some corporations even operated without authorization. But in 1842, the Supreme Court ruled that these corporations, being of a special nature, were not covered by the provisions of the Constitution.

II. EARLY EXPANSION OF "MIXED" BANKING

The Société Générale was the most important factor in the industrial and financial movement during the decade following the national revolution of 1839. But around 1835, some other banking corporations appeared. One of them, the Banque de Belgique, deserves special mention, although its foundation was due more to political than to economic factors.

During the first decade after the revolution there was, in an important section of public opinion, a suspicion that some of the directors of the Société Générale were not sympathetic to national revolution. These individuals, it was claimed, kept their faith in William of Orange and the former regime. The Société Générale was often attacked in Parliament and in the press.

Early in 1835 Charles de Brouckère, who played an important political role in the young kingdom (and who later became famous as mayor of Brussels), took the initiative in creating a new bank, the Banque de Belgique.⁵ It was commonly believed that this corporation was created to fight the influence of the Société Générale. For about a decade there was a sustained struggle between the two banks on the financial and political fronts.

The Banque de Belgique was established as a joint stock company with a paid-in capital of 20 million francs, part of which was supplied by French capitalists. The charter of the Banque de Belgique was extremely broad; it was authorized to issue bank notes and to engage in any field of commercial and investment bank-

⁵ It may be mentioned that the title of the bank misled some foreign writers, who thought that it was an official institution. Even recent writers have confused this organization with the Banque Nationale, established in 1850 as central bank of issue.

ing. Three other banking corporations were established in the country at almost the same time; their role, however, was very limited and we deal here only with the two banks established in the capital.

The Société Générale and the Banque de Belgique were the first representatives of "mixed banking." Since about the end of the past century the title "mixed" banks is used on the Continent to designate institutions practicing both commercial (deposit) and investment

POSITIONS OF THE TWO PRINCIPAL BANKS, END OF 1838
(In millions of francs)^a

Balance Sheet Items	Société Générale	Banque de Belgique
Assets		
1. Cash on hand ^b	24	1.2
2. Discounts	8	3
3. Loans and overdrafts	58	20
4. Government bonds	24	—
5. Loans on securities ^c	63	11
6. Corporate securities	40 ^d	3
Liabilities		
7. Bank notes ^e	27	3.5
8. Current accounts	30	12
9. Savings deposits	46	1
10. Bonds and notes	20	2
11. Capital	65 ^f	20
12. Surplus	24	—

^a The franc was equivalent to about 20 cents.

^b Includes some bank notes issued by the banks themselves.
See note e.

^c Collateral consisted almost exclusively of shares of industrial corporations promoted by the banks and, in what concerns the Société Générale, in shares of the bank itself.

^d Includes some shares of the Société Générale itself.

^e This item does not represent the notes in circulation; a part of the notes were held by the banks themselves and is included in "cash on hand." The actual circulation was less than 20 millions.

^f A part of the shares, included in the assets under item 6, has not been actually issued.

banking. At the beginning of Belgian banking expansion, the two leading banking corporations were engaged in this type of activity. The analysis of banking activities of this time is illustrated by the figures showing the positions of the two principal banks at the end of 1838, when the financial crisis started.

Discounts and short-term commercial loans were of negligible importance. Yet the classical theory of banking, formulated chiefly by Adam Smith and viewing short-term loans as the only legitimate banking asset was not questioned by anyone at this time. The leaders of Belgian banks simply disregarded the teachings of the economists. Guided by the circumstances of their environment, which required first of all the development of industrial capacities, they employed their full effort in financing industry.

The first "financial" operations of the Société Générale were a result of previous industrial loans. The loans made by this bank before the revolution to the collieries of Borinage had been frozen. Moreover, in view of possible new outlets for their products (to railways and the iron industry) the owners of the collieries intended to modernize and expand their equipment. The collieries, which were generally partnerships, were then incorporated and the Société Générale acquired a part of the capital stock.

The two leading banks played a prominent role in the corporate movement and in the financing of industry. Between 1834 and 1838, the most important industrial corporations were established with the cooperation, and often under the guidance, of the banking institutions. These institutions undertook not only investment banking operations, such as those practiced in the United States—underwriting and distributing of

securities issued by existing corporations (or by public bodies)—they engaged also in promoting business.

Generally things happened in the following way. When the owners of an industrial enterprise (generally a coal mine or an iron plant) wished to modernize and extend their equipment, they approached one of the leading banking institutions. After negotiations, the enterprise was incorporated. Thereupon, a certain proportion of the shares would be delivered to the proprietors of the plant, and the remainder would be subscribed for cash by the bank or by one of its financial affiliates. (See below p. 15) The cash was to be used for the modernization of the plant.

Generally, some directors of the bank would become also directors of the industrial corporation. In this way personal links would be established between the corporations. In several cases the capital of the industrial corporation proved to be insufficient for operating purposes or even for the necessary fixed investments. As a result, the corporation was obliged to request loans from the "friendly" bank. These loans, which were not "commercial short-term loans," compose the bulk of item 3 of the table on page 12.

The original purpose of banks in buying industrial shares was to dispose of them by sale to investors. Public flotations (called in Belgium "public subscriptions") were organized. In addition, the shares were listed at the Brussels Stock Exchange. But very few shares were acquired by investors, least of all by genuine investors. A certain amount was acquired by speculators. But those purchases were possible only because of loans granted by the banks and backed by the same shares. With the crisis of 1838-39, most speculators were in default.

Banks were obliged to take over the shares they held as collateral.

The result of the operations just described was a concentration of risks on the part of banks and an immobilization of their resources. The assets composing items 3, 5, and 6 in the table on page 12 were represented in reality by a small number of industrial enterprises. The principal difficulty encountered by the banks was the hesitancy of the public to buy the shares of industrial corporations. It was an entirely new venture!

The two leading banks created affiliated financial corporations. These became the forerunners of modern holding companies and investment trusts. It was believed that corporations with an important capital and a broad purpose would have more attraction for investors than special industrial corporations with a relatively small capital. With the funds obtained by selling their own shares, the affiliated financial corporations would then create or participate in the creation of industrial companies.⁶ The same underlying principle was adopted about 15 years later in the creation of the famous *Crédit Mobilier* at Paris, with the sole difference that the brothers Pereire attached a particular importance to the issuance of bonds.

The *Société Générale* was the leader in the creation of financial companies. In February 1835, the *Société de Commerce* and in September 1835, the *Société Nationale pour Entreprises Industrielles et Commerciales* were founded by the *Société Générale*. The stated purpose of these companies was "to contribute, by active

⁶ Throughout this study the terms "industrial securities" or "industrial corporations" are used in a large sense. They include extracting, manufacturing, transporting, or other non-financial corporations.

participation, in the establishment of any useful enterprise." In present day terminology these two concerns would be called holding corporations (or general financial companies in England).

In the following year, the Société Générale created the Société des Capitalistes réunies dans un but de Mutualité Industrielle commonly known at that time as Mutualité. The authorized capital was 50 million francs, of which 12 millions were issued.

The purpose of the company was stated in the following language: "to offer to the spirit of association new elements of success and attract more and more capital to useful enterprises; by investing the company's capital in a great number of enterprises there would be available to investors a sort of insurance against the temporary reverses of any single enterprise." Mutualité was thus the forerunner of modern investment trusts.

It is interesting to observe that Mutualité was unable to obtain a royal charter while government and the public were so overwhelmed by the size of the company's capital structure and by the broad terms under which the company's objectives had been formulated. Most of the chambers of commerce expressed an unfavorable opinion about the company. In fact, during the early years of its existence, Mutualité operated without a charter. However, in 1842 the decision of the High Court made it no longer possible to operate without one. Thereupon, Mutualité succeeded in obtaining a charter but was obliged to reduce authorized capital and to modify the original provisions under which the company had begun business.

The Banque de Belgique, shortly after having been founded, established a company called Société des Ac-

tions Réunies (company of assembled shares). This company was also a sort of investment trust, but it could invest its funds only in securities issued by corporations patronized by the Banque de Belgique. In the same manner as Mutualité, this company was obliged to reduce its authorized capital and to modify its bylaws in order to obtain a charter.

Unfortunately the system of financial affiliates did not work out as its initiators expected. It could have worked more or less satisfactorily, if investors had subscribed to the shares of these financial companies. But people were too cautious about the new ventures. Very few shares were absorbed by the public. Most of the securities remained with the banking institutions. The result was, that the financial corporations became nothing more or less than departments of the banks which founded them. Their existence simply complicated the capital structure of the banks. In later years, some of these financial concerns were liquidated while others—Mutualité and Actions Réunies—were able to dispose of a part of their stock to investors, although they always remained under the control of the founding banks.

In addition to the financial organizations just mentioned, three new corporations were established for the purpose of mortgage credit under the patronage of the two leading banks. The functions of these institutions consisted of issuing long-term bonds and of making loans secured by real estate. Such real estate loans were repayable in the form of annuities. One of these mortgage banks was liquidated within a few years after its establishment. The two others remained, but expanded their business only in the second half of the past century.

III. DIFFICULTIES OF EARLY BANKING AND
CRISIS OF 1838-39

In the first decade of national independence, the leaders of Belgian banking were notably in advance of their time. It is rather remarkable that in so short a period, they established such varied and modern institutions. But the population was not prepared to follow them.

The leading banks encountered almost insuperable obstacles. They resulted from the difficulty (a) in selling securities, (b) in expanding the circulation of "banking money."

The richest section of the population was then represented by the landowners (among whom were a certain number of churches and convents). Most of them were too conservative to engage in such new ventures as investment in industrial or financial securities. Some of them even had a political prejudice against industrialism. The middle classes of the cities also were inclined to question the value of these investments. Consequently, the banks were able to sell only a limited number of shares issued by industrial and financial corporations. The second impediment resulted from the obstacles to the expansion of bank notes or of deposits.¹ Both leading banks were authorized to issue bank notes. But their circulation was extremely narrow. Before 1848, it did not exceed 20 million francs, a trifling amount in a country where the circulation of coins amounted probably to 200 millions.

After the revolution, bank notes were issued in francs. But the two leading banks were violently antagonistic,

¹ It has been previously mentioned that, before the revolution, people were not accustomed to the use of bank notes because of the recollection left by the French assignats, and also because the notes were issued in florins, whereas the Belgian population used the franc as monetary unit.

and the bigger of the two was often denounced in the Parliament and in the papers as opposed to the new regime. Such a situation naturally did not contribute to increased confidence in their notes. In fact bank notes circulated only in business circles. They were not used in retail trade or for wages, and they were completely unknown in the country.⁸

In such circumstances, use of deposits was still more restricted. The "current accounts" of item 8 in the table on page 12 represented exclusively the checking deposits of a limited number of businessmen and of industrial corporations. The Société Générale fortunately could get some savings deposits, a part of which came from public institutions and from various endowments.

The policy of banking leaders at this time was certainly a daring one. They invested almost all their funds in industrial securities or in loans to a relatively limited number of industrial corporations. Such policy resulted from the awakening of the spirit of enterprise, from the necessities of industrial development, and from lack of experience.⁹ It is certain that many complications

⁸ Incidentally, we observe at this point an interesting experience in the field of free banking. During the first half of the nineteenth century, there often arose the question of free banking or more precisely of the free issue of bank notes. The controversy was dominant even in the 1860's, especially during the time of the famous French Inquiry. Partisans of free banking asserted that where bank note issuance was a monopoly, there resulted a consequent deterrent to the expansion of note circulation and to the reduction of the interest rate. In Belgium, between 1830 and 1850, there existed what may be considered a practically free banking system. The only regulation was in the form of some restrictions on the issuance of bank notes by corporations. Because of the absence of unity and the intense animosity between the principal banking institutions, there was a general distrust of bank notes. This state of affairs changed rapidly in the fifties, when the Banque Nationale was established as the only bank of note issue in Belgium.

⁹ A curious instance, showing how dangerous were practices followed at this time, was the announcement made by the Banque de Belgique that it would always rediscount at 4 per cent the long-term bonds issued

would have arisen even in normal times. But political events and rivalry between the banks aggravated the situation and produced the first financial and banking crisis in Belgium.

The reader should realize that, after the Revolution of 1830, there was no settlement between Belgium and Holland. In fact, the latter country did not recognize the new kingdom. By the end of 1838, the diplomatic situation had become strained to the breaking point. There was a widespread opinion that actual fighting was inevitable within the near future. Panic broke out among the French shareholders of the Banque de Belgique, and, as a consequence, the shares of the bank declined sharply on the Paris Stock Exchange. At the same time, on December 10, 1838, the Société Générale presented to the Banque de Belgique for redemption, bank notes amounting to 1,200,000 francs. They were paid with some difficulty. But on December 15, 1838, the Société Générale presented an additional 300,000 francs of bank notes to the bank. This time the Banque de Belgique was unable to make payment. The second bank of the country was forced to close its doors on account of its inability to make payment for \$60,000 of its own bank notes!

Before suspending payment, the Banque de Belgique applied to the government for financial support, but this was refused. The suspension provoked a financial panic. Industrial concerns which had been assisted by the bank found themselves in a difficult position. They

by the affiliated mortgage banks. Since the interest rate on these bonds was 4 per cent, the practical result was a guaranty to holders that they could obtain, at any time they wished, reimbursement of their investment without loss. What an improvident action for a bank of issue and deposit to undertake!

were unable to obtain funds even to pay wages and current expenses. The repercussions arising out of the financial plight of the bank spread rapidly to political circles.

As a result members of the government reversed their original decision. They requested Parliament to authorize the lending, out of Treasury funds, of the sum of four million francs for the Banque de Belgique. After a rather short parliamentary debate the bill was passed, and, on January 2, 1839, the Banque de Belgique was able to resume operations. At a later date, government aid was further extended by one million francs, this time without the intervention of Parliament. Thus, a hundred years ago a loan amounting to the equivalent of one million dollars was sufficient to set afloat the second bank of the nation.

The episode to which reference has just been made is interesting primarily as indicative of how some recent problems and practices are in reality of ancient vintage. Moreover, events have proved, that in cases of acute financial crisis, governments cannot stand aside but must intervene. Only a century had passed before nations began to realize, that if they were to intervene, they must take the necessary preliminary steps and adequate precautions instead of improvising emergency measures at the last moment.

IV. THE CREATION OF THE BANQUE NATIONALE

During the decade following the 1838-39 crisis, the pace of economic and financial development was slackened. Banking institutions burdened with frozen assets were restrained from promoting new industrial ventures. In 1841 the Banque de Belgique decided to devote its

activities exclusively to commercial short-term banking and, in pursuance of this objective, modified its bylaws.

The financial crisis of 1848 presented several interesting developments. In the first place, this crisis was brought about primarily as the result of political circumstances. The Paris Revolution of February 24, 1848 produced an intense panic in Belgium. Memories of the first French Revolution were vividly recalled, and people were afraid that again the Revolution would result in a European war in which Belgium would be involved. Many holders of bank notes requested redemption in coin. Finally, the law of May 20, 1848 suspended the redemption of bank notes and placed them in the same category as legal tender. The same law fixed the maximum amount of note circulation at 20 million francs for the Société Générale and 10 million francs for the Banque de Belgique, but authorized each bank eventually to issue two million francs of supplementary notes for the purpose of assisting other banks.

But banking institutions, particularly the Société Générale, held an important amount of savings deposits. Many of the customers gave notice of intention to withdraw their deposits. The Société Générale was placed in the embarrassing position of being unable to meet demands for repayment. The government was unable to assist the Société Générale because of its inability to sell Treasury notes. The government itself was in a difficult financial position. Another law of May 22, 1848 solved the financial problems confronting the Société Générale. It authorized a new issue not exceeding 20 million francs in bank notes for the reimbursement of deposits. In addition, a supplementary issue of 12

million francs to be eventually lent to the government was authorized. Here is an example of the government authorizing a bank to issue inconvertible paper money to reimburse deposits!

A contemporary reader would probably believe that such paper money would necessarily have depreciated, especially in a country where the overwhelming majority of the population was not accustomed to bank notes. Yet nothing of this sort happened. The paper money, although irredeemable, circulated at par with metallic currency and the rate of exchange on London did not rise. The explanation of this phenomenon is found primarily in the strict limitation as to the amount of issue authorized by the laws of March 22 and May 22, 1848. Second, there was the provision of the law which imposed on the Société Générale an annual tax of 4 per cent on notes issued for the reimbursement of deposits.¹⁰ By that method the Société Générale was induced to liquidate as large an amount as possible of its assets in order to reimburse the deposits, and to issue new notes only when absolutely necessary.

The result was that the legal maximum of note issuance, fixed by the two laws at 66 million francs, was never attained. Until creation of the Banque Nationale, the circulation of paper money remained generally below the 50 millions level.

The experience of Belgium in the years 1848-50 is one of the rare examples of an inconvertible paper currency which did not undergo the slightest depreciation. Moreover, the legal tender character of the notes

¹⁰ The Société Générale was also prohibited from paying any dividend to shareholders as long as notes issued for redemption of deposits remained in circulation.

played an educational role in acquainting people with the use of bank notes. The above record is not a plea for an irredeemable paper currency. But the phenomenon is sufficiently interesting from a historical point of view to be mentioned here.

After the crisis of 1838-39 the belief prevailed that issue banking should be separated from other banking activities. During the forties the conviction grew that the best method to follow would be to establish a central bank of issue. The principal difficulty of this plan was the existence of four corporations,¹¹ all of which were authorized by their charters to issue bank notes. Furthermore, their charters were granted for long periods, expiring only in the second half of the century.

The crisis of 1848 hastened the trend toward a central bank of issue. Chief proponent of the plan was Secretary of the Treasury, Frère-Orban. After negotiations with the two principal banking corporations, he persuaded them to abandon issue banking. Thereupon, the Société Générale and the Banque de Belgique subscribed to the shares of the Banque Nationale established by the law of May 5, 1850 as the central bank. The Banque began business on January 2, 1851.

The founders of the Banque Nationale were strict followers of the classical theory of banking. This theory was then popularized chiefly by the writings of Adam Smith, J. B. Say, and Count Mollien (see below, p. 171). They put particular stress on the limitation of banking assets to short-term self-liquidating bills. Accordingly

¹¹ The Société Générale, and the Banque de Belgique, both at Brussels; the Bank of Liège, established in 1835; and the Bank of Flanders, established at Ghent in 1841. Note circulation of the last two banks was insignificant.

the principal and fundamental activity of the bank was to be the discount of strictly commercial paper having a maturity not exceeding 100 days and having in principle three signatures. Holding any kind of industrial securities or industrial loans was prohibited, and even holding of government securities was viewed with much disfavor. The Bank was allowed to invest in government bonds only to an amount not exceeding its own capital and surplus. Treasury notes could be discounted only for a maximum amount of 20 million francs. Government securities were admitted as collateral only for an amount not exceeding 80 per cent of their market value.

On the other hand, contrary to the English Banking Act of 1844, the Belgian law of 1850 did not prescribe a fixed rule concerning the amount of notes issued by the bank. It simply ordered that "the proportion between the cash reserve and the notes in circulation shall be fixed by the by-laws."

The bylaws required the bank to have a metallic reserve equal to one-third of its demand liabilities.¹² But the reserve was "allowed to fall below one-third under circumstances and within limits which shall be sanctioned by the Secretary of the Treasury."¹³

To sum up: The Belgian Banking law of 1850 was an application of the classical theory of banking, com-

¹² Of the whole demand liabilities and not only of the bank notes as was the case in some other European issue banks.

¹³ In actual experience, the proportion has never been lowered directly, but the Secretary of the Treasury has allowed the Banque Nationale to consider *devises* (sight or short-term claims on foreign countries) as equivalent to coin. From the time of its origination, the Banque Nationale has had some assets in *devises*, and this policy has been especially intensified since the last quarter of the past century. The Banque Nationale was probably the first central bank to apply what has been termed a "policy of foreign portfolio."

bined with the "banking principle" as opposed to the "currency" principle. Contrary to the British Act of 1844, based on the "currency principle," the Belgian law was rather "liberal" in what concerned the amount of bank notes to be issued. But—again contrary to the Act of 1844—the Belgian law made the commercial bill the principal if not the only asset of the Banque Nationale.¹⁴

¹⁴To complete the comparison with the Bank of England, it should be noted that the provisions of the Act of 1844 provide only for the issue department, the banking (or deposit) department is free from any legal interference. In Belgium, on the other hand, there is no such distinction, and the deposits of the Banque Nationale are legally on the same footing as its notes.

CHAPTER II

FINANCIAL AND BANKING EXPANSION, 1850-1914

At the middle of the past century the effects of the industrial revolution were felt only in a few countries outside England. In the third quarter of the century construction of railways was the major factor which spread the effects of recent innovations over almost the whole of Europe. The generalization of the use of steel and ocean shipbuilding were also primary factors in the expansion of industry and trade. Belgium was then one of the chief producers of iron, steel, rolling stock, and so forth, and her industry expanded greatly. In the last quarter of the century industrial expansion was less regular, there were periods of depression, of labor troubles, and of financial slumps. But since the end of the century Belgian industry, agriculture, and trade witnessed again a phase of prosperity and of expansion, lasting until the First World War. Such is the background against which banking developments of this period will be described.

I. CURRENCY EXPANSION AND POLICY OF THE BANQUE NATIONALE

The creation of the Banque Nationale provided a firm foundation for the Belgian monetary system. Backed by the government and being the sole and official bank of issue, the Banque Nationale was in a position to benefit from the confidence of the general public. Many people had become accustomed to the use of bank notes during 1848-50, when they were not redeemable. Moreover, by

a coincidence, the bank was created at the starting point of a period of great economic expansion.

The Banque Nationale established branches in all the principal cities of the country, thereby making it possible for local bankers to rediscount their paper. As a result, bank note issue was greatly expanded. The total note circulation prior to 1848 did not exceed 20 million francs. In the years 1848 to 1850 the level was between 40 and 50 million francs. By 1855 note circulation had jumped to 100 million francs, a figure which the creators of the Banque Nationale could hardly have foreseen even for a distant future. At the turning point of the nineteenth century, note circulation was over 500 million francs, and on the eve of the First World War it exceeded one billion francs. On the other hand, the deposits of the Banque Nationale remained rather negligible. The commercial banks were rapidly accustomed to rediscount freely with the issue bank, whose rediscount policy was very liberal. Consequently they did not feel any need to maintain important reserves at the Banque Nationale.

Here was a fundamental difference between the currency systems of the Anglo Saxon and the continental countries. The Banking Act of 1844 in England and the National Bank Act in the United States created an inelastic system of note issue. As a result deposit currency became the principal circulating medium in these countries. In Belgium, on the contrary, bank notes were the principal medium of circulation. Few persons carried deposit accounts, especially before the First World War. Even important commercial and industrial concerns effected most of their payments by means of bank notes. It may be strange for an American reader to learn that operations between brokers on the Stock Exchange were

liquidated through the intermediary of bank notes and not by the use of checks.

The best way to illustrate the consequences of the evolutionary process heretofore outlined will be to reproduce the figures of note circulation and of deposits per capita in the United States and in Belgium, for the year 1913.

	Note Circulation	Deposits
United States	\$11.00	\$171.00
Belgium	28.00	80.00

Banking habits on the European continent were quite different from those of the two principal Anglo-Saxon countries. As a result of the inelastic system of note issue, American and English commercial banks did not rely too much on their central banks. In England rediscounting with the Bank of England is entirely unknown to deposit banks. In the United States no central banking existed before 1914 and even after the Federal Reserve System was established it remained "a well established principle that a bank ought not to borrow merely in order to relend at a profit." Loans of the Federal Reserve banks are used only for temporary convenience. In Belgium, on the other hand, recourse to the rediscount facilities of the central bank was always considered a normal procedure.

The discount policy of the Banque Nationale was very "liberal." This means, first, that the bank tried generally to keep the discount rate down, applying what, in present day terminology, would be called a policy of easy money. "Cheap" credit was considered indispen-

¹ Charles O. Hardy, *Credit Policies of the Federal Reserve System* (1932), p. 231. See also, Board of Governors of the Federal Reserve System, *Banking Studies* (1941), pp. 395, 401.

sable to Belgian industry and trade, which was highly exposed to international competition.²

In the second place, the Banque Nationale rediscounted freely, bills presented by commercial banks without scrutinizing too carefully the nature of operations underlying the bills. The chief concern of the bank was not the "self-liquidating" character of the bills, but the financial standing of the signers and particularly of the endorsing bank.

As a result of its liberal loan policy, the Banque Nationale was even involved in industrial loans contrary to the spirit of the law. On different occasions commercial banks hesitated to grant some loans to industrial enterprises because of fear that their funds would be immobilized. As the Banque Nationale was not allowed to rediscount loans "in current account," the following formula was finally adopted under the pressure of bankers and industrialists. The commercial bank would draw a bill accepted by the industrial enterprise and having maturity of one hundred days only. The Banque Nationale would discount it and would promise that at maturity the bill would simply be superseded by another one. In this way the bill could be renewed a number of times.

The central authorities of the bank did not always view this method of "renewable bills" with favor. From time to time they instructed local executives to discon-

² It must be added that in the years preceding the First World War the bank was criticized for the "weakness" of its discount policy. A rise of the discount rate was considered indispensable by most economists in order to "protect" the rate of exchange. We are not dwelling on this point as our study is devoted chiefly to commercial and investment banking. Currency problems will be touched here only as far as is necessary for an understanding of banking developments. See the works of Conant, Ansiaux, and Van Elewyck quoted in the bibliography.

tinue it. But their instructions were not carried out in practice. And sometimes such loans were granted with their explicit approval. Thus, some loans of the central bank were used for purchasing machines and equipment or even occasionally for building industrial plants.³ Needless to say, such loans were only a small proportion of the total credit granted by the Banque Nationale but they were theoretically significant.

II. BANKING DEVELOPMENTS

In the second half of the nineteenth century Belgium became one of the most industrialized countries of the world, participating very actively in international trade. Along with industrial progress came an expansion of financial activities. Industrial and other corporations multiplied, and the utilization of credit facilities increased tremendously.

Financial expansion was fostered by changes in economic legislation which introduced a regime of almost complete "laissez faire." The corporation law was changed in 1873; the obligation of "preliminary authorization" was abolished and corporate promotions were given an absolutely free hand. The result is reflected in the following figures: Between 1830 and 1873 there were 543 incorporations; from 1873 to the close of the century more than 4,000 corporations were organized, while 1900 to 1914 showed a growth of 4,400 new companies. Although on the whole the corporate movement did contribute enormously to the expansion of Belgian industry, it is certain, nevertheless, that there were too many unsound flotations. The rate of corporate mortality was very high.

³ Some of these loans became frozen and were transferred to the National Company for Industrial Credits, established in 1919. See p. 145.

An analogous radical change was introduced in the legal regime of stock exchanges. Prior to 1867 the stock exchanges were official institutions. Stock brokers were designated by public authority and were granted a legal monopoly to carry on business. In 1867 the law was radically changed. Anyone could establish a stock exchange and anyone was permitted to conduct a brokerage business. There were no new exchanges created, but the Stock Exchange of Brussels was overrun by a crowd which set themselves up as brokers.

There was no legislation concerning commercial or investment banking. Anybody was permitted to establish himself as a banker, or to establish a banking corporation. Consequently, the number of so-called brokers and bankers multiplied. One of the chief reasons for the expansion of unsound flotations and of securities speculation, particularly after the First World War, was the presence of this heterogeneous and numerous group of individuals.

The multiplication of links between Belgian and foreign economies also fostered the development of the capital market. In the 1860's there began a steady flow of Belgian capital for investment abroad. The first impetus for such investments was brought by the enlarged activities of industries producing durable goods. In the early 1860's, engineering companies were unable to sell railway equipment in Italy, in Spain, or in the Balkans unless they accepted in payment, bonds issued by foreign railway corporations. Most of the bonds were sold to the two leading banks which in turn issued them to the public. The Banque de Belgique was particularly active in this field.

In the following decades a great number of industrial corporations were established in Belgium for opera-

tions abroad. Generally, they were incorporated in Belgium, but sometimes abroad with Belgian capital. Sometimes they had an international character, Belgium supplying only a part of the capital. In this way corporations were established for building and exploiting railways, tramcars, metallurgical and electrical plants, and so forth, in southern and eastern Europe, in China, in South America.²³

²³ Although no extended study of Belgian capital exports is possible here, mention should be made of an incident relating to the early phases which, in its time, attracted world-wide attention. This was an attempt to mingle corporate finance with politics and religion. In the 1860's a Belgian financier, Langrand-Dumonceau, organized several corporations to draw Belgian, and even European, capital to the Austro-Hungarian Empire. The most famous were *Crédit Foncier International*, *Banque Internationale de Crédit Agricole*, *Banque de Crédit Foncier et Industriel*. Some were incorporated in England, owing to the founder's inability to obtain the necessary authorization in Belgium.

Langrand was impressed by the fact that in the major part of the Hapsburg Empire the soil was owned by big proprietors who generally lacked capital for modern exploitation of the land. Moreover, in most cases the cultivation was done by small tenants whose lack of capital was even greater than that of the landlords. Langrand's plan was to modernize the agriculture of the large Danubian Empire with the aid of capital coming from other countries, chiefly Belgium. The object was to be obtained by two methods: first, granting mortgage loans to soil owners; second, buying large estates and reselling them in small parcels to the peasants. The first method was relatively simple. It was the first use of an idea, which since then has been adopted many times (European mortgage banks granting loans in South America, in Africa, and so forth). The second method was much more complicated and raised many difficulties.

Langrand also engaged in many other operations (mainly construction of railroads) in southeastern Europe. He was a man of rich imagination and of great persuasion. Like many other financiers, he had a major defect—lack of patience. He did not allow his corporations to grow gradually, but wished instant and spectacular results. He was not motivated chiefly by the wish for immediate personal gains; he seems to have been honest and not to have misused his corporations for personal profit. But he desired immediate success for all of his enterprises. His impatience led him to establish corporation after corporation, one subscribing the capital of another. He distributed dividends based on perspective rather than actual profits.

He also made the mistake of giving his enterprises a political and

On the other hand, because of her geographical and political position, Belgium was a convenient field for the establishment of business connections between neighboring countries. Some Belgian financial corporations were established by groups, consisting of bankers from several countries, and sometimes only a fraction of the shares was held in Belgium.

As a curious example of the multiple interconnections on the Belgian capital market we can quote the Société Financière des Valeurs Americaines, a corporation established at Brussels in 1911 by a number of Belgian, French, German, and American banks. This corporation intended to issue bonds in Belgium, or rather in Europe, and to invest the funds obtained in American securities. But the First World War broke out, and the financial relationships between Europe and the United States were reversed. Instead of investing in the United States, Europe began to borrow in that country. In 1919 the corporation was liquidated.

It was one of the "historical roles" of Western European capitalism to equip "economically young" countries in the rest of the world. As shown above, Belgium played an important part in this connection. It had its share in losses inflicted by this "civilizational" task, as a large number of foreign investments became worthless for economic and, perhaps still more, for political reasons.

even a religious character. He represented himself as a catholic business man whose aim was to "christianize capital" (*christianiser les capitaux*). He had some connections with the Papacy, by which he was more or less sponsored. The American reader should realize that in Europe catholicism is as much a political as a religious phenomenon. The political character of Langrand's business attracted toward him much animosity in political as well as in business circles. About 1868-70 all of his corporations collapsed completely. The adventure had political repercussions and provoked a cabinet crisis in Belgium.

As a result of these developments the amount of securities held in Belgium constantly expanded. About 1875 the total amount of Belgian securities—including government and municipal debts—was probably in the neighborhood of 4 billion francs, in 1900 something like 8.5 to 9 billions and at the end of the First World War, 15 to 16 billions.⁴ Of this amount nearly 5 billions were represented by the bonds of public authorities (issued chiefly for building or repurchasing of railways), 1.5 billions by corporate bonds, and the remainder by stocks. These figures include securities of Belgian corporations operating abroad. Concerning foreign securities proper held in Belgium in 1913, estimates varied between 5 and 7 billions.⁵

The expansion of industry and of the capital market brought about a development of banking organizations and an extension of their activities. At the middle of the nineteenth century, banking was represented in Belgium by four corporations with the privilege of issuing notes and by some private banking houses, which did a limited volume of business. The number of banking organizations increased greatly in the second half of the century.

The establishment of the Banque Nationale in 1850 gave a vigorous impulse to the development of commercial banking. Because of the rediscount facilities granted by the Central Bank, the commercial banks were able to expand their discounts far beyond their deposits.⁶

⁴ Of course these are "gross" figures. No deduction is made for duplicate accounting.

⁵ On the other hand, it was estimated that about 2 billions of Belgian securities were held abroad.

⁶ At the end of the eighteenth century an analogous process took place in England when the Bank of England became the Central Bank of the country. The provincial issue banks were able to expand their discounts without bothering about their cash reserves, if only they had bills

Until about 1870 banking developed rather gradually. With only two or three exceptions, the government did not grant authorizations for establishing new banking corporations. Nevertheless a certain number of new banks were organized as "copartnerships on shares," which did not require an official authorization.⁷ Private banking houses also extended their activities. The leading role continued to belong to the Société Générale and to the rapidly growing Banque de Belgique, which restored its original bylaws in 1861. Both banks engaged in commercial loans as well as in financial operations.⁸

In regard to the Banque de Belgique, financial operations played finally a prominent part in its activities, especially in the handling of railroad securities. In the last resort, this bank became too closely connected with a group of railways headed by a once famous speculator (Philippart) and immobilized considerable funds in this way. In addition, one of the higher officers of the bank abused his position by speculating with the securities of the customers. In 1876 he fled the country. It was the "scandal of the Banque de Belgique" famous in the judiciary annals of Belgium. After many tribulations the bank was finally liquidated. The shareholders lost most of their capital, but no losses were incurred by the depositors.

In the years 1871-73 the activity of the Belgian

on London. These bills could always be transformed into Bank of England's notes. See Henry Thornton, *Inquiry into the Nature and Effects of the Paper Credit of Great Britain* (1802).

⁷The liability of sleeping partners was limited to the amount of the subscribed shares. These could even be issued "on bearer."

⁸"Financial operations" is used in Belgium (as in France) in a sense near to "dealing in securities." It has nevertheless a broader meaning and includes promoting, buying of industrial securities for permanent holding (for control purposes particularly), and so on.

capital market expanded in the international sphere. These were the years of the upswing phase in the business cycle ended by the crisis of 1873. Moreover, the Franco-Prussian war had directed toward Brussels some financial activities from the two neighboring countries and Belgian industry and trade benefited from the necessities of reconstruction in France. There were many flotations of internal and external securities and prices on the stock exchange rose sharply. The spread of financial activity provoked the creation of new banking corporations. Some were established with foreign, especially German, participation, for instance the Banque de Bruxelles, and the Banque Centrale Anversoise.

But about 1875-76 the international crisis and the acute fall of security prices at the Brussels Stock Exchange provoked a sharp setback for the Belgian banking world. Some small banks had to go into receivership; others, the new ones, were obliged to write off a part of their capital. Losses were generally borne by the shareholders and those of the depositors were few.

At the end of the century a new period of rapid economic expansion began. Industrial and financial activity rose again, and important banking corporations were created, some of them with foreign collaboration, such as the Banque Internationale de Bruxelles, or the Crédit Anversois. At the same time, many small banking and financial corporations were established, especially colonial companies (for the Congo) most of which disappeared after the crisis of 1900-01. The same crisis brought difficulties for more important banking corporations, and especially the new ones were obliged to write off a part of their capital, as was the case during the crisis of 1875-76.

There was in Belgium a saying that a young bank can

be compared to a young dog; it must pass through an illness. The reason is that generally new banks were established in periods of optimism and rising prices, in

ASSETS AND LIABILITIES, BELGIAN BANKING CORPORATIONS, END OF YEAR 1875, 1900, AND 1913^a
(In millions of francs)

Balance Sheet Item	1875	1900	1913	
			All Banking Corporations	Leading Corporations
Assets:				
Cash reserves.....	27	53	172	110
Bills.....	157	312	777	575
Loans and overdrafts.....	247 ^b	576 ^b	1,286 ^b	1,090
Securities.....	224	402	717	610
Other assets.....	133	334	848	40
Total assets.....	787	1,678	3,802	2,425
Liabilities:				
Deposits (sight or undetermined).....	355	893	2,330	} 1,830
Time deposits ^c	120	288	673	
Capital paid up.....	248	338	496	} 550
Surplus.....	64	118	235	
Profits.....	—	41	68	47
Total liabilities.....	787	1,678	3,802	2,425
<i>Number of banks.....</i>	<i>46</i>	<i>59</i>	<i>67</i>	<i>18</i>

^a The first three columns of this table are from annual surveys of a Belgian financial paper *Moniteur des Intérêts Matériels*. They include almost all banking corporations and in addition some corporations doing chiefly mortgage credit business.

The last column of the table relates to the 18 banks whose resources (paid in capital and surplus) amounted to at least 10 million francs. The figures were taken from the reports of the banks.

^b A part of the loans is included among "other assets."

^c Including notes and boards.

the ascending phase of the business cycle; they participated in the creation of new industrial corporations which had a difficult start. It was inevitable that the participating banks should suffer important losses.

The table on page 38 gives some statistical information about Belgian banking corporations.

On the eve of the First World War, the basis of Belgian banking was the "unit" bank. Although for nearly two decades the movement of banking concentration had been under way in England, France, and Germany, it began in Belgium at a slow pace only a few years before the war. Nearly all banks had only one operating office. There was no branch banking, except the Société Générale with a group of 18 affiliated provincial banks.⁹ Nearly all of them had a few agencies in their respective regions. The group of the Société Générale was established in 61 localities. All other banks were strictly "unit" banks, except Crédit Anversois, which established some ten agencies in the last years preceding the war.

On the whole, all small and many medium-sized localities had poor banking facilities. However, most people did not need such facilities because they used bank notes and not checks. The small size of the country and the good facilities for traveling were additional reasons. The banks themselves had no great interest in branches because they could not get large deposits. Financial operations alone, that is, securities selling, would not have covered the expenses of a permanent branch office. It was more convenient for banks to rely on stock brokers and business agents, who were established in the country.¹⁰

On the other hand, all banks were not of equal importance. The table on page 38 shows that the 18 lead-

⁹ Some of these 18 banks are included among the 18 leading banks.

¹⁰ Post offices fulfilled some banking functions, such as selling money orders, collecting bills, operating for the official savings bank, and so forth. Shortly before the First World War a system of postal checking accounts was established.

ing banks owned three-fourths of the whole banking capital and 60 per cent of deposits. In 1914, Belgium had one big bank, about a dozen medium-sized banks with resources in excess of 100 million francs (20 million dollars), and about 50 small banks. In addition, there were a certain number of private banking houses.¹¹

III. ANALYSIS OF BANKING ACTIVITIES

The conventional conception of banking held by economists and by financial writers was that deposit banks should invest their funds only in short-term commercial loans, preferably in discounted bills. Dealing in securities and still more corporate promoting were considered as in the field of investment banking or, rather, of special financial institutions.¹² But practically most continental banks combined both kinds of activities; hence the term "mixed" banks used particularly for countries such as Belgium or Germany, where banks have established permanent links with industrial corporations.¹³

Belgian banks were among the typical representatives of mixed banking. In fact, as was shown in the preced-

¹¹ Their role became negligible except for half a dozen houses (chiefly at Brussels) which had a selected clientele of depositors and whose "financial operations" were far from being negligible.

¹² It should be noted that in English terminology, contrary to American custom, there is a sharp distinction between "banking" and "finance." "Banking" is applied to short-term operations, "finance" to dealing in securities, and, in a general way, to long-term operations. In the United States "finance" is used rather in a broad sense, banking being considered a branch of finance.

¹³ On the Continent the term bank was used in a larger sense than in England. It included the "mixed banks." Nevertheless economists and financial analysts make a distinction between "classical" (short-term) and "financial" operations of the banks. In Germany they spoke about "regular" and "irregular" operations.

Since the banking reform of 1935 English terminology has been used in Belgium.

ing chapter, mixed banking originated in Belgium. The table on page 38 provides the basis for an analysis of the distinctive features of banking operations in Belgium.

The proportion of banking capital compared to deposits was high. In 1913 capital and surplus of banks amounted to approximately 20 per cent of their liabilities (in the case of 18 leading banks to 23 per cent) against 8.5 per cent in England and 16.1 per cent in the United States.¹⁴ Because of their "financial" operations Belgian banks deemed it necessary to command a relatively important capital. It was believed generally that only the bank's own resources should be used for investment in securities, which were a very different kind than the securities bought by American and English banks. (See pp. 44 ff.)

The proportion of cash reserves to deposits was low. Of course there were no legal requirements for cash reserves, not even customary requirements as in England. At the end of 1913 the cash reserves amounted to only 7.4 per cent of demand and undetermined deposits and to 5.7 per cent of all deposits, whereas in the United States the latter ratio for all commercial banks was 16.3 per cent (25.4 per cent if only national banks are taken into account). In England the customary ratio was about 10 to 11 per cent.

The small amount of cash reserves is due to the rediscounting facilities granted by the Banque Nationale. It is unnecessary to keep large cash reserves, when a bank has an interest-bearing commercial portfolio, an important amount of which can be turned into cash at any instant. Usually, cash reserves were even lower than

¹⁴ Figures concerning England and the United States extracted from the League of Nations; *Memorandum on Commercial Banks, 1913-29* (1931), Table III.

the above-mentioned ratios because of "window dressing." Figures in the table on page 38 refer to the end of the year. But it is well known that during the last weeks of the year most banks rediscounted heavily with the Banque Nationale in order to "dress" the balance sheet.

The most important aspects of banking activities are revealed by the examination of productive, or income-bearing, assets. International comparisons must be made with caution because of differences in banking technique and in making of balance sheets. However, the following table shows the distribution of banking assets among

MAIN GROUPS OF ASSETS AS PERCENTAGE OF TOTAL

Countries	Discounts	Loans	Securities
Belgium			
All banks.....	20.5	33.8 ^a	18.9
18 leading banks.....	24.0	45.4	25.5
France (principal banks).....	44.0	34.7	4.8
England.....	9.6	44.7	12.6
Germany.....	20.5	47.0	11.9
United States.....	67.0	b	16.9

^a The actual percentage was higher. See note c of table on p. 38.

^b Included in discounts.

principal categories, in 1913, for selected countries. It shows that identical figures can conceal different things.

The preceding table reveals a very low proportion of discounts in Belgium and in Germany.¹⁵ It is significant that in France where the links between banks and industry have been much looser, the proportion of dis-

¹⁵ The proportion would be even lower without the "window dressing" practiced by some banks. At the end of the year bills were drawn on some debtors and thus a part of the assets was transferred from loans to discounts. This practice is not feasible since the banking reform of 1935.

counts amounts to double that of Belgium.¹⁶ It is true that the proportion of discounts in England was still lower. But the English figure includes only what can be called the direct discounts. Besides, English banks were doing a great deal of indirect discounting by granting loans—backed by discounted bills—to bill brokers and discount companies.

The most revealing feature of Belgian banking is divulged by the high proportion of loans and by their nature. In Belgian balance sheets the different kinds of loans, advances, overdrafts, and so forth, were usually put together under the heading "advances in current accounts." Sometimes the item was simply called "debtors." It is the most important and at the same time the most characteristic part of the assets. The proportional importance of this item was nearly the same in Belgium (taking into account the 18 leading banks) and in Germany, both countries having a system of mixed banking.

It is true that the ratio was the same in England. However, in England the item "loans" included a certain amount of short-term loans backed by bills to which reference has been made in a preceding paragraph. On the other hand, even loans to industrial or trading concerns in England were of a more liquid character than in Belgium, at least in principle.¹⁷ Anyway, the Belgian

¹⁶ The French figure in the table on p. 42 concerns only the leading banks established at Paris. If the provincial banks, whose links with industry were much closer, had been included, the proportion of discounts would have been lower and, of course, the proportion of loans would have been higher.

¹⁷ Practically, in England the loans, particularly in the country, have not been always used for short-term accommodations. Besides, loans on securities also served indirectly for working capital or even investment purposes. See below p. 176.

conception of "loans in current account" was not that of a temporary, let alone seasonal, accommodation. It was admitted that these loans could increase the working capital of an enterprise. In granting a loan the bank was not concerned so much with the specific use of the loaned funds as with the general situation of the debtor. Sometimes, bank loans were even used to increase industrial equipment, when it was believed that the debtor corporation would be able to sell new stocks or bonds in a not too distant future.

In fact, industrial corporations very often reimbursed the bank loans by selling new securities. But the handling of the securities was generally undertaken by the bank itself. Sometimes the banks simply took over the new securities issued by the industrial corporation, sometimes they acted as underwriters. Exceptionally, they acted only as agents in public flotations.

In this way industrial loans have been the principal reason impelling Belgian banks toward "financial operations." As has been mentioned incidentally before, the "financial operations" of Belgian banks had a much larger meaning than implied in the United States by "investment banking" or by "dealing in securities." The principal difference resulted from the fact that most Belgian banks, particularly those established in the capital, have been engaged in corporate promoting also.

Since the beginning of the corporate and financial movement in the 1830's, as mentioned in the first chapter, Belgian banks have maintained their "industrial" character. In fact, most important industrial corporations have been established or enlarged by one or several banks, or at least with their co-operation.

The shares subscribed by the banks were offered later

to the investors.¹⁸ Sometimes the banks kept a certain amount of the shares as an investment. But generally, the principal object of the bank was not a permanent investment,¹⁹ but to make a profit by selling shares and to establish connections with an industrial corporation which would become a permanent customer of the bank.

Even if the bank sold all shares, the other links to the corporation remained: advances on current account, discounting, collecting bills, handling the financial operations of the corporation, issuing new shares or bonds. Thus, in 1913, most of the important industrial corporations had close connections with one or more banks. In some cases the industrial corporation was literally controlled by a bank. For instance, the Société Générale controlled important corporations in the coal, metallurgical, and electrical industries.²⁰ In several instances control was exercised jointly by two or three banks.²¹ The degree of control varied according to the amount of shares held by the bank, to the importance of its loans, and also to personal factors.

¹⁸ They were sold by "public subscriptions," by stock exchange introduction, or over the counter "placement direct." Shares were, of course, sold with a "premium." In principle the amount of the premium should depend on the degree of "seasoning" of the shares. Although there is no precise formula to calculate the "just" premium, it is undeniable that sometimes it was very exaggerated.

¹⁹ Of course sometimes banks were obliged to keep shares because they were unable to sell them.

²⁰ In some cases control was exercised through a "financial trust," which specialized in fields such as construction and operation of trolley cars, regional railways, electrical plants, and so forth. It resembled the American public utility holding company but most of its affiliates operated abroad. Some of them became world famous, for instance, Sofina (Société Financière de Transport et d'Entreprises Industrielles).

²¹ What precedes concerns chiefly important corporations whose shares were held, at least partly, by the general public. In addition, there were a great number of small or medium-sized corporations, more or less of the "family type" whose shares were held by a limited number of people.

Furthermore, it should be noted that generally when a bank or several banks acquired a more or less substantial amount of shares issued by an industrial corporation, some directors or officers of the banks obtained directorships in the corporation. Hence there were personal contacts, sometimes close personal ties, between banking and industrial corporations.

As stated above, the securities bought by Belgian banks were, in principle, intended to be sold to investors. Yet, finally, the most important banks were in possession of a substantial securities portfolio the importance of which can be judged by the figures in the tables on pages 38 and 42.²²

There was a fundamental difference between the securities portfolio of Belgian banks, and the securities held by English or American banks. The investments of English banks consisted almost exclusively of bonds issued by governments and other public bodies or by first-rate industrial corporations (before 1914 almost exclusively railroad corporations) and in shares of affiliated banks. In the United States the investment policy was less conservative, but even here only bonds were bought by banks. In Belgium, on the contrary, an important part of the portfolio consisted of industrial shares.

The Securities portfolio of all Belgian banks in 1913 consisted of about 200 million francs of Belgian industrial shares, 100 millions of foreign industrial shares, 100 millions of corporation bonds (Belgian and foreign), 75 millions of banking shares, and 200 to 250 millions of government bonds. It should be noted also

²² It is not surprising that most of this portfolio (610 millions out of 717 millions) belonged to the 18 leading banks. The lion's share was retained by the Société Générale, whose securities portfolio amounted to 263 millions (186 millions industrial and banking shares, 19 millions corporation bonds, and 58 millions public debentures).

that the market price of the shares held by the banks was about 50 per cent above their book value.

There have been several reasons why Belgian banks hold industrial securities. Some of them were of a transitory nature and were destined to be sold.²³ Others were held for investment purposes, especially when it was hoped that their value would increase. Still others, the majority, were held both for investment and control purposes. The holding of a "controlling" interest, sometimes only 10 to 20 per cent of the capital stock, was a means of preserving for the bank all financial and banking transactions of the industrial corporation.

It must be stated also that sometimes the holding of industrial securities was used to "manipulate" Stock Exchange quotations and, in a general way, to make profits from purely financial manipulations. It cannot be denied that "financial operations" have given rise sometimes to faults and to abuses. Yet, on the whole, there was a general agreement that by their action as promoters and by their bold industrial loans, Belgian banks contributed very largely to the expansion of Belgian industry and trade.²⁴

²³ Of course sometimes the shares remained in the banking portfolio because it was impossible to sell them; for instance, when the industrial corporation was not successful.

²⁴ When, in 1935, the system of mixed banking was prohibited (see below pp. 90 ff.), the authors of the law wrote in the explanatory statement: "It would be unjust at the moment when their definitive disappearance closes a chapter of our financial history, not to recognize the immense service rendered to the country and the colony by the banks of industrial participations [meaning the mixed banks] during a century of prodigious economic development."

CHAPTER III

FROM THE FIRST WORLD WAR TO THE BANKING CRISIS

Before the First World War the Belgian banking system, as outlined in the preceding chapter, functioned in a relatively stable economy. Since the last decade of the nineteenth century world trade has been constantly expanding, there has been a regular international flow of capital, and, on the whole, a stable international monetary system. Belgian banking, based on an expanding industry and a growing financial market, enlarged regularly its sphere of activity.

The war and its consequences brought important changes in the situation. Regular development was superseded by feverish and irregular expansion. Monetary instability caused frequent excitement. Profound modifications occurred in the structure of the banking system.

I. MONETARY INSTABILITY

Before the First World War, Belgian currency, although presenting some slight defects from the point of view of the classical gold standard, was nevertheless linked to the international monetary system.¹ For all practical purposes it was a "stable" money. On the eve of the war the circulation of bank notes was about one billion francs. At the outbreak of the international crisis, the Banque Nationale increased its issues in order to

¹ In the last years preceding the war, there was a very slight premium on foreign currencies, or rather on gold currencies (as shown particularly by the quotations of the French franc). But its effects were negligible and, on the whole, Belgium participated fully in the international monetary system. See above p. 30, n. 2.

rediscount paper presented by deposit banks which had to face a run of depositors. When the German invasion of Belgium began, redemption of bank notes was suspended; they became inconvertible paper money. At the time of the Armistice in November 1918, Belgian note issue was about 2.7 billions. In addition, there was an unknown amount of German marks in circulation. The Belgian government decided to redeem German notes circulating in Belgium at their prewar parity. The marks could be redeemed mainly on the basis of a special loan granted by the Banque Nationale. The result was, that total liabilities of the Banque Nationale rose to 7.25 billions in the first few months of 1919. The external value of the franc was maintained until March 1919, because of advances granted by the American government to all allied and associated states. In March 1919, these advances were stopped, and then the first slump of the allied currencies, the pound, the French and Belgian francs, occurred.

The fluctuating value of the franc became one of the chief controlling factors in Belgian financial development. As a preliminary, it should be pointed out, that in Europe discussions concerning inflation are directly related to the external value of the currency, the rate of exchange; whereas in the United States the emphasis is on the internal value, the price level. The reason is, that, except for a few weeks in 1914 and some months in 1933, the external value of the dollar has not fluctuated for two or three generations. In Europe, particularly during the years immediately following the First World War, governments and central banks lost control over their currencies, and the value of such currencies depreciated sharply. Since fluctuations in the rate of exchange usually preceded changes in prices, the exchanges

were watched constantly not only by business men but also by the general public.² The writer recalls how the rate of exchange became the principal topic of conversation in business meetings as well as in social gatherings of every sort. "Where is the franc today?", "What is the pound doing?" were questions heard at every instance.

In the next section the repercussion of this situation on capital market and banking activity will be discussed. Here, the monetary events only will be described. The following table will give an idea about the fluctuations in the external value of the franc. The best measure of

HIGHEST AND LOWEST PRICE OF THE DOLLAR, 1919-26

Price	1919	1920	1921	1922	1923	1924	1925	1926
Lowest..	5.65	10.82	11.30	11.48	16.16	17.47	19.11	21.97
Highest..	11.00	16.45	15.17	17.84	22.82	24.74	22.46	45.07

this value is furnished by the rate of exchange on New York or, to put it differently, the current price of the American dollar. Prewar par value of the dollar was 5.18 francs.

In the beginning of 1926 there was an attempt to stabilize the franc at something like one-fifth of its prewar value. The attempt failed for reasons which are not relevant to this study.³ This failure provoked a

² A similar situation existed in the United States during the Civil War, when the dollar depreciated relatively to foreign currencies. See W. C. Mitchell, *History of the Greenbacks* (1903), Pt. II; and Mitchell, *Gold Prices and Wages Under the Greenback Standard* (1908), Chap. 5.

³ In some sections of public opinion, especially in the Socialist press, the bankers were accused of having caused the failure of the "first stabilization" called "stabilization Janssen" (Mr. A. E. Janssen was the finance minister). Although this thesis was oversimplified, it is nevertheless true that hostility of leading businessmen (among whom were some bankers) and of the "bourgeois press" to the "democratic" ministry was one of the reasons for the failure of the stabilization. The ministry was composed of the left wing of the Catholic Party and of the Socialists,

monetary panic and, among other consequences, a refusal of many holders of short-term Treasury bonds to renew them at maturity. The government was obliged to ask authorization for a new loan of 1.5 billions by the Banque Nationale. This aggravated the panic and a new fall of the franc ensued.

In October of the same year a ministry of national union—whose leading spirit in financial matters was E. Francqui, the head of the Société Générale—succeeded in carrying out a monetary reform. The franc was stabilized at about one-seventh of its prewar value, instead of one-fifth as attempted some months earlier. The new par was 35.95 francs for the dollar and 175 francs for the sterling, instead of a prewar value of 5.18 and 25.22.

It is fair to state that the gold value of the franc had been reduced too much by the monetary reform of 1926. Prices did not rise in Belgium to a level justifying such a reduction. The lowering of the gold weight of the franc should have been in a relation of about 1 to 5.5; the parity of the pound would then have been around 140 and that of the dollar about 28.

The principal reason for the low rate at which the franc was stabilized was the wish to favor export industries.⁴ Unfortunately, most industrial and banking leaders did not realize that this "export priming" would be only of temporary benefit. Actually, during the first years following the stabilization, exports flourished and industry expanded greatly. New capital was invested in creating or expanding industrial capacity. The profits made by the corporations and the huge investments

the opposition consisting of the right wing of the Catholic Party and of the Liberal Party.

⁴Of course this reason was not given officially.

were among the principal reasons for the lively capital market and feverish banking activities during the years succeeding the stabilization of October 1926. Another consequence of the stabilization was to attract foreign funds towards Belgian obligations, the price of which fell during the years of monetary depreciation. The result was an inflow of foreign funds (and of gold) which contributed to the rise on the Stock Exchange and to the abundance of money.

In summary, it can be said that the movement of the capital market and banking activities were determined during 1919-26, chiefly by the depreciation of the currency, in 1927-29, by the flourishing state of industry as well as by the inflow of foreign funds and of repatriated Belgian funds.

Monetary stability—in the sense of stable exchange rates—prevailed from October 1926 until April 1935 when, as a consequence of the economic depression and especially of the fall of the English pound, Belgium proceeded to a devaluation of the franc, which will be dealt with later.

II. INORDINATE EXPANSION OF THE FINANCIAL ORGANIZATION

In the financial field, the principal consequence of the unsettled conditions of the postwar period was to make people ever more anxious about the depreciation of the franc and its repercussion on their savings. As currency depreciated, fixed interest securities came to be regarded with increasing disfavor. Equities representing "real values" were favored. The result was that an ever-increasing proportion of the population wished to invest their savings in stocks instead of bonds. As the value of stocks fluctuated, people changed their investments

frequently. To put it differently, investment was superseded on an ever-increasing scale by speculation.

During the war and the following years, a certain "democratization of savings" occurred. As agricultural prices rose sharply, the rural population was able to save. Wages also rose in real and in money terms during the first years after the war, and savings were made by the working classes as well. Before the war savings of this sort would have been invested at the Postal Savings Bank or in government bonds. After the war a part of these savings at least was invested in stocks and used for speculation. A new class of investors and speculators, lacking experience, was attracted to the Stock Exchange, whose activities grew considerably.

The increasing amount of speculation led to a notable increase of financial intermediaries and banking organizations. They included banking offices proper, brokers, financial agents, and so forth. On the other hand, there was in Belgium after the war, and especially after the monetary stabilization, an important movement of industrial concentration and rationalization—and for most people concentration is rationalization. The financial press devoted much space to describing the amazing results expected of the movement. It is true that most industries were really prosperous during this period, particularly because of the competitive advantage resulting from the low rate of the franc.

In most countries, 1927-29 were years of optimism, especially in the United States, and the example of America played a big role in Belgium. Every banker or financier and even many industrialists, on arriving at their offices in the morning, first of all inquired about the closing quotations in New York the day before.

All these circumstances gave a marked impetus to

financial activities. During the entire decade after the war, new issues of securities took place constantly, resulting either from the creation of new corporations or from the capital increase by existing corporations. And the Stock Exchange was almost always in a state of excitement, usually bullish, although with some recessions, until the final slump in 1929.

The following table indicates amounts of securities

CORPORATE SECURITIES ISSUED IN BELGIUM, 1913, 1919-31^a
(In millions of francs)

Year	Shares of New Corporations	Increase in Capital	Bonds	Total
1913.....	292	511	b	803
1919.....	977	1,201	c	2,178
1920.....	829	1,394	430	2,653
1921.....	436	744	473	1,653
1922.....	414	897	310	1,621
1923.....	655	1,246	124	2,025
1924.....	576	577	40	2,790
1925.....	918	1,175	308	2,401
1926.....	1,125	1,513	18	2,656
1927.....	2,678	3,372	279	6,328
1928.....	6,312	5,939	12	12,263
1929.....	7,800	6,928	236	14,966
1930.....	2,424	2,054	877	5,356
1931.....	1,397	2,193	814	4,404

^a Statistics of the Banque d'Outremer and the Banque Nationale.

^b Included in the figure of the second column.

^c Included in the figure of the first column.

issued or created by corporations in Belgium in 1913 and during the years 1919-31.⁵ These figures give the

⁵ The term "issued" causes misunderstanding sometimes, in Europe at least. It is used in the sense of offering securities to the general public ("public issues") and also to designate total securities of a corporation, regardless of whether they have been sold to the public or were distributed only among the original subscribers.

nominal amount of securities created; they do not include the "premium" resulting from the fact that in most cases the securities, or rather the shares, were sold for higher prices than the par value.

It is true that, from a general economic as opposed to a strictly financial point of view, these are "gross" figures. Many deductions must be made in order to obtain figures representing the actual value of new capital invested in industry; the value of shares issued not for cash but for other assets (plants or securities) transferred to the issuing corporation must be deducted as well as shares or bonds issued by banking, financial, or insurance corporations. After all these deductions, the following figures which represent the "net financing" or the actual amount of money made available to corporations, are obtained.

GROSS AND NET CORPORATE FINANCING
(In millions of francs)

Year	Total Value of Corporate Securities Issues (gross financing)	Amount of Net Financing
1927 ^a	6,328	3,925
1928.....	12,263	6,333
1929.....	14,966	5,932
1930.....	5,356	2,898
1931.....	4,404	2,025
1932.....	2,152	631

^a Figures for preceding years not available.

This study is concerned with "gross" figures because they indicate the growth of the amount of securities held in the country and the spread of financial activities. In the gross total of corporate securities, those created by banking and financial corporations account for more than one-third, followed by "colonial" securities, transportation, and industrials of different kinds. Many

capital issues were unsound, and some were even of a fraudulent nature. Abuses were particularly frequent in the field of financial and colonial enterprises, which had great popular appeal.

The culminating point of the rising market was attained in the first months of 1929. The peak of the general index for all stocks listed on the Brussels Stock Exchange was 716 (quotations of December 31, 1913 = 100).⁶ But the shares of a great many corporations had risen in a much higher proportion.

An interesting indication of the transformation of the Belgian capital market during the first postwar decade is furnished by the figures of the total value of all securities listed on the Brussels Stock Exchange, based on current quotations.

TOTAL VALUE OF SECURITIES
(In millions of francs)

Securities	May 1, 1914	January 1, 1929
Public bonds	4,961	21,413
Corporate bonds	1,640	2,084
Total bonds	6,601	23,497
Stocks	6,533	118,389
Total	13,134	141,886

Before the war, fixed interest securities represented nearly one-half of all securities. At the beginning of 1929 they represented a little more than one-seventh. The increase in the proportion of stocks in the total is the result of many new issues and of the general advance of quotations. It will be shown later that this increase was for the most part wiped out by the depression.

⁶ The index was calculated by a rough method and does not fully reflect the real rise of the quotations.

III. EXPANSION AND CONCENTRATION OF BANKING

As a result of the monetary and economic events described in preceding sections of this chapter, Belgian banking underwent a very important and complex evolution during the twenties. The main features of this evolution can be summarized under the following headings: (a) enormous expansion of the banking structure; (b) accentuation of industrial character of Belgian banking; (c) concentration of banking organization and banking leadership.

Owing to the increase in the number of depositors and holders of securities, the banking organization expanded greatly. Between 1914 and 1927 the number of banking corporations rose from 67 to 101. In addition, many private banking houses had been established, particularly in the country. Moreover, most of the important banks, established in the principal cities, created branch offices and became regional banks.

As has been pointed out above, in 1914 nearly all banks were unit-banks; only a few of them had branch offices. Even taking into account private bankers and some small companies not included in the statistics, it is probable, that in 1914 there were no more than 250 to 300 bank offices in the whole country. As against that the total number of offices belonging to the banks included in the table on page 58 exceeded 1,750 in 1929-30. It is quite certain, that at this moment a great number of localities in Belgium were "over-banked."

The table on page 58 will give an idea about general trends of banking developments after the First World War. It will be seen that the number of banks reached its maximum in 1927. After that year the number of merged or liquidated banks began to exceed the number of newly created banks. But before examining internal

transformations in banking organization during this period, it is necessary to analyze Belgian banking as a whole and to study the character of its activities.

ASSETS AND LIABILITIES OF BELGIAN BANKS BY PRINCIPAL ITEMS*
(In millions of francs)

Assets

Year	No. of banks	Cash Re-serves	Dis-counts	Secur-ities	Current Ac-counts	Ad-vances	Other Assets	Total Assets
1913..	67	172	777	717	1,286	848		3,802
1920..	72	1,231	1,327	2,845	4,482	827		10,713
1926..	94	2,037	3,567	4,034	9,992	1,552		21,182
1927..	101	3,030	5,281	4,198	12,910	2,080	338	27,828
1929..	90	4,067	6,910	5,956	18,461	3,339	441	39,174
1930..	92	4,346	8,385	7,201	19,571	2,692	572	42,767
1931..	66	4,118	7,626	7,651	17,592	493		37,479
1932..	66	5,642	5,881	7,568	13,223	518		32,832
1933..	63	6,837	5,946	7,452	12,181	531		32,947

Liabilities

Year	Capital Paid in	Surplus	Deferred Liabilities	Deposits (on sight and undetermined)	Profits
1913..	496	235	674	2,335	68
1920..	948	440	991	8,270	142
1926..	1,685	1,080	3,680	14,294	443
1927..	2,165	1,542	4,811	18,692	628
1929..	4,352	3,473	8,239	22,199	911
1930..	4,961	3,778		33,152	875
1931..	4,198	2,919		29,863	500
1932..	4,206	2,809		25,367	450
1933..	4,308	2,934		25,254	452

* Statistics of the *Moniteur des Intérêts Matériels*.

The increase in deposits during the decade of the twenties reflects the expansion of currency and the reduction in the internal as well as the external value of the

franc. The increase of deposits was not a result of the lending policy of banks, or at least new deposits resulted only partly from loans. The chief reason for the swelling of deposits was the expansion of bank notes, the increase in which was proportionally much larger than the increase in deposits. Between 1913 and 1930 total deposits increased eleven times (from 3 to 33 billions).⁷ At the same time the circulation of bank notes increased 16 times (from 1 to 16 billions).⁸

The inflow of deposits was supplemented by the increase in the capital and surplus of the banks, particularly in the period 1927-30. During these years the banks made use of the favorable situation on the capital market to issue new shares. Generally, they issued them at prices much higher than par value, the "premium" being allocated to surplus. The aim of this policy was to reinforce the position of the banks and, more particularly, to bring their own capital into closer relation to deposits and, still more, in the case of big banks, to their holdings of securities. The result was, that in 1929 their own resources far exceeded the amount of securities held by them. But it will be shown later, that this did not prevent banking difficulties, as during a deflationary crisis losses may be sustained not only on industrial securities but also on loans and even on discounts.

On the assets side of the balance sheet, the conspicuous

⁷ Before the stabilization of 1926 the increase in the circulation of bank notes resulted chiefly from loans to the government. See above pp. 49, 51. Yet there was also some increase in the commercial loans of the Banque Nationale. Since 1926 the increase in the issue of bank notes resulted chiefly from imports of gold, due mainly to inflow of repatriated and of foreign funds.

⁸ In the same period, the velocity of circulation of deposits increased by the development of clearing houses and of postal checks almost unknown in 1913. But, on the other hand, there was probably more hoarding of bank notes.

increase in loans on current account is the most remarkable feature of the twenties. A comparison of the figures relating to 1913 and 1930 shows that "loans" increased more than any other item of the assets, proportionately as well as absolutely.⁹

. Indeed, still more than before the First World War, loans in current account became a real link between banks and industrial enterprises, whose demands for loans were constantly large, first for reconstruction and then for expansion.

It is certain, that in these years of rising prices, of high business activity, and of optimism, bank loans were made very often with much less care than before the war. It is true that in periods of monetary instability, when prices have a general tendency to climb, it is particularly hard for a banker to judge accurately the soundness of the debtor's assets. Sometimes it seems that any loan can be made to a customer when his assets consist of commodities and equipment whose money value appears to increase constantly. In such periods, bankers should redouble their caution, but in fact they are caught in the general speculative wave and are sometimes less cautious than in "normal" times. One thing is certain: during the twenties many mistakes were made resulting finally in heavy losses.

Another notable aspect of the banking evolution in the twenties was the tremendous increase in the holdings of industrial securities. In the table on page 58 the item "securities" includes government bonds as well as industrial securities, which is rather confusing. Fortu-

⁹ The separate item "advances" which figured in some balance sheets during 1927-30 consisted in collateral loans and represents a part of the banks' contribution to the Stock Exchange speculation.

nately, a differentiation can be made for the 18 leading banks.¹⁰

During the war and even during the first year of peace, the banks invested an important part of their deposits in obligations issued by public authorities. In

SECURITIES HELD BY 18 LEADING BELGIAN BANKS*
(In millions of francs)

Year	Obligation of Public Authorities	Industrial Securities
1913.....	190	420
1918.....	1,000	440
1919.....	1,450	550
1923.....	1,450	770
1924.....	1,100	1,050
1925.....	1,000	1,170
1927.....	525	1,625
1929.....	340	3,085

* From the balance sheets of individual banks.

the years 1915-18 there was no other outlet for their funds, and in 1919 their deposits expanded so sharply, that in spite of the increase in commercial loans, they could invest in government bonds. When the value of the franc continued to depreciate, they sold a part of these bonds and they even continued to sell after the stabilization, in order to benefit from the rising quotations, and to invest in industrial securities.

The result was, that around 1927-29 the securities portfolio of Belgian banks consisted almost exclusively

¹⁰ In some cases the distinction could not be drawn with precision; for this reason "round" figures are given. The margin of error is insignificant.

of industrial securities, or rather of industrial *equities*, the role of industrial bonds being almost negligible. Before the war the industrial portfolio of banks included mainly shares of collieries, metallurgical and electrical corporations, and some colonial securities. After the war banks not only increased their holdings of this kind of shares, but also acquired equities of corporations engaged in many other industries—chemicals, glass, textiles, rayon, cement, and so forth.

The large increase in holdings of industrial securities was determined mainly by the fall in the value of the franc, giving rise to a hunt for "real values," and by the favorable industrial situation—especially during the years 1927-29—giving rise to exaggerated expectations. The lust for power of some leading bankers was an additional factor.

Competition among leading banks was also an important factor in the intensive movement of banking concentration during the twenties. The expansion of banking organization, as evidenced by the growing number of banks and bank offices, has already been mentioned. It must be added that there was also an ever-increasing centralization in the control and leadership of the banking organization.

There was a double movement of intense centralization in Belgian banking. First, the principal banks of the capital established links with regional banks, which were creating new branches in their respective provinces. When a regional bank increased its capital in step with the expanding deposits and investments, some bank of the capital subscribed totally or partly to the new shares and directorships in the provincial bank were assigned to directors or higher officers of the big bank.

Second, there were very important absorptions (some big banks, especially at Brussels, absorbing smaller ones) and mergers among regional banks.

The result of this double movement was a complete transformation in the structure of Belgian banking. Before the war the predominant type was the unit bank. There was only one notable exception, the Société Générale, whose group of affiliated banks included about 60 offices. At the end of 1930, at the time of the biggest expansion in the volume of assets and of liabilities, more than half of the banking funds were controlled by four banking groups.

The following table will show the distribution of the capital and of other liabilities of Belgian banks among principal groups at the end of 1930.

CAPITAL AND OTHER LIABILITIES OF BANKS, END OF 1930^a

Banking Groups	Capital Paid and Surplus		Callable Liabilities		Offices ^b	
	Millions of Francs	Per Cent	Millions of Francs	Per Cent	Number	Per Cent
Société Générale	2,712	31.0	10,942	32.9	401	22.8
Banque de Bruxelles	1,897	21.7	4,116	12.4	413	23.5
Algemeene-Bankvereeniging	243	2.8	1,632	4.9	232	13.2
Crédit Anversois	226	2.6	806	2.4	169	9.6
Other banks	3,668	41.9	15,742	47.4	541	30.9
Total	8,746	100.0	33,238	100.0	1,756	100.0

^a Source: *Bulletin of the Banque Nationale*.

^b Head offices and branches.

A brief statement is necessary about each group. The Société Générale group continued to remain at the head of Belgian banking. Previously the Société Générale had absorbed the Banque d'Outremer, which pos-

essed an important portfolio of shares issued by colonial corporations. As a result of this absorption, Société Générale became the controlling factor of the Congo economy, and it will be understood that this absorption aroused a widespread interest and was widely discussed in economic as well as in political circles.

On the other hand, the regional banks affiliated with the Société Générale multiplied their branches. Besides, they absorbed several old country banks. In 1913 the group of the Société Générale consisted of 18 banks with about 60 offices. In 1930 the number of affiliated banks was only 16,¹¹ but the number of offices exceeded 400. The group as a whole controlled one-third of the banking resources of the country. Moreover, the Société Générale was the ruling element in a large number of industrial corporations. In the circles of the extreme left the Société Générale was regarded as the representative and the head of Belgian financial capitalism.

The Banque de Bruxelles group was much younger. It was formed in the years following the war and included banks with smaller resources and connections than the group of the Société Générale. But this group was rapidly expanding. It consisted in 1930 of 20 banks with about 400 offices. The struggle for influence between the Société Générale and the Banque de Bruxelles was one of the factors which gave impetus to the movement of expansion and of concentration.

The third banking group headed by the Algemeene Bankvereeniging merits attention as an example of political banking. Before speaking of the Algemeene Bankvereeniging proper, it should be stated that after the end of the nineteenth century, a co-operative movement, chiefly founded and directed by priests, existed in the

¹¹ Because of mergers inside the group.

agricultural, for the most part Flemish and Catholic, districts of Belgium. One of the manifestations of this movement was the creation of local co-operative banks of the Raiffeisen type: In Belgium they were called *caisses agricoles*.

These *caisses* were of a strictly local character. Before the war they had few deposits. During the war and in the following years, peasants saved much money, the number of the *caisses* increased greatly and so did their deposits. Finally, they numbered over 1,500, of which more than 1,000 with deposits aggregating 1.5 billions were affiliated with the Boerenbond (League of peasants). The local *caisses* redeposited their funds with the Caisse Centrale de Crédit of the Boerenbond, which became the central organism for all affiliated local *caisses*.

The leaders of the Boerenbond were generally leaders of the Catholic Party. In normal circumstances this Caisse Centrale would probably have invested its funds chiefly in bonds and mortgages. But even here, the reduction in the value of franc, the speculative wave overwhelming the country, the wave of optimism since 1926-27, and the striving of political leaders for economic power, played their roles. The result was that the Caisse Centrale invested a large part of its funds in industrial securities and that they undertook various financial operations.

The Algemeene Bankvereeniging was a second member in this politico-financial combination. It grew up from a small bank established at Louvain by some catholic politicians. The Caisse Centrale of the Boerenbond subscribed a part of the capital of the Algemeene and some of its leaders became directors of that bank. On the whole there were very tight links between the two

institutions. The Algemeene extended its influence in the Flemish part of the country and finally was at the head of seven regional banks. The bank financed many agricultural industries (sugar refineries, canning factories) and took an interest in colonial and industrial corporations. It will be shown later that the difficulties of this group were instrumental in the banking crisis of 1934.

The Crédit Anversoïis was not the head of a group. It was a branch bank with about 170 offices scattered across the whole country, nearly all established after the war. When this bank was founded in 1898, it took some interest in new industrial corporations. The crisis of 1900-01 brought about a fall in the value of its securities portfolio, and the bank was obliged to write up a part of its capital and hence the nominal value of its shares. The Crédit Anversoïis then liquidated its industrial participations and henceforth limited its activities to commercial credits. In the twenties the bank again established tight relations with some industrial corporations, especially in the textile industry. In 1929 in the midst of the boom, the bank announced officially the modification of its policy conducive to "participations" in industrial corporations.¹² The bank suffered severe losses during the depression of the thirties.

The Banque Belge du Travail is included among "other" banks in the table on page 63. Although not the most important, it is worth mentioning as being the socialist bank which provoked so much discussion in Belgium. Perhaps it is worth-while to say that the Belgian socialist movement was very different from the American or even from French socialism. Belgian so-

¹² Compare the analogous changes at the Banque de Belgique in 1839 and in 1861. See above, pp. 21, 36.

cialism was on the whole of a practical nature. In some circles it was characterized as "opportunist." Its partisans described it rather as "constructive." The Belgian Socialist Party was very closely connected with the trade unions and has built consumers' co-operative societies and mutual-aid organizations of all kinds.

Most co-operative societies in Belgium, Socialist and others, have established savings departments called in Belgium *caisses d'épargne*. These *caisses* received time deposits¹⁹ which were invested by the co-operatives partly in government securities but chiefly in their own circulating capital or even in expansion of their premises.

The best known of the socialist co-operative societies was the Vooruit (Forward) established at Ghent. Its head, the famous socialist leader E. Anseele in 1913 took the initiative in creating the Banque Belge du Travail, most shares of which were held by the Vooruit. Its function was to handle financial operations for co-operative societies, trade unions, *caisses d'épargne*, and so on. After the war, operations of this banque expanded considerably. Its capital was increased gradually from one to 50 millions and its shares were listed at the Brussels Stock Exchange. The Banque Belge du Travail established several branches in industrial districts of the country, and its deposits, for the most part funds of trade unions and of other socialist organizations, increased considerably. At the end of 1930 the total amount of its assets was 550 millions. A part of its resources was invested in industrial securities, especially in the textile industry, where several medium-sized corporations were controlled by the bank.

¹⁹ "Time deposits" is not an absolutely correct expression. These deposits were repayable a small amount on demand, and the balance after a notice of one, two, or more months, according to the amount involved.

It is interesting to note that the activities of this bank stimulated discussion even in the Socialist Party. The left wing of the party rebuked the leaders of the bank for having adopted the corporate form of organization and for having introduced the shares at the Stock Exchange, where they were at certain times an object of animated speculation, in a period when socialist critics were concentrating their fire on financial capitalism. The defenders of the bank replied, that it was indispensable as a tool for the other organizations, whose aim was to "establish gradually a socialist State in the midst of the capitalistic State."

Be that as it may, the rapid expansion of the Banque Belge du Travail was one of the most interesting manifestations of the financial effervescence in the agitated decade following the war. In the next section it will be shown, that this bank was one of the foremost victims of the deflation crisis.

In the twenties the concentration movement was characterized chiefly by the formation of banking groups under the direction of the leading banks in the capital. Each "affiliated" bank maintained not merely its identity but its individuality as well.

In the first half of the thirties there developed a new phase of the concentration movement. The large banking "groups," consisting of one leading institution and affiliates, were combined in a single bank. In 1931 the Banque de Bruxelles absorbed all its affiliated banks; the main offices and branches of the former affiliates became branches of the absorbing bank. In 1934 the Société Générale adopted the same scheme of organization.¹⁴

¹⁴ Two affiliates of the Société Générale were not absorbed and kept their individuality: the Banque d'Anvers, the oldest and most important affiliate, and the Banque Belge pour l'Étranger.

The less important group of the Algemeene merged earlier.

Two major reasons explain these mergers. As the affiliated regional banks became completely dominated by the leader of each group, the maintenance of their separate existence led only to a complication in their operations and in their capital structure. The functioning of the system was simplified by the mergers. On the other hand these mergers were used as a means to write off—without attracting too much attention—losses resulting from the depression by using the internal and the open reserves (surpluses) of the banks. The result of the concentration movement can be summarized very briefly. In 1913 the typical Belgian bank was a unit bank; in the late twenties it was a regional bank affiliated with a leading bank of Brussels; since the first half of the thirties it has been the big nation-wide branch bank.

IV. ECONOMIC DEFLATION AND BANKING CRISIS

The financial crisis of 1929, with the ensuing depression and the fall of commodity prices, seriously affected the economic position of Belgium, especially after Great Britain went off the gold standard in 1931. England was one of the chief customers of Belgian industry and at the same time its principal competitor on foreign markets. Hence, the fall of the sterling had a double effect on Belgian industry. First, the decrease of the monetary value of exports to England was relatively larger than the fall of costs.¹⁸ Second, English exports obtained an important competitive advantage on the world markets.

In addition, growing obstacles to international trade

¹⁸ The costs were reduced only in so far as foreign raw materials commanded lower prices in francs.

greatly impaired Belgian trade. Exports dropped sharply. Most manufacturers, especially corporations, were faced with a very difficult situation. Their sales declined heavily in volume as well as in value, whereas wages and fixed charges fell much more slowly.

The banking situation was hit very seriously by the depression. The banks suffered from the fall in prices of their investments¹⁶ and from the difficulties in which their debtors were involved. Some banking assets became worthless, others of doubtful value.

A glance at the table on page 58 shows that banking assets reached their highest level at the end of 1930. Indeed, at this time the depression was not yet acute. In 1931 and in 1932, the situation became more difficult. Loans decreased (1) because of real reduction in the demand for loans; (2) because of the writing off of some assets; and (3) due to the fact that in some cases banks accepted securities in reimbursement of previous loans.

The strain on banking during 1931 and 1932 can be seen in the drop in deposits from 31.1 to 25.4 billions. This reduction could be carried out without a major crisis. It was offset by a liquidation of a part of the loans and of the discounts. In addition the surplus reserve was reduced by one billion for amortization purposes. On the whole the banking system bore the strain of this first phase of depression well enough.

During the two years of the depression preceding the monetary panic, only bank deposits fell. At the other financial institutions, especially at the Postal Savings Bank, deposits continued to increase. In other words a

¹⁶ Index of the quotations of 120 stocks at the Brussels Stock Exchange (January 1, 1928 = 100). Average 1929 = 99, 1930 = 65, 1931 = 47, 1932 = 35, 1933 = 34.8, 1934 = 29.5.

part of the deposits withdrawn from the banks were transferred to other institutions.

Some industrial corporations were able to sell their bonds to the Postal Savings Bank and the proceeds were used chiefly to repay debts to their ordinary bankers.

DEPOSITS OF FINANCIAL ORGANIZATIONS*
(In millions of francs)

End of Year	Banks	Postal Savings Bank	Postal Check Office	Boerenbond	Total
1930.....	33,152	7,880	2,070	1,481	44,584
1931.....	29,863	9,387	2,180	1,706	43,136
1932.....	25,367	10,015	2,465	1,637	39,484
1933.....	25,254	10,240	2,705	1,638	39,837

* *Bulletin of the Banque Nationale.*

In 1933 the economic and banking situation on the whole remained unchanged, although some small banks had difficulties, and one big bank (Allgemeene Bankvereeniging) was obliged to write off a third of its capital (from 300 to 200 millions). In March 1934 it became known that the Banque Belge du Travail (the Labor Bank) was unable to meet its obligations. Its callable liabilities amounted to about 300 million francs.

The leaders of the Socialist Party called on the government for aid to the bank in order to avoid a receivership.¹⁷ The government was inclined to give the requested assistance, and under the circumstances this attitude was certainly wise. But a great section of the political press began a violent campaign against any aid to the Socialist Bank. No aid was given. Among the

¹⁷ It is perhaps worth-while to remember that the Belgian Socialist Party (officially, it is called Labour Party) was the strongest party in Parliament, with about 40 per cent of the seats. Its chiefs were the recognized leaders of the opposition. Some of them had previously been cabinet members, while others held the title Minister of State.

principal shareholders of the bank were some consumer co-operative societies, whose shares were only partly paid. Besides, different co-operative societies had deposited with the bank a part of the funds belonging to their savings department. Failure of the bank would have brought about a failure of the co-operative societies. Clearly this should have been avoided in view of the large number of the depositors in their savings departments. Finally, the government authorized the Postal Savings Bank to make a loan, not to the bank, but to the co-operative societies, against mortgages on their real property.

On the other hand it became known during 1934, that the other political banking organization, the Caisse Centrale of the Boerenbond, was in a difficult position, and that the affiliated *caisses* were restricting the repayment of deposits.

At the end of 1934 the government introduced a bill creating an agency for small savings (Office de la Petite Epargne) whose task was to come to the aid of the various savings banks, particularly of the *caisses* of the Boerenbond. This bill stimulated new and violent discussions in the press and in parliament. On the whole the difficulties of the two political banking institutions and the violent polemics about them and about banks generally contributed to spreading public uneasiness in regard to the banking situation.

During 1934, particularly in the last months, an important amount of deposits was withdrawn from Belgian banks. The movement culminated in the first months of 1935, when a violent "run" on the banks occurred. On the whole some 7 to 8 billions of deposits were withdrawn in 1934-35. The panic stopped at the beginning of April 1935, when the franc was devalued.

The gravity of the banking crisis of 1934-35 was a foremost result of the monetary panic. Since the monetary stabilization of 1926, the maintenance of the stability (that is the gold value) of the franc had become a credo for Belgian public opinion. Even in 1931 when England went off the Gold Standard nobody questioned this policy. When on several occasions in 1933 and 1934 Parliament gave the government special powers to carry out reforms in economic and financial fields by decrees, it was always stipulated that in no way should the government touch the monetary statute of the country.

During these years a deflationary policy of the government was directed chiefly at the maintenance of the gold value of the franc. But as the depression persisted, and as the fall of the sterling became more pronounced, the conviction grew in business circles, that the government policy was wrong, and that a devaluation of the franc was inevitable. As an American economist summed up the situation, "Belgium was fighting a losing battle of deflation largely because of the steady depreciation of sterling."¹⁸

As the conviction grew that the franc would have to be devalued, more and more people, individuals and corporations, wished to take precautions and to invest their funds in foreign currencies. This was the principal reason for deposit withdrawals in 1934 and 1935. The bulk of the withdrawn deposits was used for the purchase of foreign currency or of gold. In many cases deposits were withdrawn by depositors who did not have any doubt about the solidity of their bank, but who wished to get rid of their francs. In other cases depositors, par-

¹⁸ L. H. Shepherd, *The Monetary Experience of Belgium* (1936), p. 200.

ticularly corporations and business men, did not even withdraw the money from their bank. They simply gave orders to transform their franc deposits into foreign currency deposits (sterling, dollar, French franc, and so forth). In no way could such conduct be considered an expression of lack of confidence in the bank, yet the result for the bank was just as unpleasant. No figures are available concerning the volume of these transfers, but they are known to have been very large.¹⁹

Some deposit withdrawals may have been caused by lack of confidence in banks. But the chief and foremost reason for the withdrawals was the monetary panic. Contrary to what has been asserted by some people, the franc was not the victim of a banking crisis. Rather the banking organization, which had already suffered much from the depression, was the victim of the monetary crisis. The flight of capital resulting from vanishing confidence in the franc gained momentum notwithstanding the deflationary policy of the government.

When in 1931-32 the effects of the international depression were first felt in Belgium, the government embarked on a policy of "economic deflation." This should not be identified with "monetary deflation."²⁰ The scope of the policy intended to counteract the effects of the depression was very limited, first, because the difficulties of the Belgian economy proceeded chiefly

¹⁹ The same thing happened in 1938-39. See Chap. 5.

²⁰ Whatever there was of a monetary deflation (reduction of the volume of deposits and slackening of their circulation) was brought about not by the government or the Central Bank, but by spontaneous forces in the economy. Government and Central Bank worked rather in the opposite directions by reduction of the bank rate and by their effort to expand credit. See below pp. 77 ff.

from the fall in gold prices and the slump in world trade, on which the Belgian government had no influence; second, because during the first phase of the depression the unanimous opinion in the country was against any measure which would threaten the established gold parity of the franc. However, since September 1931, the fall of the sterling had become the principal factor impairing the position of the Belgian economy.

The principal elements of the deflationary policy can be best described in a logical rather than a chronological order. The government reduced wages and salaries of its employees, old age pensions, unemployment benefits, and so on. The purpose was to relieve the budget and to set an example of economy to private enterprises. It was hoped that such measures would bring about a reduction in the cost of production, sole means of saving the export trade. The purpose would perhaps have been attained, if the sterling had remained stable after the first slump in 1931. But it continued to fall, and Belgian industry had to reduce its costs continuously.²¹

The principal stumbling block in the policy of deflation was the necessity to reduce the purchasing power of the people before the fall of prices took place, in order to bring about this fall. The social and psycho-

²¹ The fall in the gold value of the sterling decreased the price of English commodities expressed in terms of gold. It is true that the price of English imports increased, when coming from gold standard countries. But as the British Empire, and some other countries producing raw materials went off the gold standard, the price of imported materials did not increase; hence the possibility of maintaining a fairly stable level of prices, notwithstanding the fall in the gold value of the pound sterling. On the contrary Belgian currency was linked to gold, and consequently the external or gold value of the franc remained stable. Belgian exporters could reduce their prices only in so far as they were able to reduce wages and costs. Yet they were obliged to reduce their prices (in francs) on foreign markets each time the sterling dropped again.

logical difficulties of such a policy are well known. Measures were taken to reduce some taxes which were believed to restrict initiative and to hamper new enterprises. But the effect of these slight reductions was offset by increases in most other taxes undertaken to meet increasing government expenses. The budgetary economies in wages, salaries, and other items were more than outweighed by the increase in expenses for unemployment compensation and by the decrease in the returns of those taxes which depend on the volume of business activity. A balanced budget was considered indispensable in order to maintain confidence in the franc. It must be added, that during the second phase of the depression (1933-34), the budget equilibrium was necessary because issuing of government loans was almost impossible. And selling government bonds to the Central Bank would have required a special law, which it was believed in official circles, would have shaken confidence in the franc. The result was an increase not only in income taxes but also in consumption taxes and in tariffs under a government which aimed at a fall of the price level.

Some measures were intended to increase public confidence in the financial system. Corporation shares with a plural vote were prohibited, the Stock Exchanges reorganized, forward operations on exchanges regulated, and so on. Mention must be made also of the royal decree of October 24, 1934, by which certain categories of individuals are prohibited from acting as (a) directors or business executives in any corporation; (b) stock brokers; (c) bankers. The individuals excluded from these activities are: (a) bankrupt persons; (b) individuals convicted of certain delinquencies such as

false bookkeeping, theft, abuse of confidence, and so forth, if the prison sentence amounted to at least three months.

Credit measures became a very important part of the deflationary policy, chiefly because other measures did not attain the results hoped for. It is one of the paradoxes of the deflationary policy as pursued in Belgium, that it consisted partly in efforts to expand loans, eventually with the aid of the Central Bank. It must be noted that there was no analogy between this credit policy and the easy money policy carried out in the United States at the same time. In this country the aim was to increase the volume of credit in order to induce an *increase* in prices. In Belgium, the chief aim was to reduce the rate of interest and to make loans available to industry in order to *reduce* costs and prices. The fundamental point was the cost of credit, rather than its quantity. Theoretically a policy of immediate deflation should have required a reduction in the quantity of money, but such tactics would have been inconsistent with the objective of reducing rates of interest and making credits easily available.

This contradiction of the economic policy was evidenced by the bank rate policy of the Banque Nationale. During the crisis of 1929 the official bank rate was raised from 4 to 5 per cent. Very soon it began to be lowered and was gradually reduced to 2 per cent in the middle of 1930. But in 1931, after the fall of the sterling, it was raised to 3.5 per cent and remained at this level for almost 2½ years, although the private rate of discount (for first name paper) fell continuously and was much lower than the official rate. The official rate was lowered only in April 1934 to 3 per cent and

then to $2\frac{1}{2}$ per cent in August 1934, just when the monetary situation began to deteriorate and when the classical "gold standard" policy would have theoretically required a stiffening of the rate.²² But Belgium was then in the "second phase" of the depression, and the government policy was directed more than ever at the expansion of loans.

A first measure to facilitate loans to industrial enterprises was included in the budgetary law of 1933. A mechanism was created through which a government guarantee could be given for such loans. The aim was to aid sound business enterprises which could not obtain loans at all or only on very hard terms. A committee composed of one representative each of the Treasury, of the Banque Nationale, and of the Postal Savings Bank was set up. This committee had no funds but had at its disposal 780 millions in government bonds. These bonds were given to lenders (chiefly the National Society for Industrial Credit)²³ as security for approved loans.

In August 1934 credit facilities were further extended. A royal decree officially known as decree on "extension of credit" (also called Decree No. 1) contained the following provisions: The National Society for Industrial Credit was empowered to take over from the banks industrial debts up to an amount not exceeding two billion francs. In payment of these assets, the S.N.C.I. handed over to the banks, bonds which bore an interest of 3 per cent and were guaranteed by

²² Theoretically or rather in normal times. In the circumstances of 1934, a rise in the bank rate would not have attracted foreign money nor have prevented the buying of foreign currency by Belgians.

²³ A semi-official credit corporation in existence since 1919 and about which some details will be given later. It is generally designated by the initials S.N.C.I. (*Société Nationale pour le Crédit à l'Industrie*).

the State. This guarantee made the bonds eligible as collateral security for advances made by the Banque Nationale.

The rate of interest charged by the S.N.C.I. was reduced uniformly to $4\frac{1}{4}$ per cent. Besides, the maturity of the debts was fixed at 20 years after the cession by the banks to the S.N.C.I. The difference between the rate charged by the S.N.C.I. and the rate paid for the bonds was to be paid into a special fund for the eventual amortization of bad debts.

The position of the debtors was considerably improved by the reduction of the interest burden and by the extension of the maturity of the debts. The banks sustained a loss by the reduction of interest but were largely compensated by the improvement in the liquidity of their assets.²⁴ It was hoped that owing to this increased liquidity the banks could extend their industrial loans.²⁵

Whatever one may think about the decree on credit extension, it came too late to stop the monetary and banking crisis. Confidence in the franc was already shaken, and the belief was spreading that devaluation was inevitable. The banking and monetary situation was aggravated by the crisis of the Banque du Travail and of the Boerenbond. The withdrawal of deposits gained momentum.

In the first few months of 1935, the situation of sev-

²⁴ One cannot say that a doubtful debtor was replaced by a good one, because the banks remained responsible for the ultimate payment of assets handed over to the S.N.C.I.

²⁵ On the same day as the decree on "extension of credit," August 22, 1934, a decree No. 2 was issued. It undertook a reform of Belgian banking, particularly by separation of commercial from investment banking. The two decrees were considered interdependent. The second decree will be discussed in the next chapter.

eral banks became critical. The government was obliged to intervene again. Decree No. 1 of August 1934 was directed first of all at alleviation of the position of industrial debtors. This time the measures aimed at rescuing the banks. A decree of March 18, 1935 authorized the S.N.C.I. to increase by 500 million francs the amount of assets which could be taken over from the banks. On the same day, by another decree, the government handed over 500 million francs of Belgian Railway Corporation preference shares to the committee formed in 1933 (see page 78), thereby increasing by the same amount the lending capacity, or rather the "guarantee capacity," of the said committee.

At the same time the Banque Nationale liberalized considerably its credit policy and made loans to banks by way of "mobilizing debtors' accounts." In other words instead of discounting bills—the only operation provided by statutes—the Central Bank rediscounted industrial loans of the commercial banks.

These measures prevented a complete collapse of the banking structure but could not stop the monetary crisis. At the end of March 1935 a new government under Mr. Paul van Zeeland, including all three political parties, was formed. This government carried out the devaluation. The gold weight of the franc was reduced by 28 per cent. The new monetary unit (the franc of 1935) represented, in weight, about one-tenth of the so-called gold franc or the franc of 1914. Immediately after the devaluation, money ceased to leave the country, flight money came back. The acute phase of the banking crisis was over. Deposits began to increase.

One of the chief points in the program of the van Zeeland ministry was banking reform. The royal de-

cree of July 9, 1935 completed a reform which had already been started by the preceding government. A new chapter in the history of Belgian banking began.²⁶

²⁶ The result of the credit policy described above was to commit the government as guarantor of a large volume of loans granted to industrial enterprises. It is worth-while to anticipate briefly the ultimate fate of this guarantee. In 1936, when the industrial and financial situation improved, the government decided to hasten the liquidation of the loans in order to be relieved of responsibility. A decree of March 31, 1936 provided that loans guaranteed during the depression should be taken over by a special body called "office for liquidation of the crisis interventions." (Office de Liquidation des Interventions de Crise, or O.L.I.C.) The O.L.I.C. was to arrange with the debtors for the repayment of the debts or for their retransfer to the bank which made the original loan. When the O.L.I.C. was created, the debts guaranteed by the state amounted to 2.5 billions. The O.L.I.C. was managed with much energy and skill. By the end of 1938, the amount of loans guaranteed by the state was reduced to 900 millions. It was further reduced in 1939. At the beginning of 1940, it was estimated that the government would probably incur a loss of only about 75 to 85 millions. This is a small amount, considering the large volume of guaranties, and the service rendered to many industrial enterprises during the depression. It should be pointed out also that besides these "crisis interventions" the government has given its guarantee to several institutions for "normal" credit operations. See Chap. 6.

CHAPTER IV

THE BANKING REFORM

Before 1935 Belgian banking enjoyed almost complete freedom. No special legislation existed for any kind of banking, except for the issue of bank notes. Banking corporations were subjected only to the provisions of the general rather lenient corporation law. In 1935 radical changes occurred in the organization and the working of Belgian banking, by the introduction of a system of legal regulation and official control. The reform was a direct outcome of the deflationary crisis and of the devaluation.

I. MOTIVES OF THE REFORM

Before the First World War there were only a few criticisms of banking in Belgium.¹ In the 1920's an intensive movement of banking concentration occurred. Moreover, control of banking over industry increased considerably. The concentration movement aroused much concern in some circles of the public,² but as long as prosperity lasted, criticisms did not carry much weight. Things changed noticeably during the depression, particularly after the devaluation occurred.

There was widespread condemnation of bankers for

¹ In socialist literature there were criticisms directed almost exclusively toward the Banque Nationale. There were projects for the nationalization of the Central Bank or for its transformation on a mutual plan. See the writings of H. Denis and G. De Greef and the discussions in the House of Representatives concerning the renewal of the charter of the bank in 1900.

² Compare the concern aroused in England by the banking concentration which resulted in the bill of 1919, and the unwritten law that there should be no bank mergers without the consent of the Treasury.

the economic difficulties. Excesses on the Stock Exchange as well as overinvestments in some industries were attributed to the defective policy of bankers. Consequently they had to bear all the odium of the deflationary crisis. There was certainly much truth in the criticism directed against the bankers. However, most people forgot, that during the twenties bankers themselves were caught by the general situation resulting from the instability of currency, the speculative wave, and the low rate of stabilization of the franc.

The devaluation of 1935, coming only nine years after the first reduction in the value of the franc, contributed strongly to arousing against the bankers a part of the public that believed the franc had been sacrificed in order to save the banks. In addition the government's financial interventions of 1934-35, particularly the state guarantee for the "two billions," (see above p. 78) were represented as a "gift" to bankers, particularly in the Socialist press.

All this taken together resulted in a widespread opinion that "something must be done" to prevent further excesses and to avoid in the future government interventions analogous to those of 1934-35. It is worthwhile to recall that during the early thirties public opinion in most European countries evolved in the same direction, similar circumstances provoking similar reactions of the people.

In these circumstances it is understandable, that, in its first declaration to the Parliament, March 29, 1935, the national government, formed in the midst of the financial crisis, should have announced its intention to establish control over banking. The pledge was fulfilled by royal decree No. 185 dated July 9, 1935, promulgated like many other reforms of this period under special

powers conferred upon the government by Parliament.

The banking decree of 1935 was a compromise between divergent opinions in the cabinet presided over by Mr. van Zeeland. The Socialist ministers advocated a far-reaching reform with wide government control over banking. Their purpose was to give the government a tool for economic planning. Other members of the cabinet preferred a reform with more moderate aims, prescribing some rules of conduct for bankers and keeping the supervisory role of the state at a minimum. As a result the explanatory statement preceding the decree and even the text of the decree are not always very precise.

The explanatory statement begins by stressing a theoretical argument, namely, the functional identity of bank notes and of checking deposits. A parallel is established between the situation at the middle of the last century, when the imperfect functioning of issue banking led to the creation of a central issue bank, and the present circumstances, when the defective working of deposit banks required a regulation of their activity.

The report insists on the growing role of deposit banks, their central position in the economic organism, and on the disastrous repercussions which the failure of a more or less important bank can have on the whole economy of a country. The authors conclude, that it is necessary to prevent disturbances by requiring bankers "to observe some rules of conduct suitable to the nature of their liabilities." Further on the report stresses this point with more precision. "The essential rule of banking management is to maintain always a relation, determined by experience, between the deposits and the assets according to the degree of liquidity of assets."

It appears then that the fundamental aim of the de-

crec was to introduce a banking system based upon the principle of liquidity. In order to attain this objective a sweeping reorganization of Belgian banking was deemed necessary. The system of mixed banking was to be liquidated and regulation of banking activities was to be introduced. The following sections of this chapter will be devoted to a description of the reform.

II. REGULATION OF THE BANKING PROFESSION

The imperfect working of the financial system was not attributed merely to the defectiveness of the banking system. Mistakes and abuses of individual bankers were believed also to have played an important role.

In order to prevent a recurrence of mistakes and abuses it was thought necessary to regulate in some manner the profession of banking. The preliminary statement says,

The professional activity of bankers is almost of a public character. The government wants to direct the evolution of business in such way that management of banking organizations would be entrusted to a decreased number of individuals who should devote themselves entirely to this function. . . . The whole set of provisions concerning banking managers aims to assure their independence, in such manner that the exercise of their profession should become something like a trust for the management of an important part of public savings.

In English terminology one could say that the aim of the decree is gradually to make banking a profession instead of a business.

However, in order to attain this end, the decree does not impose rules for admission to the profession, which remains free.⁵ But the exercise of the profession is subject to some provisions. As a first measure the decree provides that only companies or individuals doing actual

⁵ There are, however, two qualifications. See below p. 87.

banking business can call themselves "banks" or "bankers." The term "bank" may be used only by enterprises which "receive deposits payable on demand or within two years, in order to use them for their own account in operations of banking, credit, and investment." The practical application of this definition may sometimes cause difficulties. In addition it is impossible for the general public to be aware of the actual business done by an individual or a corporation. Consequently, the decree enjoins each bank or banker to register with the Banking Commission established by the same decree.

It follows then that nobody may do banking business in the sense defined above without being registered with the Banking Commission. The Commission must publish every year a list of the registered banks.⁴ Registration must not be identified with an authorization. The Commission must only verify, whether the individual or the corporation wishing to register is doing banking business within the meaning of the decree, and whether he possesses the minimum capital required by it. When these conditions are fulfilled, registration must be granted.⁵ It is thus very different from the American system applied to national banks, which must obtain a genuine authorization or rather a charter from the Comptroller of the Currency, who can reject their request without giving reasons.

⁴ In the following pages the general term "bank" will include individual bankers as well as companies or corporations doing banking business.

⁵ Although in this connection the role of the Commission is simply one of fact finding, the decree provides the possibility of an appeal. Applicants rejected by the Commission may appeal to the Minister of Finance, whose decision is final. At the end of 1935, when the first list of registered banks was established, 175 applications had been filed. The Commission dismissed 53 applicants; 11 appealed to the Minister of Finance, who accepted two of them. Consequently, they were registered, notwithstanding the contrary opinion of the Commission.

It must be added also that the provisions of the decree have no universal application. There are some institutions doing banking business which are not under obligation to register with the Banking Commission and are not under its jurisdiction. These institutions are the public and semi-public credit institutions (see Chap. VI), the savings organizations,⁶ and the financial corporations "which receive deposits of their affiliates in order to centralize their investments, on the condition that these funds should not be used habitually for banking or credit operations with a third party, other than an affiliate." Important as these exceptions may be, most deposit banking proper is covered by the 1935 decree and is under the jurisdiction of the Banking Commission.

Access to the banking profession remains free with two qualifications. The first one, already mentioned, is provided by the decree of October 24, 1934: insolvent persons or those convicted of certain infractions are prohibited from exercising the profession of banking. (See above, p. 76.)

The other qualification concerns the requirement of a minimum capital. The paid up capital of banking corporations must be at least ten million francs. Private bankers or partnerships must have a minimum capital of two million francs.⁷ Foreign banks having branches in

⁶ Savings banks have never been considered banks in Belgium. By the present legislation they are even prohibited from using this term. They are called *caisses d'épargne*. The postal Caisse d'Epargne is classified among the public credit institutions. See below, p. 141. The other *caisses* (or "private" *caisses*)—chiefly on a co-operative basis—have been regulated by several decrees since 1934 and are supervised by the Office for Small Savings. They do not play any role in commercial banking and for this reason are not dealt with in this study.

⁷ There are transitory rules for banks and bankers whose capital at the moment of the promulgation of the decree was below the required minimum. However, transitory rules will be disregarded here.

Belgium must assign at least ten million francs of their own capital for their operations in Belgium.

Holding directorates by directors and officers of banking corporations is also regulated. The decree prohibits directors or officers of banking corporations from acting as directors or officers of any other business corporation, except of some categories of financial corporations (banking, insurance, and mortgage credit).⁸ A comparison with the American legal provisions will be useful. In this country the Clayton Act of 1914 prohibits interlocking directorates by forbidding (with some exceptions) the same person from acting as director or officer in more than one banking corporation. The aim was to stop the movement of banking consolidation. In Belgium the objective is different—suppression of personal connections between banks and other corporations. Connections with industrial and some financial corporations had to be avoided particularly. Consequently, no limitation is put on the number of banking corporations, in which the same person may act as director or officer; but almost prohibitive rules are provided, when connections between banking corporations and most other kinds of corporations are concerned.

Some other rules concerning directors and officers of banking corporations are provided by the 1935 decree. These corporations are prohibited from making loans under any form to their directors or officers. Nor are they allowed to take part, without adequate security, in any underwriting syndicate formed by their bank. When

⁸As an exception to the general rule, a bank director or officer may be a director of one "prohibited" corporation, or of two, if he does not take an active part in current activities of the bank. The Banking Commission may authorize exceptions in special cases. The prohibitions outlined here are known in Belgium as the system of "incompatibilities."

a bank has failed or is placed in receivership, all payments made to the directors as a part of profits within two preceding years shall be nullified and refunded.

III. ABANDONMENT OF MIXED BANKING

Discontinuance of mixed banking was the most conspicuous feature of Belgian banking reform. Mixed banking was conceived primarily as holding industrial securities by banking organizations. Such holdings were believed to have been a major cause of immobilization of funds and of losses. Liquidation of the system, therefore, seemed necessary. Though simple in appearance, the problem was in reality quite complicated. The so-called deflationary government in 1934 had shown its willingness to face the problem. Reference has been made previously to two decrees of August 22, 1934; the first one organized the "extension of credit" while the second dealt with banking reform.⁹ The latter decree was aimed almost exclusively at the system of mixed banking. All banks—even private bankers—were prohibited from retaining or holding shares or bonds issued by any industrial, commercial, or agricultural corporation. No other measures concerning banking liquidity or banking supervision were provided by this decree.

The reform of 1934 was an improvisation. Practically, the prohibition of corporate securities holdings was its sole feature. It was known in Belgium that this measure—separation of "financial" activities from "commercial" banking—was suggested to the government by E. Francqui, head of the Société Générale, and the strongest man in Belgian banking and finance. The reason inspiring Mr. Francqui was this: from the trends

⁹ See above, p. 79.

of public opinion and from foreign examples it was evident that government regulation of banking would be introduced sooner or later. Government control would then cover practically the whole field of banking and financial activities. From the financiers' point of view, it seemed wise therefore to split up banking institutions in such a way that government control when introduced would leave aside the "financial" (or "investment") part of these institutions. This is what happened in reality, but such reasoning can hardly be considered as a "rational" argument for liquidation of mixed banking.

When in 1935 the van Zeeland Administration approached the problem of banking control, the question arose whether it would not be better to abandon the idea of complete liquidation of mixed banking, the more so as it was evident that an immediate liquidation was practically impossible. (See Chap. V.) But it was believed unwise to undo what had been done. The principle was consequently maintained, but it was elaborated and integrated in the whole system of banking regulation.

The banking decree of 1935 makes it unlawful for any banking corporation to own stocks or bonds issued by other corporations. Exception is made only for securities issued by other banking corporations.¹⁰ However, there are two limitations to the general rule prohibiting ownership of corporate securities. The first of these is particularly interesting. Banking corporations are al-

¹⁰ Contrary to the decree of August 1934, the prohibition was not extended to private bankers and partnerships. It was considered impossible to establish for these latter a distinction between business assets and private fortunes of bankers or partners. But the Banking Commission ruled that private bankers and copartnerships could invest in corporate securities only their own funds and funds originating from long-term deposits.

lowed to own, for a period not exceeding six months, corporate securities "whose public issue has been entrusted to them." This means that a banking corporation may not buy such securities, on the stock exchange for instance, even if it intends to keep them only a short time. But the bank may underwrite corporate securities with the understanding that they will be offered to the public, provided they will be disposed of within six months.

The Banking Commission has interpreted this rule as allowing participation not only in an underwriting syndicate but also in what is called in this country a selling syndicate, and in Belgium *syndicat de sous participation*. Moreover, it is not necessary for a syndicate to be formed. A bank may act alone, provided the above-mentioned conditions are fulfilled.

It follows that Belgian banking corporations may continue to engage in investment business but with severe limitations. Such activities are made very difficult and in some cases almost impossible. Indeed, banking corporations can participate in this sort of business only if they can be sure, as far as certainty goes in economic affairs, that they can dispose of the underwritten securities within six months. This will probably be possible sometimes in regard to bonds of a well-established industrial corporation, or even in regard to their shares, particularly when the right to subscribe the new shares is reserved to the stockholders and the bank only "guarantees" the issue. But it will never be possible in regard to shares of new industrial corporations, and even for other securities there will be a great risk.

To an American reader this situation will appear quite natural, because in this country even investment bankers

rarely participate in the flotation of shares issued by new industrial concerns. But it must be kept in mind that the foundation of new industrial corporations was a specialty of European mixed banks.

It is also necessary to take account of a rule provided by the 1934 decree regulating stock exchanges and prohibiting the listing of securities issued by a corporation which has been in existence for less than two years. Private investors generally refuse to buy unlisted stocks or those which are not to be listed shortly. Bankers being obliged now to dispose within six months of any shares underwritten by them, the result is a practical prohibition of any flotation of shares issued by new industrial concerns.

Investment business of banking corporations has been made still more difficult by a subsequent ruling of the Banking Commission, that securities not disposed of within the legal limit could not be carried by the banks even if they have been entirely written off.

The perplexity of the authors of the decree is shown in the rule about the six months holding period. They wished to prohibit all ownership of industrial securities—even bonds—by banks, and at the same time they knew the important role previously played by banks in the flotation of securities and in the creation of new enterprises.

The decree of July 9, 1935 provides a second exception to the general rule prohibiting ownership of corporate securities by banking corporations. Holding such securities is allowed, when they are taken over by a bank in reimbursement of a frozen or a doubtful debt. They must be disposed of within two years. In the next chapter the practical difficulties in the way of an immediate "liquidation" of mixed banking will be stressed.

IV. REGULATION OF BANKING ACTIVITIES

The decree of July 9, 1935 is directed not only toward abandonment of mixed banking but also toward submitting banking activities to a set of rules, among which the principle of liquidity is the most important.

In order to provide a minimum of liquidity, the banking decree introduces the principle of ratios. The aim of the ratios, or of the *proportions* as they are called in Belgium, is to oblige bankers to invest some portion of their funds in liquid assets. But the authors wisely did not believe it feasible to prescribe legal ratios in the text of the decree. Instead they gave to the Banking Commission the right to establish legal ratios with the consent of the Ministers of Finance and of Economic Affairs.

The article of the 1935 decree dealing with ratios was somewhat vague in regard to the right of the Commission to alter ratios once established. It was modified by a royal decree of November 30, 1939. The Banking Commission, with the approval of the Secretary of the Treasury and the Secretary of Economic Affairs, is empowered to

... establish periodically the proportions which must exist in different categories of banks: (a) between their liquid and mobilizable assets or some component parts of those assets, on one hand, and their liabilities on sight and on short notice on the other; (b) between their capital and surplus on one hand and the amount of deposits or of liabilities on sight and on short term on the other hand.¹¹

A comment must be added to the literal translation of this provision.

The first part of the decree authorizes the Banking

¹¹ By "liquid assets" the decree means the cash reserves; whereas "mobilizable assets" means what in the United States would be called liquid assets.

Commission to prescribe *liquidity ratios*. The Commission may prescribe that certain proportions of the deposits should be invested in cash and in mobilizable assets. The definition of "mobilizable assets" is left to the Commission. The ratio may be established not only by taking into account the whole amount of liquid assets but also in regard to some sub-classes. This provision is explained officially as authorizing the Banking Commission to introduce some kind of compulsory division of risks. It implies the setting of some limits for loans to one customer.

The objective of the second part of the provision is to secure *ultimate safety*. The Commission may establish compulsory ratios between the amount of deposits and the amount of the bank's own resources. The ratios may vary according to different categories of banks. The Commission may also grant temporary exemptions.

The preceding discussion shows how large the powers are which have been granted to the Commission with the reservation, however, that they can be exercised only with the consent of two ministers. The explanatory statement preceding the decree considers the ratios only as a means of imposing on banks some rules ensuring their liquidity and safety. But in the conception of the Banking Commission these rules, together with the supervision of the capital market, could be used as a tool "to prevent excesses in periods of credit expansion, as well as in periods of credit contraction."¹² In other words, the Commission considers them as a means of "credit control."

However, the Commission has made no use of these powers. During the last few years, economic and banking conditions have been always disturbed and, even in

¹² *Report for 1936*, p. 64.

a more normal period, it would have taken time to introduce a system of compulsory ratios in a country with a very complicated banking structure, where there were no customary ratios. In one of its last reports the Commission observed that, in order to obtain desired results, it is not strictly necessary to issue regulations. The same result might be brought about by "way of recommendation, judging each case on its own merits."¹³ This is an interesting example showing that the policies of the Commission can not be judged merely on the basis of the text of the decrees.

Legal ratios of liquidity and safety are not the only rules to which banking activity may be eventually submitted. Other far-reaching decisions may be taken by the Banking Commission.

The 1935 decree empowers the Commission "to fix maximum rates of interest for some categories of credit operations." But this power is restricted by many qualifications. The decision can be made only by a majority of two-thirds of the members and with the previous consent of the Banque Nationale. Moreover, the decision can be enforced only if approved by the Ministers of Finance and of Economic Affairs.

The report does not give explanations concerning this rule. It was thought that it might become useful to set a maximum rate of interest for deposits, particularly for demand deposits. It was even held that, under certain circumstances, it could be necessary to set a maximum rate for loans or for some types of loans. So far the Commission has not used the powers granted by this provision.

The 1935 decree provides that banking corporations shall invest their "legal surplus" exclusively in bonds

¹³ Report for 1939, p. 23.

issued by public bodies. This is considered as a complementary measure of ultimate safety. The decree does not contain any provision concerning formation of surpluses by the banks. But it must be kept in mind that banking corporations are subject to the general corporation law, which compels all corporations to put aside each year at least 10 per cent of their profits until the surplus amounts to 10 per cent of the capital. This is called the "legal surplus." The general company law does not contain any provision concerning investment of the legal surplus. The decree of July 9, 1935 rules that the legal surplus of banking corporations must be invested in bonds issued or guaranteed by the State, the colony, or local public bodies. These investments must be shown in a special item on the balance sheet; they can be valued at their purchase price (even when the market price is lower), provided it is not higher than the redemption price.

The purpose of the provisions discussed so far is to provide some rules regulating operations of bankers, particularly the investment of banking funds. The 1935 decree provides also some rules about other aspects of banking, namely, the relations of bankers with shareholders or even with the general public.

One of the provisions of the banking decree concerns the publication of balance sheets and of periodical statements. Dissatisfaction with the inadequate character of balance sheets and reports of banks and other corporations has prevailed for many years in Belgium as in most other countries. In most cases balance sheets were too concise, the terminology used was vague, and sometimes designation of items was changed from one year to another without explanation. Reports generally contained only trivial or vague statements. Long ago the

French economist Courcelle Seneuil complained that banking reports contained nothing but "eulogies of the staff and funeral orations for the deceased."

There are very few legal rules concerning balance sheets in the Belgian company law.¹⁴ It is true that Belgian banks generally published a balance sheet giving much more information than required by the law. Most of them even published the composition of their securities portfolio or at least of its larger part.¹⁵ But there were no uniformity in the statements and no indications about the real meanings of items or about the method of valuation. The profit and loss account was often particularly unsatisfactory.

Experience shows that the problem is a very delicate one. On the one hand, there are very strong arguments for requiring banks to make public returns, as complete and as frequent as possible. It is a duty to the shareholder and to the depositors alike, and it is a means to make bank managers more cautious. On the other hand, in some circumstances certain information—for instance, a big loss, even if covered by profits, or a temporary reduction in deposits—may alarm unduly the depositors or shareholders and may provoke a panic.

The 1935 decree requires maximum information for the banking authorities but a relatively small amount of information for the general public. The decree requires all banking organizations (even private firms) to trans-

¹⁴ The law prescribes publication of an annual balance sheet in the annexes of the *Moniteur* (the official daily).

¹⁵ The balance sheets contained generally two items of securities. The first "securities portfolio" covered securities held more or less permanently. Most banks published the composition of this item. The other item "participations" covered securities held temporarily (participations in issue syndicates and so on). Its composition was never published; when necessary, securities were shifted from one item to another without explanation.

mit a monthly statement to the Banque Nationale, which is obliged to publish periodically, at least four times a year, a condensed statement for all banks together. The result is, that, except for the annual balance sheet, the public does not know the condition of each bank; it gets only quarterly condensed figures for all banks as a whole.

Furthermore, the decree specifies that later on a royal decree shall provide compulsory formulas for the monthly statements and for the annual balance sheets published by the banking corporations. This was done by the decree of November 24, 1937. The new formula of monthly statements to the Banque Nationale is very complete, and it is accompanied by a special detailed statement on the foreign liabilities and assets of each bank. Although strangely enough the decree prescribed communication of the monthly statement to the Banque Nationale alone, in practice a copy is also transmitted to the Banking Commission. The result is that banking authorities are perfectly informed about the condition of each bank.¹⁶

The legal formula for annual balance sheets published by the banking corporations is considerably shorter than the formula for the monthly statement.

By the decree of July 9, 1935 banks are prohibited from using their resources to influence public opinion directly or indirectly. Since the First World War the development of political democracy and of social legislation gave more ardor to factional fights. On several oc-

¹⁶ It must be kept in mind that the Banking Commission may always require complementary information by the intermediary of supervisors. (See below.) It will be explained later that, in some circumstances, they can require explanations not only about each item of the statement but even about the importance of some individual loans.

casions the leaders of some banking corporations took a strong stand in these discussions and used the authority and even the financial resources of their firms to influence public opinion through the press. On the other hand, most banks used to grant allowances, options, and so forth, to editors and publishers of financial and even of some political newspapers. The aim was chiefly to obtain their support, or to avoid their criticisms in matters such as public flotations, stock exchange quotations, and so on. Such acts are now prohibited by the banking decree. Only normal commercial advertising is permitted in the future. Banks are obliged to keep a special and detailed account of their advertising expenses and of all subsidies or indemnities granted gratuitously. This account must be communicated monthly to the Banque Nationale and in practice is sent also to the Banking Commission.¹⁷

It has been stated in the preceding chapter that during the twenties the movement of banking concentration attracted widespread attention and criticism. At the time of the banking reform the problem of concentration was not a first issue. No extended measures against banking consolidation are provided by the 1935 decree. For instance whereas interlocking directorates between banking and other corporations are prohibited, they are allowed between banks themselves. Nevertheless, the decree provides control for further banking consolidations.

¹⁷ In practice these rules do not have much importance, not only because there are other means of influencing public opinion, but chiefly because, as they are managed and supervised now, it is not expected that banks will engage again in such practices. If such practices are to be continued or renewed, it will be by leaders of financial or industrial corporations. In so far as such practices can be thwarted by legislative action, it should be done by a special law.

Henceforth, no merger between banks may be carried out without authorization of the Banking Commission. The Commission ruled later that an authorization was necessary, not only for mergers but even when a bank transfers an agency or a branch to another bank.

V. BANKING SUPERVISION

The supervision of the enforcement of banking laws is sometimes entrusted to an administrative department (like the Banking Inspectorates in Scandinavian countries), sometimes to the central bank of the country, and sometimes to an independent agency. Good reasons can be presented in favor of entrusting the supervision to the central bank. But the central banks are more and more under the control of governments, and people are often afraid of the idea of conferring upon them control of commercial banking. Moreover, there is the probability that the public would consider the central bank responsible for every failure of a commercial bank. Hence the danger that the central bank would deem it necessary to "save" any bank in difficulties, whatever the circumstances. The adoption of one or the other method depends not so much on theoretical considerations as on political circumstances. Sometimes even personal considerations play their part. Anyway, it is obvious that, when the control is entrusted to a special body, it is necessary to have close collaboration of this body with the central bank.

The enforcement of Belgian banking legislation has been entrusted to an independent agency, the Banking Commission. Reference has already been made to this "autonomous organism," to use the term of the banking decree. The Banking Commission consists of a president and six members, all appointed by royal decree for six

years.¹⁸ The position of the president is a full-time job. The members attend only periodic meetings and have no part in the current activities carried out by a staff—a very small one by American standards—under the direction of the president. Two members of the Commission are chosen by the king from a list of candidates submitted by the banks, and two from a list submitted by the Banque Nationale and the Institute of Rediscount and Guaranty. No member of the Commission may be a director, an officer, or a proprietor of a bank. The control is exercised by the Commission through the intermediary of “supervisors” about whom information will be given later.

The powers of the Commission are fairly large. They were formulated by the 1935 decree in a general sentence: “the Commission is entrusted with the task of enforcing this decree.” In addition to this general task, the decree entrusts the Commission with some specific functions: registration of banks, establishment of ratios, designation of supervisors and control¹⁹ of their activities, control of the capital market, and so on. Practically, there are no clear limitations to the powers of the Commission. It would be incorrect to consider them only as supervisory functions. Actually, the powers of the Commission are largely of a regulatory nature. Yet the decree insists on one point: the Commission cannot interfere with the granting or refusal of loans to customers. That is left within the exclusive competence of the bank directors. It follows that in principle the Commission may not learn the names of bank debtors or de-

¹⁸ It is perhaps worth-while to recall that any royal decree must be countersigned by a member of the cabinet.

¹⁹ The legal text says “control” but actually it would be much more correct to say “direction.”

positors, and that the supervisors in their reports to the Commission may expose only the general position of the bank, and not the relations between the bank and an individual customer.

The decree of 1935 provides two exceptions to this rule. The supervisor is entitled, and even obliged, to report on the relations between the bank and an individual customer: (1) when operations have been made contrary to laws and decrees; (2) when a customer is in a state of insolvency or quasi-insolvency. (3) The decree of November 30, 1939, added another eventuality; when the bank has granted loans putting its liquidity in danger. This rule has been added as a result of the revelations made after the collapse of the *Caisse Générale des Reports*, when it appeared that excessive loans had been granted to one customer. (See below, pp. 127 ff.)

It must be noted that the legal text would give one a very insufficient and even false idea of the actual significance of the functions exercised by the Banking Commission. Practically its functions are fulfilled not so much by regulations as by personal contacts, by advice, and recommendations.²⁰

The enforcement of banking legislation having been entrusted to the Banking Commission, the actual func-

²⁰ As has been pointed out above, only the banks proper are under the jurisdiction of the Banking Commission. The public and semi-public credit institutions are not subject to its supervision. In its annual reports, the Commission complained about the difficulty of securing necessary information about the activities of these institutions, resulting in the inability of the Commission to obtain a true picture of the situation of the monetary and capital market. They obtained satisfaction by a royal decree of Oct. 22, 1937, which gave them power to require reports from the representatives of the government at the credit institutions and at the Stock Exchanges.

tions of examination and control could have been entrusted to the agents of the Commission. However, the Belgian legislators preferred another solution, which will appear rather complicated to the American reader.

The supervisors are appointed by the banks from a list of candidates nominated by the Banking Commission. It was hoped that in this way the activity of the supervisors would not be considered by bankers as an "intrusion." Before explaining the working of the system, it must be recalled that the Belgian company law like the French law provides, that in each corporation there must be a special board to supervise the board of directors. This board is called the "Council of Commissioners" (Conseil des Commissaires) and is elected like the directors by the stockholders. In some English publications the "commissioners" are called "auditors," a misleading term, because in principle their powers are not limited to the auditing of accounts. But in practice the commissioners have little, if any, influence. The directors always possess or control a sufficient amount of shares to command a majority at the meetings of shareholders. Consequently the shareholders always appoint as commissioners men who are designated by the board of directors. Very often sons or other relatives of directors are commissioners and aspirants for directorships. It has been known for a long time that the boards of commissioners are without practical value. Many reorganization proposals have been advanced.

The solution adopted by the decree of July 9, 1935 seeks to combine the reform of this institution, in so far as banking corporations are concerned, with the introduction of banking control. The decree requests the Banking Commission to establish a register of super-

visors. Banking corporations can henceforth select their commissioners only among individuals inscribed on this register. Other banks must also appoint at least one supervisor. The qualifications required for registration as supervisor have been enumerated in a special regulation of the Banking Commission, approved by a ministerial decree of November 22, 1935.

The following qualifications are required. The candidate must have a diploma implying at least four years of university study and must have had at least five years' experience in banking, business organization, and accounting. If the candidate has had at least 10 years of exceptional experience, a diploma implying two years of study will suffice. If the candidate has acquired exceptional experience during a career of 20 years, no diploma will be required. The candidate must be of irreproachable character; foreigners who have lived in Belgium for at least 5 years may be treated like Belgian citizens. Decisions of the Commission are final and they need not be substantiated. Admission to the register is granted only for one year at a time. Hence a supervisor who has not given satisfaction to the Banking Commission will not be kept on the register. From the candidates inscribed on the register each bank must select one or several supervisors.²¹ Almost all banks have chosen only one.

The work of the supervisor need not be a full-time job, and is not in practice one. But the decree prohibits a supervisor from being a director, commissioner, or officer in any corporation other than the bank submitted to his supervision. Except with the authorization of the

²¹ Foreign banks having branches in Belgium must also appoint a "supervisor."

Banking Commission he may not hold a position paid for by public bodies. The compensation of the supervisors is paid by the bank, but the amount is settled in agreement with the Banking Commission.

*In the banking corporations the role of the supervisor is a double one, he is "commissaire-reviseur."*²² That is, he performs the functions of the old "board of commissioners" and so far he represents the interests of the stockholders with the board of directors. In the second place he is the delegate of the Banking Commission and in this capacity he represents the law and the public interest. The powers of the supervisor are not clearly defined by the law, partly because of their double nature. But in any event they are much wider than those of an auditor.²³ The supervisor cannot interfere with the activities proper of the bank, except when a decision taken by the management results in an infringement of the law. In such eventuality he may veto the decision and inform the Banking Commission.²⁴

Without interfering with loan operations proper, the supervisor may require information on any operation and may take cognizance of any document. In its general instructions to supervisors dated January 1936, the Banking Commission insisted that they have a permanent task. Their function is not simply to audit the accounts from time to time; they must keep constantly informed about the activities of their banks and be in touch with the management.

The supervisor supplies quarterly regular reports to

²² The term used in Belgium for "supervisor" is "reviseur."

²³ That is the reason why in this study *reviseur* is not translated as "auditor," as is done by some English publications.

²⁴ But the supervisor may not report on irregularities concerning taxes. He is prohibited from taking a part in fiscal problems.

the Banking Commission, and when a particular question arises, he is always in touch with the president, or one of the officers of the Commission. The exact position of the supervisor can hardly be judged by official texts. It depends chiefly on the nature of the relations which exist between him and the management. The best results are obtained when there is reciprocal confidence.

The preceding discussion has dealt with the supervisors of banking corporations. In banks belonging to an individual or to a partnership, the supervisor is not at the same time a commissioner. According to the decree he must only audit the accounts at least once a year.

From his contacts with many supervisors, and from his own experience, the writer can state that the role of the supervisor actually differs according to the importance of the bank.

In some small banks where the organization is more or less rudimentary and the staff small, the supervisor has a very delicate position. As a commissioner he is supposed to supervise the bookkeeping and the actual existence of assets. In case of abuse or fraud, his responsibility, not as a supervisor but as a commissioner, may be involved. Nevertheless he has no means of supervising the operations of the bank continuously. In a big bank the situation is different. There is an important staff and the supervisor has only to satisfy himself that the bookkeeping methods are satisfactory, and that there is an independent controlling department checking all operations. If these conditions are present, the supervisor has only to supervise the general policy of the bank and does not have to bother about material verifications of accounts and belongings.

The supervising system introduced by the decree of

1935 aroused many discussions in the press and elsewhere. The most widely discussed question was whether under the system supervisors may be considered independent of the banking management. How can they be considered independent supervisors, it is asked, when they are designated by the banks and are paid by them? Actually their independence is much greater than would appear at first glance. Although banks had a free choice among the supervisors, practically they were designated—especially in big banks—with the consent of the president of the Banking Commission. On the other hand, although the strict letter of the decree would suggest that a bank could dismiss a supervisor at pleasure and replace him by another, this does not actually happen. The Banking Commission would inquire the reasons for the dismissal and, if not satisfied, would not permit the new supervisor to take the oath. And without the oath he could not begin to operate.²⁵ Nevertheless, it must be admitted, that under the present order the independence of the supervisors is a question of personal conduct, and that the system perhaps does not always work satisfactorily.

The Banking Commission has not concealed its dissatisfaction with the present regime and its preference for a method whereby the supervisors would become exclusively its appointees. Banking management would then have nothing to do with their appointment and their compensation. They would become officers of the Commission. Actually an important step was taken in

²⁵ The Banking Commission decided that the oath must be taken each time a supervisor begins his functions at a bank. It follows, for instance, that a supervisor having abandoned one bank for another, must take a new oath; if he acts in two banks at the same time, he must swear twice.

this direction by a modification of the regulation of the Banking Commission concerning the admission of supervisors, approved by an order of competent ministers on October 20, 1939.

Henceforth the Banking Commission will fix periodically the number of supervisors. All former registrations have been cancelled. The principle of free choice by banks has been maintained, but practically it has been reduced to a very narrow limit.

VI. CONTROL OF THE CAPITAL MARKET

Strictly speaking, the control of the capital market is not part of the problem of commercial banking regulation, the more so as the role of these banks in the capital market has decreased in importance. Nevertheless, in Belgium the two questions were tied together because they arose at the same time, and it seemed expedient to entrust to the same body the enforcement of banking regulations and the supervision of the capital market. To a certain extent, the Banking Commission is entrusted with functions analogous to those of the Securities and Exchange Commission in the United States. However, the legislation in this matter as well as the powers of the supervising body are much less developed in Belgium than in the United States. Supervision of the capital market is a result of the excesses committed in the twenties.

The first aim of the authors of the decree was to maintain an equilibrium on the capital market. The authors seemed to have been impressed by the volume of security issues in the twenties; it appeared to them that the abuses would have been reduced by preventing the issu-

ance of too many securities at the same time.²⁸ Accordingly the Banking Commission was empowered to supervise security issues in order to prevent the capital market from becoming unbalanced. But as the conception of equilibrium in the capital market is rather a vague one and has to be interpreted by the Banking Commission, the Commission thus has a weapon, the use of which will depend largely on its own policies.

The second objective of the authors of the 1935 decree was truth in securities or full disclosure. This is a conception familiar enough to the reader in the United States since the discussions of the Securities Act of 1933. In order to fulfill both purposes the decree of July 9, 1935 provided, that anybody who wants to issue stocks or corporate debentures must give notice to the Banking Commission 15 days before the public offering. The notice must be accompanied by a statement giving all necessary information, which is less detailed than the information required by the United States Securities Act.

Two situations must be considered here, relating to the two aims mentioned above. (1) The Commission might hold that a projected issue will unbalance the capital market. It may then recommend the postponement of the issue or its partition over a longer period. If there is no agreement between the prospective issuer and the Commission, the latter can prohibit the issue for a period of three months and may make public its decision. After the lapse of three months the issuer is free

²⁸ It must be pointed out again that the text of the decree was a result of a compromise between conflicting views. The intention of some officials was to introduce a much more far-reaching regulation of the capital market. The ambiguous conception of equilibrium was adopted as a compromise.

to act. (2) The Commission might hold that the proposed issue is made "under such conditions that the subscribers may be misinformed about the nature of the business, or about the rights granted to the holders of the security." In other words, the Commission might reject an issue on the ground that the prospectus of issue is incomplete, vague, or untrue.

In this case the Commission gives notice to the corporation whose securities are to be issued and to the issuer in question. If the latter refuses to supply the requested information, the Commission may prohibit the issue for three months and may make public its decision. In addition, in this case, the Commission may request the Minister of Finance to prohibit the listing of securities on the stock exchanges.

A subsequent decree extended the powers of the Banking Commission. A literal interpretation of the 1935 decree would give the Banking Commission supervisory powers only over public issues in the strict sense of the word. A decree of November 30, 1939 provides that registration with the Banking Commission is also compulsory when an application is made for the listing of a security on a stock exchange, or when a corporation issues new shares, even if the privilege of subscription is reserved to the shareholders.²⁷

Another modification concerns the issue of debentures. The decree of July 9, 1935 required registration only for bonds having a maturity of at least 5 years. But in this manner a part of the capital market remained without supervision and therefore, since the decree of

²⁷ These operations are consequently considered as issues or public offerings.

November 30, 1939, all issues of bonds must be reported to the Banking Commission, whatever the maturity.

It appears from the foregoing that analogies between the Banking Commission and the S.E.C. are only partly valid. The Banking Commission has powers only in what concerns the public offering of securities; they do not have the other powers of the S.E.C. Concerning public issues, the powers of the Banking Commission are somewhat broader than those of the S.E.C. on one point: the S.E.C. cannot postpone an issue for reasons of market equilibrium. In its first annual report the Banking Commission said that disequilibrium in the capital market may occur when supply or demand exceed normal economic needs. A disequilibrium is also possible between different sections of the market—long-term, medium-term, or short-term—as well as within any one of these categories, either because of supply and demand conditions, or owing to the utilization of unsuitable methods of financing.²⁸

So far the Banking Commission has not exercised its right to postpone an issue for reasons of market equilibrium; it has only exercised its right to request additional information about projected issues. When information given in a proposed prospectus is not appropriate, the Commission does not go so far as to postpone the issue; it suggests the necessary improvements and these are usually made. In practice the Commission went much farther than to require mere information about material facts. For instance it requested issuers to justify the margin between the price they paid for securities and

²⁸ *Report for 1936*, p. 56.

their sales price. In certain cases the Banking Commission even suggested recourse to other methods to a corporation projecting a bond issue, for example, when it appeared that the condition of the corporation did not assure a regular payment of interest, or that the corporation intended to let bondholders assume risks generally borne by stockholders.

CHAPTER V

BANKING TRENDS SINCE THE REFORM

The devaluation of the franc in April 1935 stopped the monetary and banking panic. Capital that had fled the country began immediately to be repatriated. The shrinkage of deposits was replaced by an upward trend. In the succeeding years¹ banking activity was influenced mainly by the gradual adaptation to the new legal status and by the instability of economic and political conditions attributable mainly to international factors. Wide fluctuations in the amount of deposits resulted from the lack of stability. The expansion of public credit institutions may also be considered a characteristic trend of this period.

I. CARRYING OUT THE REFORM

Decree No. 175 of July 9, 1935 went into effect on September 1, 1935. Actual supervision, however, began on January 1, 1936. Thus, up to the invasion, the system worked for a little more than four years. As was to be expected, the reform was introduced under rather unfavorable circumstances. Although economic activity was increasing in the second half of 1935, conditions were very unstable. In 1936 the internal and external political situation was far from quiet, and it deteriorated later on. Also the reform has been carried out somewhat hurriedly. Nevertheless, the supervisory mechanism has been put in motion without much friction.

The personal factor exerted a notable role in setting

¹ 1935-40. Events following the German invasion in May 1940 will be disregarded here, as presenting only a transitory interest.

the new banking regime to work. The writer has been in touch through all these years with the supervising authorities as well as with some banking managements. He has been impressed by the importance of the personnel problem, the human element in the working of the system. Mention must be made first of the influence exercised by the President of the Banking Commission. Mr. G. Janssen, a former lawyer, in 1935 was managing director of an important banking corporation, which was controlled and almost wholly owned by one of the prominent industrial families of Belgium. Appointed as president of the Banking Commission he said to some friends: "Now I am on the other side of the barricade." His objective was the strict enforcement of the law and the extension of the influence of the Commission. A man of great intelligence and sagacity, strong character, and yet flexible enough, he rapidly imposed his authority. Although not liked by many members of the banking community, who accused him of extending too far the powers of the Commission, he was respected and his advice was heeded. It is attributable chiefly to the personality of its president, that the Banking Commission quickly became not only a legal but also a moral authority, and that supervision began without friction.²

On the other hand, the author had opportunity to

² At the beginning of 1938 M. Janssen became the governor of the Banque Nationale. Until the end of September, he was at the head of the Central Bank as well as of the Banking Commission. There was a suggestion, strongly supported by M. Janssen himself, that this situation be maintained. In this way a personal union would have been established between the two institutions although each would have kept its autonomy. Finally, however, it was deemed wise to avoid possible confusion, and another president for the Banking Commission was appointed. Some links between the Banque Nationale and the Banking Commission have existed since its inception: one of the directors of the Banque Nationale has been a member of the Banking Commission since 1935.

observe that, in the relations between banking managements and supervisors, the personnel question also played an important part. Sometimes difficulties arose because managers continued to think in terms of the "old regime." On some other occasions the supervisor did not possess the necessary authority to gain the respect of the management. Yet, in most cases the necessary understanding was shown by both sides.

The liquidation of mixed banking proved to be the most embarrassing problem arising out of the banking reform. As shown in a preceding chapter, in 1935 the banking organization was highly concentrated and "industrialized." There were about half a dozen big banks holding an important amount of industrial securities. Holding such securities was henceforth prohibited yet selling them was out of the question. Who would buy them? The only possible solution was to split each mixed bank into two distinct corporations, one having the banking functions, the other directed henceforth to financial activities.

With some variations in details, the following method was adopted. The old bank became a "financial corporation" and founded a banking corporation whose capital it subscribed.* In some cases the former mixed bank was obliged to change its name in order to avoid the word *banque*. The older name was given to the new corporation. For instance, the Société Générale retained its name and founded a new corporation called "Banque de la Société Générale." The Banque de Bruxelles became "Société Bruxelloise pour la Finance et l'Industrie"

* The English terminology is now used in Belgium. "Banking operations" means short-term credit, "financial operations," long-term credit, more particularly, dealing in securities. Contrary to American custom, the banks are no longer considered financial organizations.

(Brufina) and founded a new corporation called "Banque de Bruxelles."

The deposits formerly held by the mixed banks were transferred to the new banks with a corresponding amount of assets.⁴ The assets transferred had to be even greater than the deposits because they had to cover the capital of the new bank as well. These assets must be eligible under the terms of the banking decree, that is, no part of them could consist of corporate securities, and they must be "sound."

Actually, none of the old banks had a sufficient amount of eligible assets to cover the deposits and the capital of the new banking corporation. The deficiency was covered by a claim of the new bank against the "holding corporation."⁵ A curious result was that the holding corporation retained the entire stock of the new bank or at least a very important section of it; but the holding corporation was indebted to the bank for an amount sometimes greater than the entire stock of the bank.⁶

It follows that actually the liquidation of mixed banks was far from being carried out. During the entire period covered by this chapter, the chief concern of the Banking Commission was the problem of the relationship between the banks and the financial institutions

⁴The financial corporations were enabled to retain deposits with more than two years' maturity and, what is much more important, all deposits of affiliated corporations. See above, p. 87.

⁵In Belgian publications these corporations—the former banks—are generally referred to either as "financial corporations" or as "holding corporations."

⁶On one or two occasions the holding corporations have disposed of a certain number of shares issued by the new bank. For instance, the Société Générale gave its shareholders the privilege of exchanging shares of the Société Générale for the shares of the new bank. In practice, the Société Générale retains now only half of the shares issued by the bank. Of course, one-half of the shares represents a "controlling" interest.

holding their capital stock. The Banking Commission insisted particularly that the debts owed by the financial corporations to the banks should be repaid as soon as possible. Some financial corporations were able in 1936-37 to sell a part of their industrial securities and to pay the debts owed to banks in whole or in part. Other corporations, whose assets were not marketable, have not been able to pay off the indebtedness. Political and economic difficulties in 1938-39 did not make solution of the problem easier. Time was needed, and in 1940 the invasion came. An actual liquidation of mixed banking not only implied paying off the debts owed to the banks by the financial corporations; it was also necessary for the corporations to sell the banking shares they retained. But this part of the program required still more time.

Liquidity has been the leitmotiv of the policy pursued by the Banking Commission since its inception. As stated above, the Banking Commission did not use its powers to establish compulsory ratios. But the aim of liquidity found its expression in the importance given to the "coefficients" (the actual ratios) reflecting the situation at the end of each month and reported regularly by the supervisors to the Banking Commission.¹

The coefficients referred to are: (1) The "treasury coefficient" corresponding to what would be called in the United States "ratio of cash reserves." By "treasury" one must understand not only cash proper but also

¹ The term "coefficient" used in the publications of the Banking Commission will be used here also in order to avoid a confusion with legal ratios provided by the banking decree.

The coefficients concerning the end of the year situation are published in the annual reports of supervisors to the stockholders. Besides, quarterly figures are published concerning the whole banking situation. See above, pp. 97 ff.

deposits at the Banque Nationale and at the Postal Check Office. The coefficient is calculated relatively to the demand deposits. (2) The "liquidity coefficient" or ratio of liquid assets; the items considered liquid are: bills eligible for rediscount at the Banque Nationale, government bonds at 80 per cent of their current value,⁸ balances with banks and other receivables with a maturity not exceeding 30 days. The coefficient is calculated in relation to the total amount of short-term liabilities. (3) The "solvability coefficient," or the "relation between the bank's own funds and the funds of others," that is, the relation between the capital and surplus on the one hand and the amount of callable liabilities on the other. This could be called "the ultimate safety proportion."⁹

In carrying out the reform much attention has been given to the monthly banking statements. The Commission aimed at making the statements as complete and accurate as possible. They were accompanied by special statements about assets and liabilities in foreign currencies. These returns, completed by the reports of supervisors, give the Banking Commission a complete knowledge of the condition of each bank.¹⁰ But the monthly returns have another use. The big banks already had a very detailed bookkeeping system, but this was not always true of smaller banks. In order to make regular and detailed monthly returns, they have been compelled to complete and sometimes to revise their bookkeeping methods. In the end, these returns proved to be very useful for the bank managers themselves.

⁸ This is the amount of loans granted by the Banque Nationale on government bonds.

⁹ Some of these coefficients are reproduced below.

¹⁰ As stated above, these returns are not published, only summary figures being published quarterly for the whole banking situation.

Judged from this point of view, the action of the supervising authorities certainly had an educational influence of a very useful character.

A royal decree of November 24, 1937 provided a formula for annual balance sheets. It is much less elaborate than the formula for monthly returns. Nevertheless, it gives a relatively complete idea about the situation of the reporting bank, as far as a balance sheet can do it.

One or two concrete examples will show the nature of problems arising out of making up the balance sheets. Internal reserves are generally considered a good policy strengthening the position of a bank.¹¹ On the balance sheets these reserves were often included in "deposits." The Banking Commission believes strongly that the deposit items of a balance sheet should contain only liabilities to third parties. The only remaining method of keeping an internal reserve is then to reduce the valuation of some assets. This method is easy when part of the assets of the bank consists of securities, particularly stocks. It has been used often by mixed banks. However, the method presents some difficulties, when the assets of a bank consist chiefly or exclusively of loans and bills. If these assets are considered sound, they must be valued at their face value, and in this case they cannot contain a reserve. The Banking Commission does not admit in principle formation of "hidden" reserves. Nevertheless, the total amount of loans to customers may be reduced by a certain sum because of the general risk involved in lending operations. For instance, if a bank has invested 10 million francs in sound loans, it could evaluate this item only at, say,

¹¹ Reserves in the sense of "surplus." In Belgium the term "hidden reserves" is sometimes used.

9.5 millions, provided the balance sheet would not become entirely misleading thereby. In other words, it is a question of measure and of circumstances and is left to the responsibility of the board of each bank.

Mention should be made of the problem concerning the valuation of government bonds for the purpose of the balance sheet. Although the corporation law does not contain any rule relative to this point, it is always believed that a prudent management should not value securities higher than the stock exchange quotations. The problem became acute in 1938-39, when government bonds fell sharply. Some banks held huge amounts of these bonds and valuation at the current price could eat up an important part of their surpluses and even of their capital.

The following comment was made on this point by the Banking Commission:

The evaluation of these securities depends on the merits of each case. Certainly, it is necessary to take account of the market price, but there are other elements to be considered, such as the yield of securities and their maturity. The valuation may also differ according to maturity of deposits for which the securities are the counterpart. The responsibility of bank managers would certainly be considerably reduced, if they took care to explain in the balance sheet or in the annual report, on what basis the valuations were made.¹²

II. RECENT BANKING DEVELOPMENTS

The last prewar phase of Belgian banking evolution began in April 1935 when, after the devaluation, the banking crisis came to an end. Before analyzing the developments of this phase, it may be of some use to outline the extent of the crisis which culminated in the first

¹² *Report for 1938*, p. 16. See also *Report for 1939*, p. 24.

months of 1935.¹⁸ To judge accurately the effects of the crisis upon the banking system, it would be necessary to have figures relating to the situation in April or May 1935, in order to compare them with those of 1930 or 1933. Unfortunately figures are available only as of December 31, 1935. And comparison with preceding years is hampered because of the change in the structure of banking during 1935, that is the separation of all big banks into two distinct corporations. Nevertheless a comparison of the tables on pages 58 and 122 discloses that the total amount of deposits, including bankers' balances was:

33.1 billions at the end of 1930
25.2 billions at the end of 1933
21.6 billions at the end of 1935

But the last figure must be broken down in the following way:

Deposits of Belgian banking corporations	17.5 billions
Deposits of foreign banking corporations	2.3 billions
Deposits of other banks	1.8 billions
Total	21.6 billions

As the figures for 1930 and 1933 are only for Belgian banking corporations, the figure of 17.5 billions for 1935 must be substituted for that of 21.6 billions. It appears thus that between the end of 1933 and the end of 1935 the deposits dropped by 7.7 billions, following a decrease from 1930 to 1933 of 7.9 billions.

The figures just quoted are approximate. The reduction could have been larger, because figures at the end of 1935 include an important amount of deposits made in the second half of that year. On the other hand, when

¹⁸ Such an outline was impossible before the explanation concerning the "splitting" of principal banks in 1935 was given.

the separation of banks occurred, the financial corporations kept a certain amount of deposits. However, the

ASSETS AND LIABILITIES OF BELGIAN BANKS, 1935-39
(In millions of francs)

Balance Sheet Items	December 31, 1935	June 30, 1937	September 30, 1938	December 31, 1938	December 31, 1939
Assets:					
Cash reserves ^a	4,455	2,962	1,493	2,106	1,634
Balances with banks . . .	3,135	4,440	3,647	3,782	3,165
Receivables at short notice	b	b	1,509	1,539	1,135
Bills	4,456	4,698	2,190 ^c	3,747	2,903 ^c
Loans and overdrafts . . .	8,267	8,429	6,794	6,565	5,747
Customer's liabilities for acceptances	d	d	895	872	767
Government bonds	3,231	4,819	4,166	3,853	3,161
Other securities	974	1,193	1,008	983	1,326
Miscellaneous	1,756	2,415	336	220	588
Immobilized assets ^e . . .	392	578	642	634	610
Total	26,666	29,534	22,682	24,303	21,037
Liabilities:					
Deposits, demand and short term	16,067	17,881	12,868	14,592	11,934
Deposits exceeding one month	3,036	3,377	1,742	1,721	1,221
Bankers balances	2,528	2,637	1,469	1,783	1,345
Due on short notice . . .	—	—	459	389	404
Acceptances	d	d	895	872	774
Miscellaneous	1,691	2,252	1,939	1,640	2,029
Capital accounts	3,344	3,387	3,309	3,308	3,330
Total	26,666	29,534	22,682	24,303	21,037

^a Cash, deposits at the Banque Nationale and at the Postal Check Office.

^b Included generally under Miscellaneous.

^c The drop is due to the rediscounting with the Central Bank.

^d Not included in the assets or in the liabilities.

^e Chiefly premises. In some cases premises are owned by special affiliated corporations. Before 1938 stocks or debts of these affiliates were included in other items of the assets.

preceding figures give a fair account of the strain undergone by Belgian banking between 1931 and the middle of 1935.

Banking developments of 1935-40 were dominated mainly by wide fluctuations in the amount of deposits. These fluctuations resulted from the economic instability and still more from the uncertainties of the international situation. The table on page 122 summarizes banking trends since the end of 1935. The increase in deposits which began in the middle of 1935 lasted until the middle of 1937. Then a chaotic period began. In the last months of 1937, the economic position deteriorated, and the international political situation became more and more insecure. Particularly after the occupation of Austria in March 1938, the banking situation was dominated by the ups and downs of international politics. Several times panics resulted in withdrawals of deposits and in buying of foreign currency. The total bank deposits jumped from 19.1 billions to 21.2 billions between December 31, 1935, and June 30, 1937. It was mainly a result of the inflow of money from abroad. The banks increased their commercial loans at this period only by about 400 millions. They used their funds chiefly to buy government bonds and to increase their balances with foreign correspondents. In the second half of 1937 the deposits were reduced by about 1.8 billions. In the first quarter of 1938 there was a breathing spell, but in the second quarter the panic was violent as a consequence of the "Anschluss." In May the panic was aggravated by the crisis of the French franc, and this time there was not only a withdrawal of deposits but also an intense demand for foreign currency. The panic reached its climax in August and September at the time of Munich. On the whole, deposits dropped by 6.6 billions or more than 30 per cent between July 1937 and September 1938.

In the last quarter of 1938, after Munich, deposits came back again to an amount of almost two billions. The movement continued in January, but in February there were some internal political difficulties. More important, in March 1939 a new international crisis occurred, resulting from the occupation of Czechoslovakia. In February, March, and April the banks lost two billions. From May to July the downward movement stopped, and there was even a slight increase in deposits. But in August the international crisis exploded with the utmost violence, resulting in war. Deposits were withdrawn again, and at the end of 1939 they amounted to 13.1 billions, a low for the last 15 years. In the following months the situation remained relatively stable. When the German invasion of Belgium occurred on May 10, 1940, a moratorium was immediately proclaimed, and depositors received only small amounts.¹⁴

On the whole during the years 1937-40 Belgian banks were subject to several violent crises. From the middle of 1937 to the end of 1939 their deposits were reduced from 21.1 billions to 13.1 billions or by 38 per cent. The drop in deposits was not accompanied by an identical reduction in banking loans. In 1937-38 Belgian banks used their cash reserves, their balances with foreign bankers, they sold government bonds, and used largely the rediscount facilities with the Banque Nationale, whose policy was very liberal. On the whole Belgian banks withstood the crisis of 1937-39, or rather the successive waves of the 1937-39 crisis, without failure.

¹⁴ One June 30, 1940 the amount of deposits dropped to 12.1 billions. Since then there has been a constant increase due to the monetary expansion. See R. Ardenne, *German Exploitation of Belgium (1942)*, p. 54.

In 1939 difficulties occurred in which three banks were involved. One, the Banque des Céréales, at Antwerp, was a small establishment specializing in financing the wheat trade. With a capital of 20 millions it had deposits amounting to 10 millions. Its customers were chiefly merchants and brokers trading in wheat. One of the principal managers was also the chief debtor. The situation arose before the introduction of banking supervision. The principal losers were some other Antwerp banks which had rediscounted the paper of the Banque des Céréales. The general public did not lose anything.

The difficulties incurred by the two other banks raised more delicate problems. The Crédit Anversoïis was established in most towns and boroughs and had a very large number of depositors recruited mainly from the lower middle classes. When the depression of the thirties occurred, an important part of its assets consisted of shares and loans to industrial concerns. Interests in one textile concern were particularly large. The "holding corporation," resulting from the splitting of the Crédit Anversoïis, carried all frozen assets, and the bank had an important claim on the holding company.

As pointed out before, several holding corporations were able to liquidate some of their assets during the revival of 1935-37 and to repay partly or wholly their debts to banks. But there were some companies whose assets were entirely frozen and which yielded no income. As a result, they were unable to repay the banks or even to pay interest on their debts. The holding company of the Crédit Anversoïis was in the worst position. The problem gave much concern to the Banking Commission. Strictly speaking the Commission could have given instructions to the supervisors not to permit the

inclusion in the balance sheets, of assets which did not bear interest and those for which the prospects of repayment were small. The result would have been to put these banks immediately in receivership. Experience has shown how disastrous forced liquidations are. Consequently, it was thought better to wait, so that some assets could be disposed of gradually, and others might increase in value. The difficulty of such a policy is that nobody knows how long it will last and what the ultimate result will be. This policy proved to be successful in most cases, but not in regard to the *Crédit Anversois*. Finally it appeared that the situation of the "holding company" was such that its debts could no longer be considered as having a face value. In December 1939 the *Crédit Anversois* was obliged to suspend payments. At the time its deposits were about 430 millions, held chiefly by small depositors.

The suspension aroused vigorous discussion in Parliament and in the press. Many critics blamed the Banking Commission for not having prevented such a situation, although it had existed before the Commission came into existence. Besides, the Banking Commission could not be considered responsible, as long as it did not interfere with the granting of credits. Public meetings carried resolutions demanding a State intervention in favor of the depositors. Before the suspension, there were negotiations between the Treasury and the representatives of the Association of Banks. Projects were prepared for raising a fund to aid distressed banks, by the co-operation of the Treasury and of all banks of the country. It would have been the nucleus of a deposit insurance. But finally the Treasury refused to make any contribution, not so much it appears because of its own financial diffi-

culties, as because of the fear of creating a precedent with the effect that the State would have to intervene financially whenever banks failed. It was decided to put the *Crédit Anversois* in liquidation, and shortly afterward the invasion took place.¹⁵

The other big banking event of 1939 did not result in a failure but nevertheless merits attention. The *Caisse Générale des Reports et des Dépôts* was an old establishment in Brussels. For many years its specialty was granting loans on securities chiefly to stockbrokers. After the First World War, directors extended their policy to other operations. The bank had the misfortune to come under the leadership of a financier who was one of the greatest speculators in Belgium, perhaps in Europe. Under his guidance the *Caisse* established close relations with the *Bank Mendelssohn* at Amsterdam, to which excessive loans were made without adequate cover. When the *Bank Mendelssohn* failed, the situation of the *Caisse des Reports* was impaired. The deposits were not threatened, but the major part of the capital and surplus (393 millions) was lost. There was great excitement because the *Caisse* had a large number of small shareholders. The perilous situation in this case had arisen in recent years, and the Banking Commission was accused of having failed in its task of supervision by not having prevented it. Partisans of the Commission objected that the Commission was not allowed by law to interfere in the relations between a bank and its customers. Indeed, the Commission may not even know the names of the customers. Nevertheless the supervisor

¹⁵ Immediately after the suspension, the Institute of Rediscount and Guarantee offered the depositors of the *Crédit Anversois* reimbursement of 75 per cent of deposits not exceeding 10,000 francs and 25 per cent of the other deposits.

of the Caisse des Reports could have reported to the Banking Commission on the imperiled situation of the Caisse. From what is known, it is not certain whether the supervisor was not aware of the situation—the loans to the Bank Mendelssohn were scattered in several accounts—or whether, knowing it, he failed to report in time.¹⁶ At the beginning of 1940 the liquidation of the Caisse was decided upon. Another corporation under the name of Banque des Reports was established in order to take over the deposits of the Caisse with a corresponding amount of sound assets. The capital of the new bank was subscribed in the following manner: 30 millions by the receivers of the former bank, who brought in the “salvaged” part of the old capital, and 20 millions by some important banks of Brussels.

At the outbreak of the present war Belgian banking had a very different organization from ten years before. In 1930 Belgian banking was at the peak of the expansion movement described in Chapter III. Deposits were at their highest level, and the banks had a controlling interest in most important industrial corporations. Banking leaders exercised great influence in most fields of economic activity. Then came the crisis and the deflation. Banks suffered heavy losses, deposits as well as assets of the banks dropped. Later on, the banking reform and the extension of the role played by official institutions reduced again the power of the banking organizations. Finally, the international disturbances of 1938-39 provoked a new shrinkage of funds at their disposal.

The table on page 129 gives a general idea of transformations in the Belgian banking organization between the two world wars.

¹⁶ It has already been stated that after this incident the banking decree was modified and the powers of the Banking Commission enlarged. See above, p. 102.

**CAPITAL AND OTHER LIABILITIES OF BELGIAN BANKS, END OF
SELECTED YEARS***
(In millions of francs)

Belgian Banks	Liabilities			Number of Banks
	Capital and Surplus	Other	Total	
Banking corporations:				
1920.....	1,388	9,261	10,649	72
1930.....	8,739	33,152	41,891	90
1933.....	7,242	25,254	32,496	63
1939.....	2,767	15,045	17,812	70
All banks:				
1939.....	3,330	17,707	21,037	113

* These figures have not been compiled on a strictly comparable basis, but the margin of error is small.

The present state of banking consolidation resulting from the concentration movement in the twenties and the thirties is shown in the following table which presents assets of Belgian banks at the end of 1939.¹⁷

Banque de la Société Générale	6,854 millions
Banque de Bruxelles	3,217 millions
Kredietbank ¹⁸	1,146 millions
	11,217
21 corporations with assets between 50 and 1,000 millions ¹⁹	5,749 millions
46 small corporations	847 millions
9 foreign corporations	1,522 millions
34 partnerships and private banks	1,702 millions
	9,820 millions
	21,037 millions

¹⁷ Source: Statistics of the Banking Commission.

¹⁸ The Kredietbank results from the merger of the Allgemeene with a provincial bank. See above, pp. 64 ff.

¹⁹ Included in this group are the Banque d'Anvers (assets 686 millions) and the Banque Belge pour l'Etranger (assets 210 millions) both affiliated with the Banque de la Société Générale. The importance of this "middle" group was reduced in 1939-40 by the closing of the Caisse Générale des Reports and of the Crédit Anversois.

The same concentration is manifest in the branch system. The maximum number of branches was 1,752 in 1930. It dropped to 933 at the end of 1939,²⁰ 740 of which belonged to the three banks appearing at the head of the table on page 129, and 193 to 36 other banks.

Comparisons of the nature of banking assets between 1930 and 1939 are not easy, because the figures have not been arrived at on the same basis. Nevertheless, the following table will give a fairly accurate account of these changes.

ASSETS OF BELGIAN BANKING CORPORATIONS,
END OF YEAR 1930 AND 1939

Assets	1930		1939	
	Millions of francs	Per cent	Millions of francs	Per cent
Cash.....	4,346	10.1	1,354	7.6
Balances with banks and call money.....			2,243	12.6
Bills.....	8,385	19.6	3,661	20.6
Loans.....	22,263	52.0	5,704	32.0
Securities.....	7,201	17.0	3,788	21.2
Other assets.....	572	1.3	1,062	6.0
	42,767	100.0	17,812	100.0

The absolute and relative decrease in "loans" is the most striking feature of this table.²¹ The relative importance of the item "securities" is slightly increased. But it now includes virtually only government bonds. In contrast to the industrial securities held in 1930, government bonds are eligible as collateral to the Central Bank and consequently are liquid assets.

On the whole the preceding figures disclose that the

²⁰ Without taking into account the branches of the *Crédit Anversois* which closed in December 1939.

²¹ It is true that some items now included under "Balances in the banks and call money" were probably included in 1930 under "loans," but the margin of error is small.

first aim of the bankers was liquidity. This objective prevailed during the whole period after the banking reform. The liquid condition was always emphasized when the quarterly reports and the coefficients were published. Some of these coefficients are shown in the following table.²²

	Cash Per Cent	Liquidity Per Cent	Solvability Per Cent
End of 1935	27.7	78.2	15.2
End of 1936	21.7	80.2	12.2
End of 1937	18.2	80.6	13.3
End of 1938	17.5	74.3	15.9
End of 1939	15.7	69.2	19.0

During the period 1935-39 financial activities remained very moderate. The issues of new securities were almost as limited as during the depression years 1932-34. The "net" amount of securities issued²³ remained

NET SECURITIES ISSUED AND DIVIDENDS PAID BY BELGIAN
CORPORATIONS, 1927-38
(In millions of francs)

Year	Net Securities Issued	Dividends Paid
1927.....	3,925	2,395
1928.....	6,333	2,898
1929.....	5,932	3,479
1930.....	2,898	4,245
1931.....	2,025	3,547
1932.....	687	2,447
1933.....	544	2,134
1934.....	326	2,183
1935.....	470	2,167
1936.....	320	2,869
1937.....	946	3,787
1938.....	504	4,297

²² They apply to all banks and are calculated as mentioned before, pp. 117 ff.

²³ Or rather created. See above, p. 54, n. 5.

below the amounts disbursed by corporations as dividend payments. Only in 1937 was there a slight revival.

Some people maintained that the liquidity policy of bankers was exaggerated and resulted in excessive cautiousness in the lending policy. Such policy as well as the anemia of the financial market were believed to hamper industrial expansion and were attributed by some papers to the banking legislation of 1935 and to the spirit in which it was enforced. The last report of the Banking Commission rejected this view. The report said:

One must be very cautious in judging recent banking legislation and the repercussions it can have had on the economic development of the country. . . . Since the promulgation of this legislation international relations have been deteriorating constantly. Economic conditions have also been very unfavorable. With special regard to Belgium, that country witnessed a moderate economic expansion in 1935-37. But at that moment the banks and the financial corporations were obliged to restore their situation imperiled by the prolonged depression. They were concerned much more with the re-establishment of their liquidity and the cleansing of their balance sheets²⁴ than with the promotion of new enterprises. This policy was absolutely unrelated to the changes in their legal regime and they would have followed it under the former regime as well as under the present one.²⁵

The writer would endorse the judgment of the Commission if the word "absolutely" were dropped. The observation is true in a general way but one may wonder whether the legislation and the insistence on liquidity did not contribute to bolstering up the policy of extreme liquidity. After all there is no way of measuring the influence of various factors.

²⁴ "Assainir les bilans," a term hardly translatable, meaning to get rid of doubtful debtors, amortize losses, and so forth.

²⁵ *Report for 1939*, p. 18.

It is worth-while to mention that in financial circles and in some sections of the press—generally reflecting the views of the financial community—criticisms were directed much less against banking regulation proper than against the provisions of the 1935 decree concerning public issues, and against the spirit in which the Banking Commission enforced them. There can be only a psychological explanation of this fact. Regulation of banking was considered indispensable by almost everybody, even by banking leaders. The leaders of financial corporations—chiefly former leaders of mixed banks—hoped that the supervision of public issues would be a mere formality. They did not anticipate that the Banking Commission would scrutinize seriously the character and circumstances of each issue. Hence the criticism by the financial press.

III. CREDIT POLICY OF THE BANQUE NATIONALE

The reform of commercial banking provided by the decree of July 9, 1935, was only one of the changes made in the credit structure of the country after the First World War, especially after 1935. The reorganization of the whole credit system represented an important part of the reforms accomplished by the van Zeeland Administration.

Besides the regulation of commercial banking, the measures adopted may be classified under two headings: (1) changes in the status of the Banque Nationale, and (2) extension of the role played by public credit institutions. In this section the transformation of the principles underlying the credit policy of the Banque Nationale will be set forth. Two problems must be considered in this connection: (1) dealings in government

bonds, and (2) the nature of commercial credit operations of the bank.

In a preceding chapter the precautions taken by the founders of the Banque Nationale, in order to reduce to a minimum the bank's holdings of government securities, have been stated. Investments in government bonds could not exceed the capital and surplus of the bank, discounts of Treasury notes could not exceed a maximum figure of 20 millions, even loans secured by government obligations were viewed with much disfavor.

The Banque Nationale observed these principles strictly until the First World War. Then the bank was obliged to advance 480 millions in order to pay the first military contribution to the "occupying" power, Germany, and immediately after the armistice the bank lent to the State a much higher amount (5.8 billions) in order to withdraw the mark currency from circulation. (See above p. 49) Officials as well as bankers, particularly the board of the Banque Nationale, considered these loans a temporary measure due to the war. It was hoped that the government would be able to repay them later. Actually, 600 millions were repaid during the years 1920-24. But in the second quarter of 1926 there was a crisis provoked by the failure of the first attempt to stabilize the franc. In order to be able to redeem maturing Treasury notes, the government was again obliged to borrow from the Central Bank a sum amounting to 1,025 millions. This was an emergency measure, a remote consequence of the war.

In October 1926, when the franc was stabilized, the government debt to the bank was reduced to 2 billions, partly by using the proceeds of an international loan and partly by the utilization of the "profit" resulting

from the "revaluation" of the gold reserves of the bank. The remaining two billions were to be repaid gradually. At the same time the bylaws of the Banque Nationale were revised and the maximum amount of Treasury notes allowed to be discounted by the bank was raised from 20 to 100 millions. Owing to the reduction in the value of the franc, the amount of 100 millions was, in actual purchasing power, inferior to 20 million prewar francs.

In the decade following the First World War, the prejudice against holdings of government bonds by central banks was as pronounced as before. This prejudice had a particular opportunity to appear at the beginning of 1926 when the first stabilization attempt was in progress. Among different financial measures proposed by the government at that time was a bill concerning the Banque Nationale. This bill removed the limitations upon investments in government bonds and authorized the bank to buy and sell such bonds freely, "in order to modify the quantity of money in circulation without affecting the credits outstanding."²⁶

The Committee of the House rejected the proposition unanimously. It feared that "buying and selling of government bonds . . . would inevitably bring about artificial rises and falls of quotations and would disturb the market of these securities." Still more they feared that "the State could by this means [that is, buying government bonds by the Central Bank] contract big loans at the bank and provoke again an inflation."²⁷ Consequently, the Banque Nationale remained under the rule of the original law.

²⁶ Credits meaning loans.

²⁷ Chambre 1925-26, Doc. No. 158, pp. 36 ff.

During the depression of the thirties, particularly after the advent of the van Zeeland government in 1935, there was much talk about open-market operations. Applied to Belgian circumstances, this term was an inappropriate imitation of American terminology. In the United States the Federal Reserve banks may in principle deal only with the affiliated banks. Hence, federal banks which buy bills or bonds outside of the system, carry out "open-market" operations. But in Belgium there is no such thing as member banks. The Banque Nationale, as is true of all other European central banks, may deal not only with any bank but with any person. In Belgium when people spoke about open-market operations they meant buying and selling—chiefly buying—of government bonds by the Banque Nationale.

The basic reason for the development of "open-market policy" was provided by the needs of the Treasury. Officially this reason was never stated, but it was known by all informed people. On the other hand, the opponents of this policy were moved by the traditional fear of excessive loans granted by the bank to the government, resulting in inflation. A decree of July 27, 1937, reformed the bylaws of the Banque Nationale. The chief modification allowed the Banque Nationale to increase its holdings of government bonds.

It is worth-while to mention the reasons for the reform put forth by the authors of the report preceding the decree. They recalled that the Banque Nationale was created in order to regularize the credit situation in discounting short-term commercial bills. Today, they said, the regularizing role of the bank remains unchanged, but the tools at its disposal are insufficient. The

quantity of bills on the market was falling owing to the movement of industrial and financial concentration. Consequently, the amount of discounting done by the Banque Nationale decreased, as well as its influence on the market. Hence the decree intended to provide a tool by which the bank "would exercise the necessary action on the money market in reducing or increasing the quantity of money by way of selling or buying government securities."

One can see in this last sentence the influence of theories of "credit control" by action of the Central Bank. But it may be stated that the primary aim of the reform was to give the Banque Nationale the means of supporting the economic policy of government by eventually helping the Treasury.

The decree of 1937 raised the maximum amount of treasury notes to be held by the Banque Nationale from 100 to 500 millions. The provisions concerning long-term bonds are more complicated. It has been stated that the bank was authorized at its inception to invest its capital and surplus in government bonds. Besides, the bank had some bonds resulting from emergency loans made since the First World War. The decree of 1937 provided that, in addition, the bank is allowed to buy government bonds up to an amount of one billion francs.

Taking into account the fears that such power might lead to inflation, the decree provides two precautions in order to "prevent any abusive use of the open-market policy for an unhealthy financing of the budget." First, the maximum amount of treasury notes, fixed at 500 millions, was to be held only temporarily. The amount actually held could not exceed 200 millions for a period of more than 12 consecutive months. The second pre-

caution concerned long-term bonds. The bank was authorized to buy only bonds issued for two years at least and already listed on a stock exchange.

The decree of July 27, 1937, modified also the regulations concerning the discounts of the bank. These regulations were liberalized in several directions. The maturity limit for eligible bills was raised from 100 to 120 days. Much more important was the modification in the nature of the paper discounted. The bylaws of the bank prescribed previously that the bills discounted should have what is called a *cause réelle*, that is, should be based on an actual commercial transaction. The new bylaws drop the requirement of a *cause réelle*. Although they still provide for discounting commercial paper, this term is used henceforth in a wider sense and includes financial paper. As stated by the governor of the Banque Nationale, the form and the character of the discounted paper are now left to the discretion of the bank.²⁸ On this point the reform of 1937 simply adapted the regulations to actual practices. Nevertheless, it is interesting as a change in doctrinal conceptions. Still more interesting and significant was the introduction in the bylaws of a new provision allowing the bank to "grant discount credits for financing industrial commitments for medium term; but the bills must not exceed 120 days of maturity." Practically, it is an authorization to practice "renewable" credits, of the kind discussed above. (Chap. II, sec. I). One last innovation introduced by the decree of 1937 must also be mentioned. The Banque Nationale was authorized to subscribe to shares issued by financial institutions of "public utility,"²⁹ up to an

²⁸ Report for 1937, p. 9.

²⁹ In French terminology "public utility" is used in an abstract sense. It is synonymous with "general interest."

amount equal to one-fourth of its own capital and surplus. Although the amount involved is not high, this authorization is interesting as a tendency to increase the role of official institutions even to the neglect of old established banking rules.

The "open-market operations" introduced by the reform of 1937 were considerably extended by a new reform of the Banque Nationale in August 1939. This time the reform was dictated frankly by the necessity of financing the budgetary deficit, which resulted from the economic depression, growing military expenses, and the impossibility of issuing long-term loans. The necessity of a new reform stemmed from the limitations imposed on an open-market policy by the decree of 1937. It was thought at that time that the 500 million limit for treasury notes and one billion for bonds would be quite sufficient for a long time to come. In the middle of 1937 no one could foresee the gravity of the Treasury deficit resulting from depression and military expenditures.

The logical solution would have been to remove limitations on open-market operations completely and to give full discretion to the Banque Nationale. This method would have removed the unfavorable psychological effects produced each time when the maximum had to be raised. And after all, under a gold standard with a minimum gold reserve fixed at 40 per cent, such a measure should have seemed admissible even to advocates of a conservative monetary policy. A solution of this sort was favored strongly in some official quarters. But it was feared that a complete removal of limitations would create a situation where the Treasury could draw too easily on the bank. It was also feared that a

complete removal of limitations on open-market policy would provoke talks about inflation.

Be that as it may, the decree of August 24, 1939, raised the maximum from 1.5 billions to 5 billions for treasury notes and bonds together.³⁰ Henceforth there was to be only one maximum for both kinds of securities. Moreover, the decree repealed the provisions of the previous decree requesting that bonds bought should be at least two years old.

It is worth noting that government bonds held by the Banque Nationale are shown in a special item of the weekly statements of the bank, while the treasury notes are put together with the commercial bills. But the bank publishes a special quarterly statement concerning its holdings of government securities.

In this way we are informed that these holdings amounted to 1,545 millions on August 30, 1939, and to 4,421 millions on March 30, 1940. Then came the invasion. The statutory limitations on the bank's loans to the government were set aside. But this study is not concerned with what has happened since the invasion.

³⁰ Leaving aside bonds held in representation of the capital and surplus and former emergency loans to the State.

CHAPTER VI

DEVELOPMENT OF PUBLIC CREDIT INSTITUTIONS

The idea of credit institutions managed in the "public interest" and disregarding considerations of profit, is not new in Belgium. The Banque Nationale was established in 1850, the Crédit Communal in 1860,¹ the Postal Savings Bank in 1867.² Yet no other organizations of this kind had been established before the First World War.

During the thirties there was a notable increase in the number of public credit institutions and in their influence. Some of these institutions are similar to the independent agencies in the United States. Some of them are owned by shareholders, although the governor or the president, and at times the directors also, are appointed by

¹ The Crédit Communal, although established as a corporation, is actually a kind of co-operative society whose membership includes only provinces and municipalities (communes). It issues bonds whose proceeds are used to grant loans to the members. Its activity has been particularly useful for many small communities.

² The name of this bank is Caisse Générale d'Epargne. In fact, the Post Office is only an agent, collecting and disbursing funds for the account of the Caisse. The Caisse is an independent agency managed by a board whose members are appointed by the King. There are nearly 6 million depositors in a country of 8.5 million inhabitants. But many customers are children whose deposits do not exceed a few francs. In many communities, the parents of each newly born child receive a pass-book in the name of the child with one franc credit. At the eve of the invasion, the amount of deposits was around 13 billion francs. The Caisse invests its funds chiefly in government bonds, but industrial bonds are also purchased. In addition the Caisse grants loans to co-operative societies for agricultural credit and to societies building "cheap" lodgings or making long-term loans for the purchase of such lodgings. These loans are sometimes called "social investments." See below, the role of the Caisse in financing institutions for small business.

the King. All these institutions have been created by special laws and are under official control. In official documents they are generally designated as "credit institutions created or regulated by special laws." Commonly they are called *institutions de crédit*,³ sometimes *institutions parastatales* or *organismes parastataux*. The last two terms sometimes include organizations such as the railway corporation.

The increase in the number of these institutions was due in Belgium as in this country to what H. G. Moulton calls the "shifting balance of power" by which "control of the character of the economic life of the nation has in substantial measure been transferred from private to public hands."⁴ Most of the institutions are engaged in granting special credit facilities to some sections of the population. Two of them have a larger field of activities, the Banque Nationale, dealt with in the preceding chapter, and the I.R.G.

THE INSTITUTE FOR REDISCOUNT AND GUARANTY

The I.R.G. is a product of the 1934-35 banking crisis, which had demonstrated again the difficulty of mobilizing banking assets in very large amounts. It was established by a decree of June 13, 1935, in order to secure the mobilization of banking assets not eligible for rediscount with the Central Bank, to satisfy some special credit needs, "and yet to respect the traditional rules governing the issue of legal fiduciary money."

The I.R.G. was created as "an institution of public utility" but has taken the form of a corporation. The

³ This term consequently does not include the banks governed by the decree of July 9, 1935. See above p. 87.

⁴ H. G. Moulton, *Financial Organization and the Economic System*, p. 483.

capital of 200 millions, 20 per cent of which is paid up, was subscribed by the banks. The liabilities of the Institute are guaranteed by the State. They cannot exceed two billions. Bills endorsed by the Institute may be rediscounted by the Banque Nationale. The I.R.G. is administered by a board of six members appointed by the King. Three of them must be chosen from a list of candidates nominated by the shareholders.

The field of activities of the I.R.G. is not sharply limited. It can virtually discount or rediscount any paper "on short and on middle term." The principal aim of the I.R.G. is to intervene in special circumstances, when a bank must mobilize assets not eligible for discount at the Central Bank. Upon the agreement of the directors, the bank may transfer such assets to the I.R.G. as security for a draft accepted by them. The draft may eventually be discounted with the Banque Nationale. In times of crisis this recourse to the "ultimate lender" is, of course, inevitable. But it was not intended that the I.R.G. should be simply a kind of intermediary between commercial banks and the Central Bank. The Institute obtains funds by itself, chiefly by the issue of notes having 60 to 90 days maturity. They became a preferred short-term investment for banking funds.⁵

Since its inception the I.R.G. has granted loans to several institutions. In addition it has rendered service by granting to banks promises to rediscount eventually their medium-term loans (*overtures de crédit*). The system works as follows. An industrial firm obtains an order for locomotives or machine tools, for

⁵ They are reserved for banks and are issued by competitive bidding. The rate of interest is very low.

instance, which will not be completely fulfilled for some years. The firm will require from its bank a loan (*crédit de fabrication*) which will be repaid only when the goods have been delivered. Before granting such a loan the bank sometimes requires from the I.R.G. a promise to rediscount it eventually. For such a promise a small "commission" is charged.⁶ The I.R.G. also intervened in the liquidation of some banks by granting loans for immediate repayment of deposits, partial or total. At the end of 1939 the amount of loans was 413 millions, of "credits allowed," not utilized, 344 millions.

NATIONAL COMPANY FOR INDUSTRIAL CREDITS

Notwithstanding the close relations between banks and industry, there were before the First World War some complaints about the deficiency of industrial credit. The complaints, it is true, were heard much less in Belgium than in other countries, for instance in France. The problem arose from the difficulties encountered by medium-sized and smaller industrial enterprises in obtaining loans on medium or long terms. The argument was that bigger industrial corporations were able to issue bonds easily or to obtain long-term loan accommodations with the banks. Smaller industrial firms, even if organized as corporations, did not have sufficient standing to issue bonds or to obtain long-term loans from the banks, it was said.

⁶ An *ouverture de crédit* granted by the I.R.G. is a promise of rediscount; consequently, the risk of the loan remains entirely with the lending bank. So, although somewhat similar to, it is in reality different from the "take-out" agreement by which the R.F.C. and other loan agencies take over a portion of the risks resulting from industrial loans granted by commercial banks in the United States. See N. H. Jacoby and R. J. Saulnier, *Term Lending to Business* (1942), pp. 42 ff.

During the First World War a committee, sponsored by the Banque Nationale, worked out a project for the creation of an industrial bank. A bill was introduced in Parliament shortly after the Armistice and became the law of March 19, 1919, by which the Société Nationale de Crédit à l'Industrie (S.N.C.I.) was established as a corporation with a capital of 25 millions subscribed by the Banque Nationale.⁷ The capital was not paid in cash. Instead the Banque Nationale transferred to the S.N.C.I. the "frozen" assets which had resulted from prewar loans. (See above pp. 30 ff.)

The object of the S.N.C.I. is to grant industrial credits on medium and occasionally on long term. It was stressed in 1919, that the Society would provide primarily for medium-sized industrial enterprises. The loans were to be granted only through the agency and with the guaranty of a bank. The Society was authorized to issue bonds and notes guaranteed by the government. Their amount could not exceed ten times the capital and surplus of the Society. During the first years of its existence, the activities of the S.N.C.I. consisted chiefly in granting loans to industrial enterprises whose plants had been injured during the war. For about five or six years the S.N.C.I. was managed by the representatives of the Banque Nationale and could be considered almost as an accessory of it.

In 1926 the S.N.C.I. was reorganized. Its capital which had been raised to 50 millions in 1922 was again raised to 150 millions. A part of the new shares was subscribed by the big "mixed" banks, whose representatives began to dominate the board of the S.N.C.I. The

⁷ The Banque Nationale was not yet allowed to hold securities issued by the public credit corporations. The shares of the S.N.C.I. were therefore distributed to the shareholders of the Banque Nationale as a bonus.

ties with the Banque Nationale were broken. At the same time, the improved budgetary condition of the State allowed for repayment to the S.N.C.I. of advances made for postwar reconstruction. Henceforth it was able to devote itself to industrial credit proper. At the end of 1931 loans granted by the S.N.C.I. amounted to 1,374 million francs. From then on, outstanding loans were reduced regularly, and in 1937 they amounted to only 680 million francs.⁸ In that year the S.N.C.I. was thoroughly reorganized. The aim of the reform was to expand the field of activities of the S.N.C.I. and to bring it more closely under the control of the State.

A new and wider definition of the object pursued by the corporation was adopted. The object now is: "to promote, through credit operations on medium and long-term and subsidiary on short-term, the activity, improvement, transformation and expansion of Belgian industrial and commercial enterprises; especially in assisting the transformation and modernization of plants, development of new fabrications and reorganization of national industries." Since 1937 the S.N.C.I. may grant loans directly. The guaranty of a bank is no longer necessary. Loans may be granted for 10 and exceptionally for 20 years. The amount of the Society's indebtedness may reach 15 times its capital and surplus. The representatives of the banks have been eliminated from the board of directors. The governor is designated by the King, the nine directors are designated by the stockholders, four of them chosen among candidates nominated by other official credit institutions.

Principal items of the balance sheet of December 31, 1938, were: Assets: loans, 899 millions; government

⁸ This refers to normal loans. For the special emergency loans granted in 1934-35 and transferred to the O.L.I.C. in 1936, see above pp. 78, 81.

bonds, 185 millions; liabilities: debentures and notes, 858 millions; paid-in capital, 175 millions; surplus, 36 millions. (In 1934 subscribed capital was increased to 205 millions by a transfer of 55 millions from surplus.)

Most of the loans are granted to heavy industries. Coal mines and allied industries absorbed 32.9 per cent of the loans, metallurgy 16.3 per cent, railways, public works, and construction industries 15.4 per cent. The S.N.C.I. rendered important services, but did not benefit especially small- or medium-sized enterprises.

CREDIT GUARANTY FOR EXPORT TRADE

Financing foreign trade is closely connected with the problem of industrial credit. For Belgium the problem is particularly important because of the significance of exports for the whole economy. For many years it was believed in Belgium, that the principal defect of Belgian banking organization was the lack of special facilities for export trade.* In England and in Germany such facilities were often granted by banks with branches abroad. Belgian banks had no branches abroad and only in the last years before the First World War, two banks especially interested in foreign trade began to expand. These were the Banque Belge pour l'Etranger (affiliated with the Société Générale) with some connections in the Far East and the Banque Italo-Belge with connections in South America.

After the First World War, foreign markets were disorganized. Moreover, many orders arrived not from foreign business firms but from foreign governments.

* The writer has devoted a special study to this problem: "Le Financement de l'Exportation en Belgique," *Bulletin de la Banque Nationale*, November 1938.

Export credits implied not only ordinary risks but also those of exchange fluctuations and political hazards as well. England was the first country to establish a scheme of government guaranty against credit risks related to exports. When the crisis of 1920-21 brought about large unemployment in Belgium, the government decided to follow the British example. The law of August 7, 1921 established the Commission du Ducroire (Committee for Guaranty). It was a departmental committee whose function was to grant exporters a government guaranty for their claims on foreign debtors. But the guaranty could not exceed 55 per cent of the claim. At least 20 per cent had to be guaranteed by a banker, the debt had to be contracted in francs, and the debtor had to accept bills drawn upon him. These conditions prevented any utilization of the official scheme by exporters, because at this time contracts in international trade were stipulated almost exclusively in sterling or in dollars. Moreover, it is not the business of bankers to guarantee the solvency of a foreign firm. Furthermore, governments or public administrations generally do not accept bills drawn on them. Besides, each operation had to be approved by royal decree. Not only were these formalities very bothersome, but the public character of royal decrees prevented many firms from claiming the benefits of the scheme.

Gradually, a certain number of laws and decrees modified completely the working of the scheme. It is now administered by the Office National du Ducroire, an *autonomous* agency whose board is designated by the government.

The banking guaranty for a part of the risk is no longer necessary. The government guaranty may cover

75 per cent of the *final* loss. But the risk of the exporter must exceed the profit expected from the transaction. Accordingly, the exporter must bear a risk equal to at least 20 per cent of the *initial* amount involved. In other words the government guaranty is suspended when the exporter has received 80 per cent of the value of the export. The plan now provides two kinds of risks. Risks "A" relate to goods sold to foreign governments or public administrations. They are guaranteed by the Office. Risks "B" relate to ordinary commercial transactions. They are left to credit insurance companies but may be reinsured partly or wholly by the Office.

From the inception of the scheme to December 31, 1938, 975 millions out of 1,717 million francs of exports under this scheme were covered by the government guaranty. At that time, 248 millions of risks "A" and 13 millions of risks "B" were still covered by the guaranty. As in the case of the S.N.C.I. loans, the heavy industries were the principal benefactors. More than 60 per cent of the exports involved consists of deliveries for railways, more than 20 per cent of materials for construction, and only about 15 per cent of products of textile industries. The government had not yet had to pay compensations for guaranteed risks. However, some important foreign debtors have not been paying their debts. It is likely that the government will have to pay rather large compensations in settlement of these bad risks.

The law introducing the scheme of government guaranty was enacted in 1921 for a five-year period. It was hoped at the time, that the scheme would be liquidated after the crisis had passed. It was renewed for five years in 1926 and again in 1931. In 1932 the plan

was made permanent. The "crisis measure" became a lasting institution.

LOANS FOR SMALL BUSINESS

In French-speaking and some other European countries the term "middle classes" is used instead of small business. The problem is concerned chiefly with *lower* middle classes and the American term is much more convenient than the European. It is difficult for craftsmen and tradesmen to obtain loans from ordinary banking institutions. Their debtors are generally the ultimate consumers against whom they cannot draft a bill. Their bookkeeping is often rudimentary. For ordinary banking institutions such customers do not offer enough security, and overhead expenses are large. During the second half of the past century, many attempts were made to establish mutual or co-operative credit institutions, generally called "popular banks." Nearly all attempts failed.¹⁰

After the First World War most European governments gave much attention to the problem of credit for small business. There were economic as well as political reasons for this consideration. Economically the movement of industrial and commercial concentration rendered the position of small business more difficult. Politically many statesmen came to the conclusion that the maintenance of a numerous and prosperous middle class was a condition of social stability. On the other hand, political parties, conservatives as well as socialists,

¹⁰ In French terminology "popular banks" is used only for urban credit institutions (*crédit populaire urbain*) to which this section is devoted. Whereas urban mutual credit institutions generally failed, the rural credit co-operatives had great success in most European countries. The difference comes not only from the dissimilarity of economic conditions but also of social structure and of social habits in town and village.

wished to obtain the support of the middle class at the elections.

At the time of the invasion, in 1940, there were in Belgium three organizations devoted to "credit for middle classes." Two served the necessities of very small business, the third provided credit for more important enterprises. The last mentioned organization will be discussed first.

1. *Caisse Nationale de Crédit pour les Classes Moyennes*. The "National fund of Credit for middle classes" was established in 1937 and succeeded a temporary fund created in 1934. It is another example of a "crisis measure" leading to a permanent institution. Its purpose is to grant loans to "medium and small enterprises." Loans may be granted (a) directly, (b) through the intermediary of special companies, (c) through the intermediary of branches of the Banque Nationale. The Caisse has a capital of 50 millions, 35 millions subscribed by the State and 15 millions by the Postal Savings Bank. The Caisse may issue bonds up to an amount of 350 millions. Such bonds are guaranteed by the State. It is administered by a board of directors appointed by the King. Up to the end of 1939, loans had been granted to 1,172 individuals. They amounted to 255 millions. The average loan per debtor was 217,500 francs, a relatively large amount.

2. *Caisse Centrale du Petit Crédit Professionnel*. The Central Caisse for small professional¹¹ credits was established in 1929 for the purpose of granting loans to craftsmen and small traders. Loans are granted only through the intermediary of local or regional co-opera-

¹¹ "Profession" does not have the same meaning in French as in English. It simply means occupation or job.

tive credit associations, which are supervised by the Central Caisse. The State has granted to the Caisse an endowment of 50 millions. The Caisse may also re-discount paper with the Postal Savings Bank, under the guaranty of the State, up to an amount of 150 millions. It is administered by three directors appointed by the King. At the end of 1938, there were about 50 credit associations through which the Caisse since its inception granted 11,250 loans for an amount of 291 millions. The average loan is 25,883 francs, a relatively moderate figure. The amount outstanding was 103 millions.

3. *Crédit à l'outillage artisanal*. This institution (credit for craftsmen's equipment) designed to grant loans to aid in the modernization of the equipment of small workshops, was established in 1929. There is no special staff. The State simply has given a guaranty to the Postal Savings Bank for loans of this type up to an amount of 75 millions. The loans can be granted only through the intermediary of a local co-operative society. Each society must be affiliated with a federal society created on a regional or trade basis and approved by royal decree. No loan may exceed four-fifths of the price paid for the equipment. The duration of the loans, repaid by annuities, is generally five years. There are now five federations with 66 affiliated local societies. To the end of 1937, 3,124 loans were granted amounting to 49,733,000 francs.

The importance attached by the government to the credit institutions for small business has also led to the creation by a royal decree dated October 14, 1937, of a "Council for Coordination of the Middle Class Credit Institutions." The Council includes two representatives of each of the three institutions, and one representative

each of the Banque Nationale, the Postal Savings Bank, and the Central Office for Mortgage Credit.¹²

CENTRAL OFFICE FOR MORTGAGE CREDIT

This institution (Office Central du Crédit Hypothécaire) may be considered as belonging to the group of "middle class organizations," because its activities should be particularly useful for men of little means. Established by the decrees of January 7, 1936 and of October 14, 1937, this office is to regularize the market of mortgage loans for housing. Its main function is to work for a reduction in the rate of interest. It may grant loans itself in limited amounts, but it acts chiefly as intermediary by assisting debtors who borrowed at high rates of interest and who wish to obtain cheaper loans. It may also rediscount mortgage credits extended by financial institutions. The work of this institution was hampered by the financial instability of 1938-39 and its activities did not expand much when the war broke out.

THE NATIONAL INSTITUTE FOR AGRICULTURAL CREDIT

Established by decree of September 30, 1937, this organization was also hampered by the uncertainties of

¹² Two other organizations are intended to provide loans of a special kind for lower middle and working classes. The Société Nationale des Habitations et Logements à bon marché (national corporation for cheap lodgings) was established by law in 1919. Its object is promoting construction of family houses and apartment buildings for people with small means. By issuing bonds the corporation obtains necessary funds, which are lent to affiliated co-operative societies at low rates. The difference between the rates is supported by the State. About 300 co-operative societies are affiliated with the national corporation.

The Société Nationale de la Petite Propriété Terrienne (national corporation for small agricultural property) was established by a royal decree of February 1935 in the midst of the financial crisis. The aim is to promote small land ownership, particularly to aid the "coming back to the land" (retour à la terre) of unemployed or other people from industrial areas. The activity of this corporation is on a very small scale.

the political and financial situation. It has received an endowment of 30 millions, furnished half by the State and half by the Postal Savings Bank. Similar to the Central Office for Mortgage Credit, its purpose is not so much to extend new loans as to facilitate the activities of existing institutions.

The preceding discussion has shown how rapid the development of official credit institutions since 1935 has been. A royal decree of October 22, 1937, established a "Council for Credit Institutions" with the purpose of co-ordinating their activities. The Council includes representatives of the Banque Nationale, the Postal Savings Bank, the National Society for Industrial Credit (S.N.C.I.), the Institute for Rediscount and Guaranty (I.R.G.), the Office National du Ducreire (Export Credits), the National Institute for Agricultural Credit, the Council of Middle Class Credit Institutions, and the O.L.I.C.

The expansion of public credit institutions was only in its first phase when the invasion of 1940 occurred. Hence the results of this movement cannot be analyzed, though it is worth-while to describe it.

PART II
BANKING THEORY IN THE LIGHT OF
BELGIAN EXPERIENCE

CHAPTER VII

SIGNIFICANCE OF BANKING IN ECONOMIC LIFE

So long as credit operations related only to selling goods on a time payment basis, or of lending metallic money, no important theoretical issues presented themselves. The basic issues as to the significance of credit and banking arose only when credit operations took the form of the issuance of bank notes and the creation of deposit accounts, which increased the quantity of the circulating medium.

The classical theory of money and credit was formulated chiefly as a reaction against the exaggerations of some mercantilist writers. Consciously or unconsciously, those who formulated the theory were also influenced by the failure of John Law's credit inflation boom. One of the primary purposes, particularly in the writings of David Hume and Adam Smith, was to dissipate confusion between *money* and *capital*. The result was a tendency to minimize the importance of money—to overlook its dynamic aspects.

In order to destroy the mercantilists' concept, the founders of the classical school laid stress on the quantitative theory of money. Locke and Hume, particularly, reasoned along this line: since the value of money depends on its quantity, the possession of a larger or smaller stock of money is of no significance for a given country.¹ They considered money as a simple tool with-

¹ "If we consider any one Kingdom by itself, it is evident that the greater or less plenty of money is of no consequence, since the prices of commodities are always proportioned to the plenty of money." David Hume, "Of Money," *Essays, Moral, Political, and Literary*,

out repercussions on the working of the economic system.²

Classical economists based their analysis essentially on a barter economy in a state of equilibrium; money was for them a "veil" hiding true relationships between goods and incomes. Finally, the classical conception finds its fullest expression in the famous statement of J. S. Mill, "There cannot in short be intrinsically a more insignificant thing in the economy of society than money."³

T. H. Green and T. H. Grose, eds. (1912), Vol. 1, p. 309.

"Money having chiefly a fictitious value, the greater or less plenty of it is of no consequence if we consider a nation within itself." "Of Interest," Vol. 1, p. 321.

² Yet David Hume, who, in the question of money, was the spiritual father of Smith and of the whole classical school, wrote some sentences in which he stated that *an increase* in the quantity of money can be conducive to an increase in production. "In every kingdom," he wrote, "into which money begins to flow in greater abundance than formerly, everything takes a new face; labour and industry gain life; the merchant becomes more enterprising, the manufacturer more diligent and skilful, and even the farmer follows his plough with greater alacrity and attention. . . . To account for this phenomenon we must consider that though the high price of commodities be a necessary consequence of the increase of gold and silver, yet it follows not immediately upon that increase. . . . When any quantity of money is imported into a nation . . . it is confined to the coffers of a few persons, who immediately seek to employ it to advantage. . . . They are thereby enabled to employ more workmen than formerly, who never dream of demanding higher wages. . . . If workmen become scarce, the manufacturer gives higher wages, but at first requires an increase of labour. . . . The farmer and gardener, finding that all their commodities are taken off, apply themselves with alacrity to the raising more . . ." And Hume concludes: "It is of no manner of consequence, with regard to the domestic happiness of a state, whether money be in a greater or less quantity. The good policy of the magistrate consists only in keeping it, if possible, still increasing; because by that means he keeps alive a spirit of industry in the nation and increases the stock of labour, in which consists all real power and riches." *Essays, Moral, Political, and Literary*, Vol. 1, pp. 313 ff. These considerations could have served as a starting point for an analysis of the role of banking. But they were either overlooked by the classical school, or dismissed summarily, as by J. S. Mill, for instance, *Principles*, 1929 ed.; p. 551.

³ *Principles*, p. 488. A few pages later he writes: ". . . if the whole

The classical school viewed credit and banking as of minor economic importance. In their conception banking was a purely technical device to supersede metallic money by a more convenient circulating medium, without bearing on the expansion of capital.

Adam Smith summed up his theory of banking in the famous sentence: "It is not by augmenting the capital of a country, but by rendering a greater part of that capital active and productive than would otherwise be so, that the most judicious operations of banking can increase the industry of the country."⁴ In the following lines of the same paragraph Smith defines banking operations as "substituting paper in the room of a great part of . . . gold and silver," this "very valuable part of the capital of the country, which produces nothing to the country." Banking operations liberate a part of the metallic stock which can be exported in exchange for "an additional stock of materials, tools and provisions in order to maintain and employ an additional number of industrious people," as Smith explains elsewhere.⁵

In Smith's opinion the only advantage of banking is that it permits the export of a substantial part of the metallic currency. He did not and could not well go farther, as he witnessed only the very beginnings of banking expansion and of modern industry. From a practical point of view Smith attributes to banking an extremely important role. This is rather surprising, considering his theoretical views. He stresses the importance

circulation of money was doubled, prices would be doubled." (p. 492.) He notes incidentally that average "general prices" would be doubled, some could perhaps rise more, others less. But he does not draw any conclusion from this statement.

⁴ Adam Smith, *Wealth of Nations*, Edwin Cannan, ed. (1922), Vol. 1, p. 303.

⁵ The same, Vol. 1, p. 277.

of banking institutions in speaking of Scotland,⁶ but his most interesting considerations about the practical effect of banks are to be found not in his fundamental work but in his lectures delivered in 1763. "We find," he says, "that the commerce of every nation in Europe has been prodigiously increased by the erection of banks. In this country everybody is sensible of their good effects and our American colonies, where most of the commerce is carried on by paper circulation, are in a most flourishing condition." And yet nobody could pretend that in the American colonies at least, paper money simply took the place of exported coin.

It is worth-while to note that Hume, who gave so detailed an account of the "favorable" effects exercised on industry by an increase in the quantity of money, nevertheless "entertains a doubt concerning the benefit of banks and paper credit which are so generally esteemed advantageous to every nation."⁷ On the contrary, Adam Smith, who completely disregarded Hume's analysis of the beneficial effects resulting from a steady increase in the quantity of money, attaches, nevertheless, considerable importance to the "erection of banks," and the use of "paper circulation."

Nevertheless, Smith's judgment of banking as not "augmenting the capital of the country" became a credo for the whole classical literature from the end of the eighteenth century. Here again the classical theory finds its fullest expression in a statement of Mill: "Credit being only a permission to use the capital of another person, the means of production cannot be increased by

⁶ The same, Vol. 1, p. 280.

⁷ *Lectures on Justice, Police, Revenue and Arms*, Edwin Cannan, ed. (1896), p. 192.

⁸ *Essays*, Vol. 1, p. 311.

it, but only transferred."⁹

The same idea was stressed by most writers for well over a century. To quote only one economist, writing at the beginning of the twentieth century: "This is the cardinal fact to be kept in view in following the tortuous course of credit through its manifold forms—that physical capital cannot be increased by issuing documents against it, or by exchanging those documents one against another."¹⁰

The major defect of the classical theory was, or is, that it neglects the special character of credit resulting from banking activities. Because of this, the theory was not able to give a realistic explanation of the role of banking. In most nineteenth century handbooks of economics it was explained at length that the banker is an intermediary; he lends funds—or capital—entrusted to him by depositors or by note-holders. Sometimes it is added that he is instrumental in the transfer of *saved* funds, thus neglecting completely the difference between savings and commercial (or rather issue and deposit) banks. It is often added also that by the action of banks the use of capital is transferred from less efficient owners to more efficient borrowers. Sometimes the word "funds" is used and sometimes "capital," but it is always implied that the depositor entrusts the bank with the result of his previous savings, thereby relinquishing the use of some capital. The precise meaning of capital generally does not appear from the context.¹¹

⁹ *Principles*, p. 511.

¹⁰ Charles A. Conant, *Principles of Banking* (1906), p. 12.

¹¹ Only a few quotations will be given here by way of illustration. Credit is "a transfer of already existing capital; the person, for instance, who accepts a bank note for payment loans a part of his capital to the bank." William Roscher, *Principles of Political Economy*, English translation, (1878), p. 269 n. 2. "Banks become real reservoirs of

But such implications do not correspond at all to what is really happening in a developed banking system. Only to a limited extent do the deposits of commercial banks come from the previous savings of depositors. Most of these deposits result from the lending operations of banks themselves. In no way is the depositor or note-holder relinquishing the use of some real capital. Moreover, the study of economic history reveals that banking activities result in an increase of the whole real capital of a country and not merely in the transfer of the use of existing capital.

Some nineteenth century writers took account of banking money merely by integrating it in the quantitative formula. The oldest formulations of the quantity theory had in view only metallic money. More modern theorists simply considered bank notes and deposits as a part of the money in circulation. But the dynamic aspect of the problem, the fact that the flow of new money generally has some influence on the production of goods, pointed out incidentally by Hume, was neglected by most writers.

capital . . . which receive in one place the capital which is superfluous elsewhere, in order to supply some other place with that which is necessary to it." The same, p. 273.

"Bankers borrow in order to lend again. . . . Trade in capital would be impossible without the assistance of intermediaries called banks." Charles Gide, *Principles of Political Economy*, English translation (1924), p. 289.

The banking system "enables capital to be transferred from those persons by whom, and from those places where, it is not required for active use to those requiring it." *Palgrave's Dictionary of Political Economy*, Henry Higgs, Ed. (1925), Vol. 1, p. 92.

"An issue bank is an establishment which has its own capital, and which by notes, by deposits, and also by bonds seeks to attract other capital, often many times as big as its own; it loans the major part of the whole capital for fixed maturities, whereas its own capital cannot be claimed, but the capital of others can be claimed mostly on shorter maturities." G. Schmoller, *Gründriss der Allgemeinen Volkswirtschaftslehre*, (1919), Vol. 2, p. 246.

The classical theory originated in a period when formation of capital was very slow, in a country where manufactures were beginning to expand but when the rest of the world was predominantly in the agricultural stage. The classical economists implied that the factors of production, particularly the scarce capital goods, were fully employed. Although their reasoning often began with "in the long run," they conceived nevertheless chiefly a static society. After all they could not foresee the rapidly expanding and changing society of the nineteenth and twentieth centuries. But their ideas continued to prevail even when circumstances changed profoundly. It is one of the examples of theories formulated in given circumstances and held over even after the circumstances have changed.¹²

Very early, about the beginning of the past century, some writers observed the inadequacy of the classical theory. They noted that the expansion of banking money (notes or deposits) brought about by loans to traders and manufacturers results in an accretion to their funds. These are used mostly to build new plants and equipment. Hence a greater proportion of existing equipment, materials, and labor are devoted to production of capital goods. But, those writers held, the increase in prices, resulting from the inflow of new money, reduces the consumption by people with inelastic incomes. Thus credit expansion, by modifying the allocation of existing productive capacities, results in an increase of real capital. But such increase is possible only because some factors of production are diverted from production

¹² "Although the necessity of a flexible and evolutionary thought is particularly necessary in economics—in view of the changing character of the economic system—the tendency to adhere steadfastly to the principles laid down by our predecessors is, I believe, particularly marked." H. G. Moulton, "Scientific Method in the Investigation of Economic Problems," *The Scientific Monthly*, March 1936, p. 219.

of consumer goods to production of capital goods. The "forced frugality" as Bentham called it, resulting from the rise of prices, is the actual source of new capital.

This concept was more or less included in the writings of Thorton and Malthus, and was clearly developed by Bentham and Walras. Even Mill incidentally conceded it as a "corrective though a very slight one" in a footnote added in 1865 to the second sentence quoted above. But generally the authors did not dwell upon this concept. It was, moreover, disregarded by contemporaneous economic theory and was almost forgotten until recently.²³

Newer theories give a significant place to bank credit in the formation of capital. The inadequacy of the classical concept of banking finally became evident. Since the beginning of this century, the accumulation of data, the

²³ See F. von Hayek, "A note on the development of the doctrine of 'forced savings,'" *Quarterly Journal of Economics*, November 1932, reproduced in *Profits, Interest and Investment* (1939). See also E. Whittaker, *A History of Economic Ideas* (1940), pp. 695 ff; J. Viner, *Studies in the Theory of International Trade* (1937), pp. 187 ff. The only heretic of the nineteenth century whose ideas were not completely overlooked was H. D. Macleod. The chief aim of his numerous writings was to prove that "credit is capital," an "addition to existing capital." Although he made some very close and refined theoretical analyses, his general theory of credit was weak. His reasoning in this matter was based chiefly on a confused use of the term "capital," which is defined as anything producing a profit. Hence liquid funds were included in the category, and also credit. Macleod's writings aroused real enthusiasm in some circles where his theory "credit is capital" was hailed as revolutionary. On the other hand, the academic economists either disregarded him completely or—notwithstanding the cautiousness of his conclusions—treated him as an illusionist somewhat comparable to Law. Macleod is an example of those writers who do not lack intellectual vigor or knowledge, but who by confused arguments, by numerous repetitions, also by some degree of egotism, discredit an interesting idea. In spite of the real importance of some sections of his writings, Macleod on the whole tended to discredit any non-orthodox approach to credit theory, rather than to arouse interest in new methods of thinking.

propensity for closer theoretical analysis, and also the study of cyclical fluctuations, resulted in a re-examination of the significance of banking credit. The idea of credit expansion as modifying the allocation of productive resources has been resuscitated and developed. It appears that the idea has been revived independently by several economists (Taussig, Schumpeter, Wicksell) at almost the same time. The "forced frugality" of Bentham has become the "forced savings" of contemporary writers.

The idea is presented now with much more refinement. The method of presentation is not always the same. Yet the main points of the reasoning follow the same lines as the ideas of Bentham and Walras summarized above: the creation of banking credit lowers the rate of interest,¹⁴ businessmen avail themselves of the opportunity, and, with funds obtained from banks, they make new investments. But such investments are possible only because factors of production are diverted from industries producing consumer goods. The consumption of these goods is decreased because of the rise in prices resulting from the expansion of money. Consequently, there is an increase of real capital but it results from a reduction in consumption forced on the public by the rise of prices. The new capital is produced

¹⁴ Generally it is said that the interest rate is falling below the "natural rate" or below the "equilibrium rate." Sometimes, not always, these terms are used in the same meaning. But the definitions differ. J. N. Halm, *Monetary Theory* (1942), p. 205, lists the following alternate definitions given by Wicksell: the natural rate of interest is the rate: (1) "at which the demand for loan capital and the supply of savings exactly agree," (2) "which more or less corresponds to the expected yield of the newly created capital," (3) "at which the general level of commodity prices has no tendency to move upward or downward," (4) "which would be established if one would not make use of monetary transactions but real capital would be loaned *in natura*."

by a "forced levy operated through credit creation."¹⁵ It results from "savings" "done under duress."¹⁶

The fundamental assumption of this theory, explicitly stated by some writers—particularly by Wicksell and von Hayek—is that normally the economy is in a state of full employment. Hence the credit expansion can only divert the factors of production from some activities to other channels: the increase in production of capital goods may occur only at the expense of the production of consumers goods.¹⁷

The theory of forced savings holds only if and when the fundamental assumption—full employment—is correct. It follows that the theory of forced savings can not be termed false. It is correct within the limits of the given assumption. But it is incomplete for several reasons. First, account must be taken of depressions, when factors of production are only partly employed. Second, even in "normal" times, at least in recent decades, there has not always been full employment.¹⁸ Last—and historically this is perhaps the most important consideration—the conception of full employment is far from being as clear and simple as it seems at first glance. Even when there is, or seems to be, full employment, an increase

¹⁵ A. C. Pigou, *Industrial Fluctuations* (1927), p. 132. Some of the exponents of the theory, particularly von Hayek, see in this "artificial" diversion of factors of production the main cause of business cycles. But we cannot here deal with this aspect of the question.

¹⁶ D. H. Robertson, *Money* (1929), p. 99.

¹⁷ Yet Wicksell grants that "it is, of course, not impossible for the rise in prices to be counteracted to a certain extent by an increase in production, for example if previously there had been unemployment, or if higher wages had induced longer working hours, or even by the increasing roundaboutness which is undoubtedly invoked by a fall in interest rates, even if it occurs artificially." But in his opinion "all these are secondary considerations." *Lectures on Political Economy* (1935), Vol. 2, p. 195.

¹⁸ See E. G. Nourse and associates, *America's Capacity to Produce* (1934).

in the formation of real capital—without reduction of consumption—is often possible, by a different allocation of factors of production. This is the mechanism which operated in many countries during the transition from a purely agricultural state to an industrial or rather a complex state. And historical evidence shows that credit expansion has played a role in such development.

A new and broader approach to the problem was developed in 1918 in an article by Harold G. Moulton.¹⁹ His reasoning is based chiefly on an analysis of the evolution of the American economy, principally since the Civil War, and on a close examination of banking practices. He noted that during an extended part of the nineteenth century economic expansion in the United States had been largely supported by banking funds, and that contrary to the prevalent opinion a very important part of these funds was used not for circulating capital but for investment purposes.²⁰ On the other hand, Moulton notes that during periods of economic expansion the increase of production is not only in capital goods but also in consumption goods. It can not be held, consequently, that an increase in the production of capital goods must occur at the expense of the production of consumer goods. Moulton concludes, then, that the prevailing conception according to which capital expansion (that is, an increase in production of real capital goods) must necessarily be based on *previous* savings, has no foundation. In periods of expansion the progress in productivity is such as to provide for an increase both

¹⁹ "Commercial Banking and Credit Formation," *Journal of Political Economy*, Vol. 26. These ideas were subsequently amplified in *The Formation of Capital* (1935) and *Capital Expansion, Employment and Economic Stability* (1940).

²⁰ This point will be stressed in the next chapter.

in capital goods and in consumption goods.²¹ The role of credit is to allow businessmen to use productive capacities which otherwise would not have been used, or used much less regularly and completely. It has been said, in objection to the foregoing conception, that real capital can not originate "from nothing." Such a thing was never contended. New capital results from the use of materials, land, and labor; the role of banking credit is only to bring into action a mechanism by which the use of these factors is intensified.²²

As long as there are unused factors of production, or as long as existing factors may be used more intensively, there is theoretically a possibility of increasing the output of capital goods without decreasing the production of consumption goods.²³ The banking organization has

²¹ "The formation of capital is accompanied by a virtually concurrent expansion in the production of consumption goods. The traditional theory . . . that the process of capital formation necessarily involves the curtailment of consumption and the transfer of labor and materials from production of consumption goods to the creation of capital goods—finds no support whatever in the facts of our industrial history. The process involves rather a larger utilization of our productive energy at certain periods when an expansion occurs in the output of both capital and consumption goods and then a smaller utilization of our productive energy when the construction of both capital and consumption goods is declining." *The Formation of Capital*, pp. 47 ff.

²² See also J. M. Clark's adherence to Moulton's view *Strategic Factors in Business Cycles* (1934), p. 192: "The elasticity of credit undoubtedly facilitates and speeds the process of capital accumulation by enabling business to secure and spend at any time larger amounts of capital funds than have been furnished for the purpose by prior savings. The ultimate savings can, in a real sense, be furnished later, out of the increased productivity of the processes themselves."

²³ See Moulton's analysis of von Hayek's views, in *The Formation of Capital*, pp. 164-66; J. M. Keynes, *General Theory of Employment, Interest, and Money* (1936), pp. 79 ff., also objects to the use of the term "forced savings" except in a state of full employment. Keynes points out rightly that when Bentham formulated the idea of "forced frugality" he had in mind, as he expressly stated, the consequences of an increase in the quantity of money (relatively to the quantity of things purchasable with money) in circumstances of "all hands being employed and employed in the most advantageous manner."

often been the agent which put these unutilized forces in action. As pointed out above, this mechanism was particularly instrumental in periods of rapid industrialization resulting in intensive capital formation.

It is true that credit expansion can also have detrimental effects. There is no doubt, for instance, that credit expansion contributed largely to the irregularity of business activity, as displayed chiefly by business cycles. It can be argued also that banking credit was an important factor in promoting business concentration. We are not concerned here with those aspects of the problem, inasmuch as they relate to economic policy rather than to banking theory, which is our subject.

Modern theory arrives then at a conclusion similar to that indicated in a confused manner by some older writers, who insisted on the productivity of bank credit. There are, however, two important differences in the older and the newer methods of analysis. The older writers concluded that credit was productive either by confounding money with real capital or by using the term capital in a confused manner. Such confusions are avoided now; the productivity of credit is derived from an analysis of the mechanism by which funds created by banks react on the economic process. Second, present-day theory takes account of the limitations of the possible action of credit expansion on capital formation. Credit expansion may give results only if there are prerequisite conditions: available labor, some degree of skill, available land or raw materials, and an adequate social organization.

The analysis of limitations to the productive effects of credit policy is essential from the point of view of banking policy. The most important of these limitations may result from several factors: (1) a state of full

employment, or of full employment of some factors (of some categories of workers, for instance); (2) the position of the country in the world economy. An expansionist credit policy is more likely to bear results in a large self-supporting, or nearly self-supporting, country than in a country depending upon the world market, especially when it is a small country; (3) the reaction of credit expansion on other component parts of the economic situation, for instance, expansion of central bank credit may arouse fears of "inflation" and upset the normal functioning of the financial system; (4) the absence of an inducement to use the funds resulting from credit expansion. This is the principal difficulty encountered by the credit policy in periods of depression. Businessmen do not use the available funds, as there is no expectation of a profit from their use.

A detailed discussion of these limitations is beyond the scope of this study. They are rather problems of practical banking policy and can be judged only in given concrete circumstances. Here we are concerned only with the general theoretical problem. In Chapter IX some phases of Belgian banking history will be recalled in order to illustrate the foregoing conclusions.

CHAPTER VIII

LIQUIDITY AND SHIFTABILITY THEORIES OF BANKING

The discussion in the preceding chapter centered upon the general *theory* of banking credit and its bearing on production. This chapter is devoted to a discussion of the principles of banking *policy*. Again, it is necessary to recapitulate briefly the evolution of the so-called principles of banking management.

Most of the earlier writers on financial problems looked upon bankers as mere exchange dealers. The reason was that prior to the eighteenth century—on the Continent even until the nineteenth century—dealing in exchange, or, more precisely, making remittances between cities, was the principal business of bankers.¹

The classical theory of banking policy emphasized the maintenance of liquidity by means of short-term commercial loans. Adam Smith was the first to scrutinize the principles which should govern banking loans, and to formulate what became the classical theory of banking policy, known also as the liquidity theory of banking. His fundamental principle concerning banking policy is contained in the following excerpt:

What a bank can with propriety advance to a merchant or undertaker of any kind, is not either the whole capital with which he trades or even any considerable part of that capital;

¹ In 1759 a French writer defined banking as "a traffic in money which is remitted from one city to another by correspondents and by means of bills of exchanges." Savary des Brusselons, *Dictionnaire du Commerce*, Vol. I, p. 328. "The banker's business is to change not to lend money," wrote Montesquieu, *Spirit of Laws*, Book 22, Chap. 16. See the author's study "Les débuts du Crédit Industriel Moderne," *Revue de l'Institut de Sociologie* (Brussels 1929).

but that part of it only which he would otherwise be obliged to keep by him unemployed, and in ready money for answering occasional demands. If the paper money which the bank advances never exceeds this value; it can never exceed the value of the gold and silver which would necessarily circulate in the country if there was no paper money. . . . When a bank discounts to a merchant a real bill of exchange drawn by a real creditor upon a real debtor; it only advances to him a part of the value which he would otherwise be obliged to keep by him unemployed and in ready money for answering occasional demands.

And he concludes:

Payment of the [discounted] bill, when it becomes due, replaces to the bank the value of what had been advanced, together with the interest. The coffers of the bank, so far as dealings are confined to such customers, resemble a water pond, from which though a stream is continually running out, yet another is continually running in, fully equal to that which runs out; so that, without any further care or attention, the pond keeps always equally, or very near equally full.²

Smith's principle of practical banking is thus related to his general theory of banking: bankers should issue

² *Wealth of Nations*, Vol. I. p. 287. The words "without care or attention" are not merely a rhetorical figure. Adam Smith actually believed that the banking business, if conducted on the above-mentioned principle, may become a matter of simple routine. In another part of his book he expresses his well-known skeptical opinion about joint stock companies, or corporations as they are designated in the United States. "The directors of stock companies," he writes, "being the managers rather of other people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own." (Vol. II, p. 233). And he concludes: "The only trades which it seems possible for a joint stock company to carry on successfully, without an exclusive privilege, are those of which all the operations are capable of being reduced to what is called a routine, or to such a uniformity of method as admits of little or no variation. Of this kind is, first the banking trade. . . ." (Vol. II, p. 246).

notes only in so far as they take the place of coin which otherwise would be kept by traders and manufacturers. The practical criterion suggested by Adam Smith is that bankers should grant loans only by way of discounting short-term "self-liquidating" bills of exchange arising from commercial transactions.³

Among the successors of Adam Smith it was probably J. B. Say who expressed in the most extreme manner the idea of self-liquidity. In his opinion, an issue bank could eventually reimburse all its notes provided the discounted paper "should come from solvent people and its maturity should not be too remote." "In order to reimburse all of its notes," he writes, "a bank has simply to stop issuing new notes; in other words, stop discounting and wait until the bills discounted mature. These bills will be paid either in coin or in notes. In the first case the bank obtains funds to reimburse the notes, in the second case no reimbursement is necessary."⁴

The same idea was expressed by Count Mollien, the finance minister of Napoleon I. For him the fundamental principle was that a bank must discount only true bills of exchange. "No bank can fail if it remains faithful to this duty." What is a true bill of exchange? A bill which "represents products of labor required by consumers and which will be paid by their income"; or a bill "guaranteed by *values stored* and required by

³ Smith admits, it is true, and even praises the technique of cash advances, without discounting. But these advances must be based on the same principle; in the course of "some short period" the repayments of the customer must be fully equal to amounts borrowed by him. (Vol. I, p. 288). In other terms the customer must use borrowed funds only for short-term, self-liquidating operations.

⁴ *Traité d'Economie Politique*, 6th ed. (1841), p. 307.

consumers."⁵ The products back of the bills were evidently considered as a *specific* security.⁶

The writers just quoted have contributed most to the popularization of the liquidity principle on the Continent. The discounting of self-liquidating commercial paper as the essential function of bankers became the fundamental principle of banking theory.

The theory of liquidity became the guiding principle of most banking legislation during the nineteenth century. The principle of "commercial covering" became the fundamental role of continental acts regulating issue banks, of which the Belgian law of 1850 is one of the most characteristic.⁷ It meant that, apart from the metallic reserves, the assets of issue banks must consist exclusively—or almost exclusively—of discounted short-term self-liquidating bills. The result was exclusion of industrial loans as well as corporate securities of all kinds, and also rigid limitation on the admission of government bonds to portfolios of the issue banks.

The foregoing concerns only note issue banking, as deposit banking in Europe was not regulated by law before the First World War except in one or two countries. In the United States the framers of the National Bank Act, passed in 1863, were not primarily concerned about the problem of liquidity, although they had this

⁵ *Mémoires d'un Ministre du Trésor Public* (1845), Vol. 1, pp. 450, 457, 458. The same idea is reproduced in Vol. 3, p. 150. These ideas were expressed in memoranda handed by Mollien to Napoleon I.

⁶ The same idea was expressed later on by P. J. Proudhon, in a famous sentence, when he said that the bills of exchange represent a "valeur faite" (which could be translated "performed value"). He implied that the money received from the selling of goods against which the bills were drawn was used to reimburse the banker.

⁷ In the introductory statement to the bill establishing the Belgian Central Bank (Banque Nationale), in 1850, it was stated that the business of issue banks was to "discount bills representing values (that is, goods) produced and even delivered."

problem in mind. But the authors of the Federal Reserve Act aimed chiefly at the creation of a banking system guaranteeing the elasticity and the liquidity of the banking organization.

In the course of the nineteenth century both economic and financial organization underwent great changes. During Adam Smith's time banking business was conducted, in England, chiefly by private houses issuing bank notes. Each banker relied on his own resources for note reimbursement. There were no rediscounting facilities. Moreover, Smith lived at a time when business enterprises were relatively small; where the motivating force was the merchant rather than the manufacturer. There were no great corporations with a large organized market for their securities, and even the market for government bonds was rather limited.

Since then the economic organization of most countries has changed completely. The growth of large-scale business enterprises increased the need for fixed and working capital. In highly industrialized countries, funds were required for much longer periods than in those countries where the economy was based on handwork and small-scale manufacturing. In so-called "new countries" with a highly industrialized agriculture producing on a large scale, farmers generally required more or less prolonged loans.

In most countries the right to issue notes was gradually transferred to one central bank, which is primarily a bankers' bank. Instead of making direct loans to traders and manufacturers, the business of central banks is largely that of rediscounting the paper of deposit banks. The sale of corporate securities assumed large proportions and security exchanges were organized to facilitate the marketing and shifting of bonds and stocks.

Banks made extensive loans with securities as collateral, and they also made direct purchases of securities.

The nature of bank loans also underwent pronounced changes. So-called commercial banks did not confine themselves to discounting trade bills, in fact, the changes in industrial and commercial organization gradually reduced the volume of two-named paper arising out of commercial operations. This is especially the case in the United States, where in the period following the Civil War trade and bank acceptances almost entirely disappeared and were replaced by direct loans by banks to customers on current account.⁸

Actually, the banks financed the needs of industrial enterprises not only for circulating capital but also for long-time working capital and sometimes even for fixed capital. Even the English deposit banks, regarded by economists as preserving the classical principles of short-term commercial credit, furnished some funds for investment purposes, either by loans on "unseasoned" new securities or by advances on current accounts.⁹

Economic and financial evolution eventually led to the formulation of the theory of shiftability. For several decades economic literature did not take account of the changes in business operations and banking practice. The

⁸ A reduction in the use of bills was also manifest in Belgium after the First World War.

⁹ Yet it may be pointed out here that at times English banks have been criticized for not giving enough assistance to industry in need of long-term capital, although "their appeal to liquidity is largely illusory." A. J. K. Grant, *A Study of Capital Market in Post-War Britain* (1937), p. 186. The question how to obtain greater collaboration between banks and industry chiefly for investment or working capital purposes has often been discussed by economists, business men, and official committees. See, for instance, H. S. Foxwell, "The Financing of Industry and Trade," *Economic Journal*, December 1917; Macmillan Committee, *Report of the Committee on Finance and Industry* (1931); and the bibliography in Grant cited above.

liquidity theory was formulated by Adam Smith for scattered note-issuing banks granting loans mainly to traders. The theory continued to be adhered to in a regime where the manufacturer became the determining factor, and where the moving force of the banking organization was the deposit bank, enjoying the rediscount facilities of a central bank and the machinery of the Stock Exchange.

Finally, however, economists and financial writers began to observe that the theory expounded in treaties did not accord with reality: the practical operations of bankers were far different from what the liquidity theory purported to explain.

In Europe writers on banking gradually acquired the habit of distinguishing between different degrees of liquidity. Certain assets were considered of first degree liquidity; other assets, of second degree; and still other assets of third degree liquidity. Writers were not always in agreement about the classification,¹⁰ but at any rate the term liquidity no longer had the same meaning as before. When the older writers referred to "liquidity," they meant a bank's ability to obtain cash from its discounted bills at maturity from the proceeds of the commercial operations (self-liquidity), whereas later writers in using the term referred primarily to the possibility of obtaining cash either by rediscounting bills of exchange or by selling other assets.

It may be observed that for many years general economic theory did not take account of the change

¹⁰ For instance, securities held by the banks were considered by some as simply liquid, by others as being only of the second degree liquidity—or as being of first degree liquidity up to a certain percentage of their amount, second degree up to another percentage. See a table with different classifications of assets according to their degree of liquidity in A. Weber, *Depositenbanken und Spekulationsbanken* (1922), p. 337.

which took place in the liquidity concept, and writers on banking did not draw any theoretical conclusions as to their observations concerning the various degrees of liquidity.

The first basic attack on the liquidity theory came from an American economist. Harold G. Moulton noted the wide divergence between the practice and the theory professed not only by economists but also by bankers. In 1918 he calculated that in the United States around 50 per cent of all banking loans were devoted to investment uses, and that the proportion reached approximately two-thirds, when account was taken of their investments in securities.¹¹ In the same article Moulton explained that in the present-day industrial and financial organization, the so-called commercial loans of banks, do not correspond at all to what older writers called "self-liquidating paper." These loans are granted not by discounting bills but by opening a "line of credit."¹² Such loans may be considered self-liquidating only in case of "seasonal accommodations," which represent only a minority of loans.

The new theory holds that for an individual bank, liquidity consists chiefly in the ability to shift assets to other banks. For the replenishing of their cash reserves, banks do not rely usually on the proceeds resulting from the maturity of their commercial loans. Before the establishment of the Federal Reserve System, these loans formed the least mobilizable item of the banking assets. Normally the reserves were replenished either by call-

¹¹ "Commercial Banking and Capital Formation," *Journal of Political Economy* (1918), p. 658. See also, G. W. Edwards, *The Evolution of Finance Capitalism* (1938), p. 166.

¹² In Europe, bill discounting is more developed than in this country, but even the proceeds of discounted bills are often used as permanent working capital.

ing loans on securities (generally reimbursed by the debtors, from loans granted by other banks), by selling bonds, or, since 1914, by rediscounting with a Federal Reserve bank.¹³

Consequently for each bank individually the problem of liquidity is not a problem of making self-liquidating loans so much as it is a problem of shifting assets to other banks in exchange for cash. In Moulton's words, "liquidity is tantamount to shiftability."¹⁴

For the banking system as a whole there is no liquidity. The foregoing analysis concerns the situation of a deposit bank taken individually. For the deposit banking system as a whole, liquidity, or rather shiftability, exists only as long as the central bank—the lender of last resort—keeps on rediscounting. Of course, the lending capacity of the central bank can be considered unlimited, particularly when the currency is not on a gold standard basis. But that this has nothing to do with self-liquidity proper is evident. In what concerns the central bank itself, liquidity of its assets can be achieved only by securing accommodations from the central banks of other countries.¹⁵

The conclusion of the preceding discussion is that

¹³ On the Continent the practice of rediscounting with the central bank is, of course, much older than in the United States.

¹⁴ Moulton, "Commercial Banking and Capital Formation," cited above, p. 723. See also Moulton, *Financial Organization and the Economic System* (1938), p. 318.

¹⁵ The foregoing discussion is concerned with a situation when the banks seek by themselves to mobilize a high proportion of assets in a relatively short time, namely, in a period of panic. In a depression, a part—sometimes important—of the assets, even of the central bank, may be liquidated, by the mere reduction in demand for loans or by forced liquidations. But it will not happen in a short time; besides even in this hypothesis the liquidation of assets can be only partial. Moreover, no confusion should be made between "liquidity" and "liquidation." It can even be said that the aim of liquidity is to prevent forced liquidations.

liquidity, not in the sense of self-liquidity but in the sense of shifting assets, can exist for one or a few bankers, but that there is no liquidity, even in the broader term, for the banking system as a whole.¹⁶

Experience shows that banking instability arises chiefly from making loans on inflated types of assets. It has often been pointed out that during the crisis of 1932-33 in the United States, the banks which suffered the greatest distress were mainly those which were heavily involved in security operations, where there had been a great drop in market values. On the other hand, banks involved by short-term commercial loans were comparatively safe. Some people concluded that the validity of the old theory, according to which loans should be expanded only for short-term, self-liquidating paper was once more demonstrated. But it should be recalled that in the crisis of 1920-21 the experience was the reverse. On that occasion the difficulties arose mainly in connection with commercial loans. Bond holdings were not only readily marketable, but as a rule they were stable in value. On the contrary, the decline in the value of commodities was so catastrophic that the safety of commercial loans was quickly destroyed. The weakest assets in the portfolios of the banks were those which fulfilled most accurately the description of automatic self-liquidating loans, namely, the trade acceptances evidencing a specific sale of commodities.

The explanation of this sharp contrast between the two periods under consideration is to be found in the fact that in the boom period preceding the collapse of 1920 speculative activities and price advances centered largely in the commodity

¹⁶ See H. G. Moulton, article quoted; also *The Formation of Capital* (1935); W. F. Mitchell, *The Use of Bank Funds* (1925); C. O. Hardy, *Credit Policies of the Federal Reserve System* (1932), Chap. 17.

market, whereas in 1929 they centered almost entirely in the security markets. . . . Accordingly, in the one case the depreciable assets were chiefly the commercial loans, whereas in the other they were mainly securities. In both cases it was bad management to make continuous extension of bank credit on the security of highly inflated assets.¹⁷

This explanation is also corroborated by some events in Belgian banking history. In 1875-77 the stock exchange crisis, following the boom of the preceding years, hit chiefly some banks loaded with stocks. In 1920-21 there was not really a banking crisis in Belgium, but some banks suffered losses resulting mainly from commercial credits (for instance loans on commodities). In the thirties, due to the exceptional gravity of the financial crisis and of the depression, losses resulted from securities as well as from loans and discounts.

With the development of central banks, real liquidity of commercial banks, that is, their ability to shift assets, depended largely on the legal regulations and the practices of the central banks. Before the establishment of the Federal Reserve System, commercial banks of this country could rediscount bills only by inter-bank accommodations, which were rather limited. One can then maintain that, owing to the organization of stock exchanges, bonds of a high standard enjoyed greater liquidity than commercial paper.¹⁸

With the establishment of the Federal Reserve Sys-

¹⁷ H. G. Moulton, *Financial Organization and the Economic System*, p. 121.

¹⁸ See a recent statement by an official of the Federal Reserve System that "investments more often conform to the character of secondary reserves than loans do." Secondary reserves are assets "that can be converted into cash at almost any time without loss." R. I. Robinson, "Commercial Bank Operations," in *Banking Studies* by Members of the Staff, Board of Governors of the Federal Reserve System (1941), p. 177. In other words, investments are often "more liquid" (or rather more easy to shift) than loans.

tem, which originally was based on the classical theory of liquidity, commercial bills became the best banking asset, enjoying the highest degree of shiftability. But actually the use of the bill of exchange or of the commercial acceptance did not expand. The result was that in order to obtain real liquidity the regulations and the practices of the Federal Reserve banks have been modified and their rediscount facilities enlarged.¹⁹

In Europe, at least on the Continent, the commercial bill has long been considered the most suitable banking asset, not so much because of the teachings of the classical theory, but because it was readily rediscounted by the central bank. In most countries, government bonds were also considered a highly liquid asset because they were admitted as collateral for the loans at the central bank.²⁰ In some countries certain bonds, other than the governmentals, were also accepted as collateral by the central bank and consequently were also assets of high liquidity.

We have explained in the historical section that in Belgium the rediscount facilities of the Central Bank

¹⁹ Liberalization or easing of the eligibility requirements of the Federal Reserve banks was one of the chief aims of the Banking Act of 1935, and of the new regulation governing discounts and advances issued by the Board of Governors of the Federal Reserve System on Oct. 1, 1937. See R. B. Westerfield, *Money, Credit and Banking* (1938), pp. 652 ff. In the same connection one may quote the revision of standards of bank examinations agreed upon by the American supervising agencies in 1938 and the new regulation on investment securities issued at the same time by the Comptroller of the Currency. It was intended that "in making loans whether for working capital or for fixed capital purposes, the banks should be encouraged to place the emphasis upon intrinsic value rather than upon liquidity or quick maturity." *Federal Reserve Bulletin*, July 1938, pp. 563 ff. See also *Report of the Federal Deposit Insurance Corporation for 1938*, pp. 61 ff.

²⁰ See above pp. 24-25 concerning Belgium, where the government bonds are accepted as collateral by the Central Bank only for 80 per cent of their current value.

have been enlarged during the thirties (admission of financial bills, of paper representing renewable loans, increase in the amount of government bonds allowed to be held by the Banque Nationale).²¹

Some of the most significant trends in recent banking policy may be explained only in the light of the shiftability theory. The changes in legislation governing central banks to which reference has been made in preceding paragraphs is an illustration of the practical necessity of acting upon the shiftability theory even though the principle is not clearly recognized.

In a highly developed industrial and financial system, the "automatic" self-liquidity on which the classical theory relied proved to be a fiction. In times of emergency, particularly, liquidity can be obtained only by the intervention of the central bank. When the charters of most of them were drawn, central banks were considered simply as issue banks, which would devote themselves to the discount of commercial paper. Their character as *central* banks devoted chiefly to the rediscount of paper presented by other banks, evolved later on, with the expansion of deposit banking. But deposit banks discounted fewer and fewer commercial bills, and engaged chiefly in granting loans or even in buying securities. The result of the expansion of deposit banks was that in normal times the loans of central banks were considerably reduced, and their control over the money market was weakened.²² On the other hand, in times of stringency the deposit banks did not have enough eligible paper. The liberalization of the rediscounting

²¹ See above, pp. 136 ff.

²² This tendency was manifest in England before the First World War. In order to regain control over the market and to render its rate effective, the Bank of England was sometimes obliged to sell government bonds, thereby reducing the reserves of deposit banks.

facilities (loan facilities would be more correct) of the central banks resulted from the necessity of adapting their operations to the changed character of operations performed by the deposit banks.²³

Another recent tendency may also be explained only in the light of the shiftability theory. That is, the creation of special institutions in order to "organize" the shifting of assets, such as the Institute for Rediscount and Guaranty in Belgium and, to some degree at least, the R.F.C. in this country.²⁴

In so far as they have been conceived as temporary organisms for "salvage" operations, they are out of the scope of our analysis. But so far as they have been created since the crisis and established as permanent institutions, like the Belgian I.R.G., they correspond to a sound conception of the necessities of present-day banking with which this study is concerned. Not only is the liquidity of the commercial banking system as a whole a mere fiction; even when only a few banks are obliged to dispose of an important fraction of their assets, they encounter generally almost insurmountable difficulties. It is rational then to provide institutions to facilitate the shifting of assets, especially in times of emergency.

One could question the utility of such institutions be-

²³ It should be remembered that in some cases even before the statutory changes were made, central banks had been more "liberal" in their loans than the strict wording of the statutory regulations would imply. This was particularly true in time of emergencies.

²⁴ Some other institutions recently created in this country belong in the same category, such as the Commodity Credit Corporation and the Federal Intermediate Credit Banks.

Recently an official of the Federal Reserve System wrote that the Federal Reserve banks and the institutions we have just mentioned "serve to maintain the liquidity of certain bank assets." D. M. Kennedy, "Credit and Saving Institutions Other than Banks," in *Banking Studies*, cited above pp. 162. Evidently liquidity here means shiftability (in the sense of rediscountability).

cause of the fact that, in time of emergency, inevitably, there must be recourse to the central bank. Therefore, should not the liberalization of rediscount requirements of these banks be the only measure necessary to facilitate the shifting of banking assets?

It is true that the liberalization of rediscounting facilities is the fundamental measure, yet the creation of special institutions can be supported as a complementary measure. Such institutions can help avoid recourse to the central bank in times of minor emergencies. They can smooth the shifting of assets to the central bank even in extreme emergency. This is the reason why they can be legitimately established as permanent institutions, although intended to act mainly in emergency situations. Naturally they should operate in full collaboration with the central bank.

CHAPTER IX

LESSONS OF BELGIAN BANKING HISTORY

This chapter will be devoted to the formulation of some conclusions drawn from the historical part of the present study.

Economic requirements exert a primary influence upon the character of banking development. Writers on banking theory and policy sometimes forget that bankers operate in given historical and economic circumstances, and that, if they are to perform the services required, they are obliged to adapt themselves to their environment. Adam Smith's hypothesis of a merchant or trader requiring funds for short self-liquidating operations, correct for England at the middle of the eighteenth century, found only limited applicability in Belgium in the nineteenth century. Belgium was and is chiefly a producing and not a trading country.¹ Consequently, since the beginning of banking development in Belgium, bankers had inevitably a tendency to establish connections with industrial enterprises which chiefly required funds for fixed capital and working capital purposes.

The close interrelationship between banks and industrial enterprises is well illustrated, for instance, by the evolution of the Banque de Belgique. The reader will recall that this corporation, founded in 1835, was devoted chiefly to corporate financing and industrial loans. After the crisis of 1838-39, the directors decided

¹ It has been said many times that Belgians are good producers and bad merchants. The shortcoming of Belgian commercial organization for foreign trade has often been discussed; it can be explained by historical reasons which have no direct bearing on the present subject.

to devote their operations exclusively to commercial short-term loans, and, to fulfill this purpose, the corporate charter of the bank was changed. But in the fifties, when industrial development was again revitalized, the bank was under such strong pressure to share in the expansion that the original text of the charter was restored.

The history of most Belgian banks, particularly of important corporations, may be cited as showing how bankers were attracted to industrial financing by environmental forces. It may be recalled also that even the Banque Nationale, whose founders were strong followers of the classical theory, and which was restricted by law and regulations to self-liquidating operations finally devoted some funds to industrial loans.²

Industrial expansion was at times handicapped by obstacles to credit expansion. The beginning of modern banking and industry in Belgium provides an interesting example of the relationship between credit expansion and capital formation discussed in Chapter VII. It is a negative example, in the sense that it shows how the absence of credit expansion may hamper industrial progress.

During the 1830's Belgium was a densely populated country with relatively important natural resources, experienced manufacturers, and skilled craftsmen. In other words, Belgium possessed the necessary requirements for an industrial expansion through the development of new techniques borrowed from England (particularly the steam engine). We have related the expansion of industrial corporations between 1834 and 1838, and the role played by the banks in this expansion. But even during these years of development, banks were ham-

² See above pp. 30 ff.

pered by the difficulty of expanding loans through banking money, owing to the fact that the use of checks was almost unknown, and even the use of bank notes was extremely limited. Let us recall that at the end of 1838, whereas the circulation of metallic currency was probably about 200 million francs, notes in circulation amounted to less than 20 millions. Concerning demand deposits, they exceeded somewhat the figure of 30 millions but their turnover was very limited. They did not become a circulating medium. After the panic of 1838-39 the whole banking system was frozen. The banks were almost unable to grant new loans, and during the whole decade of the forties banks reduced their activity mainly to the management of their frozen assets. The pace of industrial expansion was considerably slackened, not to be resumed until the 1850's.

The lack of a central issue bank was a primary source of trouble. The faulty policy of banking leaders was given as the reason for banking difficulties at the time of the 1839 crisis and later. The banks, it was said, concentrated their efforts on corporate financing and industrial loans; hence the immobilization of their funds, then the crisis, and later their inability to extend new loans.

The explanation was correct. It is true that in a country having no experience of industrial securities whatever, the bankers participated in the financing of too many corporations and were unable to "unload" the stocks on the public. But this was only part of the story. The other reason for the difficulties of the banks, was their inability to extend the use of bank notes and deposits. The use of deposits being almost unknown, the issue of bank notes was the only means by which the banking corporations could have developed their loanable funds. But people were reluctant to use notes. The

circulation of bank notes remained at almost negligible levels until the middle of the nineteenth century when a central bank of issue was established.

The almost complete absence of banking currency resulted in inability to expand loans and circulating funds. Moreover, the absence of a central issue bank imposed on each banking corporation the necessity of relying on its own reserves, when a run of depositors or note holders occurred. The crisis of 1838-39 would probably have been much milder had a central issue bank, enjoying public confidence, existed. As it was, the crisis stopped almost completely, for more than a decade, any credit expansion and financing of industry by banks.

The banking crisis of 1848, provoked by the third French Revolution, was followed by a short period of inconvertible paper money with legal tender capacity which, curiously enough, accustomed people to the use of bank notes. Then, in 1851, the Banque Nationale was established; its notes rapidly gained universal confidence.

In the second half of the nineteenth century industrial development was promoted by credit expansion. The authors of the law of 1850, establishing the Banque Nationale, were inspired by the classical theory of banking. The chief, almost exclusive, operation of the bank was to discount short-term, self-liquidating commercial paper.³ The authors of laws and regulations concerning the Banque Nationale considered that the fundamental advantage of the central bank would be to secure a currency backed by liquid assets. Practically the essential result was that, inasmuch as the bank was the only issue institution and was backed by the government, its notes enjoyed a much wider confidence than those issued

³ See above Chap. 1, sec. 4.

earlier by other banks, and their circulation expanded rapidly.

As shown in the historical part of this study, the establishment of the Banque Nationale, promoted the development of commercial banking.

Commercial banks multiplied and expanded their operations chiefly because of the rediscount facilities granted by the Banque Nationale. Later on, the use of deposits also expanded. The expansion of banking currency gave the banks an opportunity to develop their loans both for circulating capital and for investment purposes.

On the whole credit expansion and banking initiative played an important role in industrial expansion after the middle of the last century.⁴ There was rapid progress in industries producing capital goods as well as consumer goods. The rate of progress was certainly accelerated by credit expansion in Belgium as it was in the United States.⁵ Both countries had the prerequisite conditions for economic progress. In the United States they were represented chiefly by broad lands and rich natural resources, which attracted large numbers of people. In Belgium they were represented by a dense population and industrial skill which attracted raw materials when domestic resources were partly exhausted.

Banking developments in Belgium since the middle of the past century can be explained only by the shiftability theory. In the historical part of this study it has been explained at length that discounted bills always formed only a part of the assets of Belgian banks. The

⁴ See above (p. 47 n. 24) the acknowledgment by the authors of the Banking decree of 1935, of the services performed by the banks of industrial participations (meaning the mixed banks).

⁵ See Chap. 2, sec. 3. Also H. G. Moulton and Associates, *Capital Expansion, Employment, and Economic Stability* (1941), Chap. 1.

chief item of their assets consisted of "advances in current account," the borrowers using the funds as working capital and even for fixed capital purposes. Banks were also largely engaged in "financial operations," which meant promoting, underwriting, and distributing industrial securities and, in some measure, investing funds in the same securities (in equities rather than in bonds). In normal times corporate securities were "unloaded" from time to time by selling on the Exchange or by "public subscriptions." In times of stringency important quantities of bills were rediscounted with the Central Bank.

It follows from the preceding discussion that the "self-liquidity" of assets played a minor role in Belgian banking practices. As in the United States, real liquidity was provided by shiftability. In Belgium the possibility of shifting assets was provided, first, by rediscounting with the Central Bank and, second, by selling securities. In the United States prior to 1914, shiftability was provided in the first place by Stock Exchange facilities and, in the second place, by rediscount facilities, granted chiefly by banks of central reserve cities. In any case, the self-liquidity of assets was of minor importance.

The Belgian banking system did not of course always work smoothly. Banking difficulties occurred several times, but no banking system based on fractional cash reserves had worked without occasional strains. During the nineteenth century, or rather up to the First World War, banking disturbances were not more frequent than in countries following more "orthodox" practices, such as England. Moreover, in several instances failures of so-called banking institutions did not result from actual banking crises: owing to the terminology used in Belgium until recently, some corporations have been con-

sidered banks, which in England would not have been placed in this category. Such corporations did not hold deposits at all or only in small amounts. On the other hand, banking difficulties did not always result in losses to depositors. Even the failure of such an institution as the Banque de Belgique resulted in losses to the shareholders only.

This does not mean that no mistakes have been made by Belgian bankers. The so-called "financial operations" are particularly liable to induce imprudent bank managers to engage in hazardous activities ending in large frozen assets and losses. More particularly, such situations are likely to develop in times of disturbed monetary conditions, as witnessed in Belgium during the 1920's.

After the First World War unstable monetary and economic conditions were the primary influence on banking trends. During the twenties and the thirties, Belgian banking development was particularly influenced by the disturbed monetary conditions, described in Chapter III. From 1919 to 1926 the fluctuations and persistent depreciation of the franc induced a search for "real" values and a constant flow of funds toward industrial securities. In 1926 the stabilization of the franc at a low level gave a special, although temporary, advantage to exporting industries. To this factor was added the influence of funds flowing in from abroad and of the contagious influence of the American boom. As a result the flow of money toward industrial investments persisted and was even accentuated.

Banking corporations were involved in the same movement. Partly in order to safeguard the "real" value of their assets, partly from delusion of the temporary advantages of the exporting industries, partly because

of the urge for power on the part of several banking leaders, the banks extended considerably their loans to, and their investments in equities of, industrial, colonial, or other corporations.

As a result of this, the industrial expansion of the twenties was partly unsound and based on false assumptions. Investments in most industries were overdeveloped, particularly in the exporting sectors. The same situation provoked a widespread speculation in securities and an exaggerated rise in quotations.

In the early thirties Belgian industry and banking were hit not only by the world economic slump but also by the new display of international monetary instability. About the time that rising wages and costs cancelled the benefit deriving from franc stabilization at a low rate, England went off the gold standard, sterling depreciated, and the franc became an "overvalued" currency. Immediate readjustment of the gold value of the franc would have provoked a violent panic. A policy of economic deflation was imposed by psychological rather than by economic factors, and again psychological reasons prevented a timely change of policy even when the failure of such policy became evident.

Notwithstanding the quite "illiquid" character of industrial loans and investments, Belgian banks were able to pay off in 1933-34 large amounts of the deposits until withdrawals became overwhelming because of the monetary panic. Moreover, there were no important banking failures, and losses were taken chiefly by stockholders rather than by depositors.

Bankers were held responsible, to a greater degree than they should have been, for the general financial crisis, particularly the slump in security values and the depression. Excesses had been committed and mistakes

had been made by banks during the twenties. But it follows from the preceding discussion that, in some measure, the errors of policy had developed out of the generally unhealthy condition of that period, particularly out of the currency inflation and the fluctuations in the value of the franc. On the other hand, the banking panic of 1934-35 was not primarily the result of an unsound banking position but of the "flight from the franc." Nevertheless, bankers were held responsible for the financial crisis and the depression. This was the principal reason for banking regulation and supervision introduced in 1934-35.

The preceding discussion does not tend to deny the necessity of regulating deposit banking under conditions such as existed in Belgium. But no exaggerated hopes should be indulged, regarding the effects of banking regulation. The unsound developments of the twenties would have produced a crisis and a depression, even if banking had been regulated much earlier. Some mistakes and some abuses could have been avoided, but the general trend of economic development would have remained the same. The experience of the last two decades, in the United States as well as in Europe, demonstrates that legal regulation is only a minor factor in the banking situation. For a smooth functioning of commercial banking relative stability of economic and monetary conditions is much more important than legal regulations and supervision.

The chief aim of the Belgian banking legislation of 1935 was to introduce a system of liquid commercial banking. Liquid banking was considered a prime factor contributing to business stability. The objective was to be obtained mainly by two means. The first was the liquidation of "mixed" banking. This meant prohibition

of the holding of corporate securities. But, as practically no other machinery for investment banking existed, the 1935 decree allowed commercial banks to continue underwriting and distribution of securities, with the restriction that the so-called "undigested" securities (securities not taken over by investors) could not be held more than six months. This last provision made underwriting almost impossible. In the opinion of the writer, it would have been more advisable not to prohibit holding of corporate securities but to limit such holdings by some quantitative principle, such as a ratio between the capital of the banks and the amount of securities held.

The provision of the 1935 law giving the Banking Commission power to promulgate a set of rules (the "ratios") governing the loan operations of bankers was the second means by which bank liquidity was to be sought. These rules would eventually concern the cash ratio, the liquidity ratio, and the capital to deposits ratio. We are concerned here chiefly with the liquidity ratio.

The definition of liquid assets was left to the Banking Commission. In practice items considered liquid by the Commission have been chiefly bills eligible for the rediscounting facilities of the Central Bank and government bonds up to the amount of their eligibility at the Central Bank. That such liquidity has nothing to do with self-liquidity is emphasized by the fact that in 1937 the provision requiring that bills discounted by the Central Bank should have a "real" commercial basis has been given up. Purely financial paper is consequently considered liquid.*

All these rulings and practices show clearly that in Belgium as in the United States liquidity became a mat-

* Moreover, the Banque Nationale has been allowed to rediscount bills representing medium-term loans. See p. 138.

ter of legal definition that could be changed when necessary.

As a matter of fact, the Banking Commission did not establish any rule concerning cash or liquidity ratios; they were expected to be established later in "more or less stable circumstances." Yet in practice the action of the Commission and of the supervisors was inspired chiefly by the anxiety about liquidity. When the supervisors began to function early in 1936, they started immediately to calculate actual cash and liquidity ratios in banks entrusted to their supervision. A kind of competition developed among banks, each one wishing to throw into relief, in the annual balance sheet, its high reserve and liquidity ratios.

The Banque Nationale, entrusted with the publication of banking statistics, also began to calculate ratios for the whole banking system and to bring them forward in quarterly statements. The Banking Commission also gave extended tables in its annual reports of ratios, for various categories of banks. Yet the high liquidity ratios of 1936 and 1937 resulted partly from large purchases of government bonds, which naturally in no way were of a self-liquidating character.

On the whole the anxiety for so-called liquidity dominated the minds of bankers as well as of supervising authorities. The principal danger of such policy was that bankers might sometimes refuse sound loans, only because they would reduce their high liquidity ratios. Another danger was giving to the public an erroneous impression of the real liquidity of the banking system as a whole.

If a personal note may be allowed here, it may be added that in 1936 the author, who was in touch with

the President of the Banking Commission, submitted a memorandum pointing out these dangers and advising the President to discourage the supervisors from laying too much stress on the ratios, in their reports to stockholders. But once the practice started, it could not be easily stopped; "liquidity" had become a dogma which it was almost impossible to resist.

On the whole during the second half of the 1930's the loan policy of the banks became extremely cautious. Moreover, the banks stopped almost completely their "underwriting" operations.

We have quoted above the opinion of the Banking Commission stating that the extreme banking cautiousness and the absence of new "ventures" were unrelated to the changes in the legal banking status. Such policy was attributed exclusively to the disturbed international situation and to the liquidation of the preceding crisis.⁷ Although there is much truth in this statement, it probably minimizes the effect of banking regulation and of the spirit in which it was carried out.

We find here an excellent illustration of the fundamental difficulty encountered by any banking regulation. The practical problems of a single institution as well as of the whole banking system cannot, in most cases, be resolved by a rigid formula. Generally they are questions of degree and of circumstances. For instance, some kinds of investments or loans may be made legitimately only up to a certain point—which varies from one bank to another and even for the same bank according to circumstances.

In the writer's opinion Belgian legislation, like most other recent European reforms, has put too much stress

⁷ See page 132.

on the kinds of assets the banks may buy. It was a tendency which can be explained as a reaction against excesses practiced in the twenties, but it became overemphasized itself.

CHAPTER X

PROBLEMS OF BANKING POLICY

About thirty or forty years ago problems of banking policy seemed relatively simple and the principles of policy were well-established. Preservation of a stable money was considered the fundamental task of a central bank; monetary stability was synonymous with the fixity of the gold value of the currency and practically resulted in the stability of foreign exchanges. The principal business of a central bank was to watch constantly its gold reserves. The central bank increased its discount rate when reserves fell and lowered it after the gold reserves had been replenished.

Practically, the gold standard provided a basis for national currencies and for an international monetary system not only because of the policies of central banks but also—perhaps even chiefly—because the world economy was expanding on the basis of relatively stable trade conditions and of regular international movements of capital.

The organization of central banks was also a more or less settled question. About the middle of the last century there were, at least on the Continent, very heated discussions among partisans and adversaries of state central banks. The partisans of state ownership of central banks argued that since these banks were endowed with a legal monopoly, it was unfair and irrational to entrust them to private corporations. The adversaries argued that a bank owned by the state would become an instrument in the hands of the Treasury and would end in practicing monetary inflation. Practically

in most countries a middle way was chosen. Generally, the functions of the central bank were entrusted to a private corporation, controlled by the state. It is fair to add that in many cases the control of the government was more or less perfunctory.

But experience showed that state or private ownership was not the controlling factor in the actual working of central banks. In Sweden, for instance, the central bank was owned by the state and yet it was never misused by the government; in Spain the central bank was a private corporation whose directors did not hesitate to put their facilities, frequently and in peacetime, at the disposal of the Treasury, which paid an interest on loans granted merely by printing bank notes. The actual working of a central bank rests not so much on its legal status as on the condition of public finances, the political state of the country, the sense of responsibility displayed by political leaders, and the degree of political education of the public. At any rate, at the beginning of this century neither the policy of central banks nor their organization was a subject of first concern for economists or statesmen.

Nor was commercial banking a major issue. In handbooks of economics the self-liquidity theory was explained without much attention to what was really happening in the banking world. Commercial banking was regarded as ordinary business and was regulated by the government only in a few countries. Banking difficulties occurred mostly (in 1900-01 or 1907, for instance) as component parts of general economic crises ending the ascending phase of a business cycle, and business cycles themselves were regarded as something like a natural disease. Moreover, no major banking crisis occurred during the two decades preceding the First World War.

Although in the last years immediately preceding the war the question of deposit banking regulation was discussed in some quarters (in Germany, in Switzerland, in Denmark); the banking problem on the whole attracted little attention.

This picture was completely changed during the two decades separating the First and the Second World Wars. General economic instability, currency and credit disturbances, gave rise to new tendencies in banking policies as well as in banking theories. Some of these tendencies, for instance the movement for price stabilization through money and bank policies, derived from older ideas, but they began to carry weight only after the First World War.

During the twenties the most notable current of ideas in the field of banking was connected with the programs for business stabilization (mostly by means of price stabilization) through the control of credit by the central banks. Many of these projects were based simply on a more or less crude conception of the quantity theory of money.¹ Other projects, particularly those of selective credit control, were based on refined concepts. But their common mistake was to consider the policy of central banks as *the* controlling factor in business cycles, whereas it is only one of the factors.

The 1929 slump and the depression of the thirties discredited the idea of credit control to such a degree that it is perhaps at present too much disregarded. As shown by the analysis in Chapter VII, credit policy is a potent factor of economic expansion. It was an error,

¹ Some writers did not make any distinction between the variations in the quantity of money resulting from the bulky inflations due to war financing or civil disturbances and the limited variations resulting from ordinary bank loans.

however, to view the power of central banks as a dominating influence, independent of the whole set of economic and political factors, which determine the complicated working of the contemporary economy.

The major difficulty of the present situation is that there are no generally adopted principles of central banking policy. There is a widespread agreement that central bank policy can no longer be guided primarily, still less exclusively, by the gold reserve situation and the state of foreign exchanges.² But whereas the classical gold standard was able to provide central banks with precise—if not automatic—rules of action, none of the recent formulae can provide such rules. Some recent propositions—stabilization of the general level of prices, stabilization of prices of the factors of production, stabilization of incomes, “neutral money” and so forth—are too debatable issues. Only such general formulations of central banking aims as stabilization of general business conditions or maintenance of sound credit conditions seem acceptable. But they are too vague to provide rules of action.

Moreover, most analysts agree now that central banks cannot take into account one factor only, be it prices or inventories, or interest rates, as indicating the trend of business.

As a result of extreme economic instability and, in some measure at least, of the confusion of ideas, the policy of central banks rests now on a pragmatic basis. Those who formulate the policy act on a day-to-day

² An article dealing with the functions of the governor of the Bank of England, in *The Economist* (March 1941, p. 400) contained the following statement: “It is no longer his first commandment to husband the gold reserve, and therefore to be on constant watch for storm signals in the foreign exchanges. If the governor nowadays should have one dominating interest it should rather be in the finance of British industry.”

basis, experimenting and testing their weapons of control.

One of the most significant consequences of this situation is that the powers of the leaders of central banks have been increased and their field of action enlarged, particularly by "liberalizing" the eligibility conditions for their loans, to which allusion has been made in Chapter VIII.

There occurred also a significant evolution in the relationships of central banks with governments. Following the First World War there was a marked tendency to segregate completely central banks from government influence. It was believed that the "inflations" of the war and the immediate postwar period had been provoked or at least facilitated by government contacts with central banks. The international financial conference of Brussels in 1919 passed a unanimous resolution recommending the complete autonomy of central banks. The Financial Committee of the League of Nations, in helping the financial reorganization of several countries, required as one of the first conditions of its assistance, the segregation of all links between the government and the central bank. In such a way complete autonomy of the central bank was provided in Austria, Hungary, Greece, Estonia, and so forth. In Germany the same autonomy was obtained by the Dawes Committee. In several South American countries, where central banks were established during the twenties, special precautions were also taken in order to assure their independence from government interference.³

But in the thirties the tendency was completely re-

³ See above p. 135 regarding the vigorous opposition of the Committee of the House in 1926 in Belgium against any dealing in government bonds by the Banque Nationale.

versed. Partly because of the general extension of government control over all fields of economic life, partly because credit policy was considered an important or even the most important weapon with which to fight the depression, government control over central banks was extended in many countries.

The new trend was notable not only in totalitarian countries, where the central banks became practically government departments, but even in democratic countries: in Denmark the central bank, which formerly was a business corporation, became in 1936 an official institution entirely controlled by the state. In 1936 also the Banque de France was reorganized, the influence of shareholders practically excluded, and government control strongly reinforced. Analogous reforms have taken place in Canada, in New Zealand, and other countries. In the United States the Bank Act of 1935 strongly reinforced the powers of the Board of Governors of the Federal Reserve System appointed by the President, and reduced the powers retained by the boards of the Federal Reserve banks, chosen by the shareholders (member banks).

As a result of recent developments the central banks are in a large measure under the control of governments, and at the same time they have much larger powers, without being subject to precise rules of action. It follows that in the last analysis, the personal factor, the composition of their boards is of decisive importance in the determination of policies of central banks.

There developed also a tendency to regulate the deposit banks and to reduce the liberty of action of their leaders. The tendency was particularly manifest in the thirties. Bankers were made responsible for all mishaps of the financial crisis, particularly the slump of security

values, and of the depression. Consequently, during the thirties most continental countries where deposit banking was previously unregulated introduced a more or less strict regime of banking regulation and supervision.

We are witnessing today a tendency contrary to that prevailing a hundred years ago, which was still predominant at the eve of the First World War. At that time the commercial banks were considered, in most countries at least, as private enterprises, which would give the best results in an atmosphere of complete freedom. The interference of authorities with central banks was also reduced to a minimum. Nevertheless, the central banks, enjoying a monopoly, were more or less distrusted. That is the reason why most central banks were established as corporations and also the reason for strict limitations—in most countries at least—on their holdings of government securities.

Today the deposit banks, moved by the "profit" motive, are distrusted, their activities are regulated and supervised. The central banks and the supervising agencies moved—or supposed to be moved—by the "general interest" are endowed with enlarged discretionary powers.

During the nineteenth century there was in most countries a tendency not only to reduce to a minimum the role of government in all fields of social life, but also to define by statute their powers and their methods of action. "Government by law" took the place of "government by men." Personal discretion of governments was eliminated or at least was intended to be eliminated. This tendency has been partly reversed by recent developments, particularly since the First World War. Not only has the scope of action of governments been prodigiously enlarged, but it has been deemed neces-

sary to widen the powers of discretion belonging to governments and to governing agencies. The new tendency is particularly noticeable in the field of banking where the authorities (central banks and agencies controlling deposit banking) have been granted powers of personal discretion within very large and elastic limits.⁴

Most, if not all, of the recent reforms on the Continent have been inspired by the principle of liquidity. It was generally held that the banking crisis of the thirties was provoked chiefly by the immobilization of banking funds. Those who held this belief overlooked that the crisis did not result from the nature of banking assets. No banking system based on fractional reserves could resist a general run of depositors. The crisis resulted from a wide range of economic and political conditions—the money and credit inflation of the twenties, the exaggeration of short-term international loans,⁵ the vagaries of the exchange after England went off the gold standard,⁶ and so on.

But it must be kept in mind that generally liquidity is not understood now in the classical sense of self-liquidating commercial paper. It is accepted in the sense of eligibility to the rediscount facilities of the central bank. Although eligibility requirements have been more or less liberalized in many countries, one may wonder whether the liquidity complex has not dominated too strongly the minds of some legislators.

The liquidity principle, when it means short-term,

⁴ It is important to point out that most recent laws regulating deposit banking provide only general rules and entrust the controlling bodies with very large regulatory powers.

⁵ This was a preeminent factor in the German and English banking crisis of 1931.

⁶ The depreciation of the English pound was the decisive factor in the Belgian banking crisis of 1934-35. See above, Chap. 3, sec. 4.

self-liquidating loans, does not provide a rational rule either for quantitative or for selective control of credit. During the expanding phase of the business cycle the liquidity principle leads to an excess of loans, whereas in the depression the same principle may prevent a useful expansion of loans. A selective control should take into consideration the situation in each section of economic activity, and here again the "short-term" character of banking loans is not an adequate guiding principle.

It must be recognized that it is not possible to formulate precise rules concerning the nature of banking loans. Only some general quantitative rules appear desirable, such as the cash-reserve ratio or the ratios of banking capital to deposits. Experience shows that, even in the matter of quantitative regulations, rigid rules may prove harmful, and as a result a large amount of discretionary power has been left to supervising or directing authorities.⁷ The regulations should be of such a character as to leave to managers enough room for necessary initiative and judgment in individual cases. The exact nature of regulations cannot be inferred from theoretical formulae. It rests with the economic and political conditions of each country. In a general way it can be said that in the matter of banking regulation the fundamental problem is to find a golden mean between rigid rules and complete freedom of bank managers.

In the last analysis the problem of banking policy is a problem of men and of public opinion. Whatever the nature of legal provisions, they can embody only the general framework of banking activities. Finally, the results of banking activities will always depend on deci-

⁷ See the evolution of American legislation concerning the cash reserves of member banks. In Belgium the Banking Commission has been given power to modify the minima ratios. See above, pp. 93, 101.

sions taken by the leaders of the banking organization—the bank managers and the chiefs of controlling and directing agencies.

Seen in historical perspective, recent banking experiments and regulations appear as a stage in “that long and gradual process by which men are learning to keep money, the good servant, from becoming at times a bad master.”⁸ In this long and gradual process the human element will necessarily be a preponderant factor. The most important problem of banking organization is consequently that of securing the best men for governing boards of the banks and of the controlling agencies.

The problem of choice of managers of commercial banks rests chiefly with the education of public opinion, and the development of professional ethics among business leaders. The legislator can play a relatively limited role as long as deposit banking remains a private business. He can only provide some measures in order to foster control of stockholders over managers, by requiring publication of detailed statements.⁹ Some legislation also endeavors to prevent mingling of interests between bank managers and actual or prospective customers.¹⁰ However, legislation is naturally concerned much more with bodies having some degree of authority over banking organization as a whole—the boards of

⁸ W. C. Mitchell, *Business Cycles* (1927), p. 136.

⁹ The requirement of detailed statements is also necessary in order to make possible control by public opinion, such as represented by newspapers or by publications of economists. Such a control is justified by the fact that banking, although a private business, represents a public interest.

¹⁰ See above, Chap. 4, sec. 2, the system of “incompatibilities” introduced by the Belgian decree of 1935, by which directors and officers of banking corporations are prohibited, with some exceptions, from holding of directorates in other business corporations.

the central banks and the boards or individuals entrusted with the control of commercial banking.

Presidents or governors of central banks are generally appointed by the governments or at least with their consent.¹¹ The boards of directors are generally chosen by the shareholders.¹² The recent tendency has been to increase the control of governments over the choice of presidents and directors of the central banks.¹³ In some countries a voice is given—in the appointment of directors—to special organizations which, taken together, are regarded as representing general interest. In Belgium, for instance, some directors must be chosen by the shareholders from lists of candidates nominated by the superior councils for trade, for small business, for agriculture, for labor.¹⁴ But generally the role of these directors is insignificant. The evil is that the nomination of this type of director has sometimes been inspired by political considerations. On the other hand, the organization of councils supposedly representing general interests is far from adequate. Nevertheless, it seems that the best solution can be expected in this direction.

Concerning the designation of authorities entrusted

¹¹ England is the most notable exception. In principle the Bank of England is free from any government interference. Yet there is now in that country a consensus—often expressed in the press—that when the present governor retires his successor will be appointed with the consent of the Treasury.

¹² It must be added that in some countries the designation of the president by the government was a pure formality, since traditionally one of the directors was always appointed as president.

¹³ Without speaking of the countries where the central bank is practically an administrative department.

¹⁴ These councils are standing bodies entrusted with advisory functions and appointed by the government from the most representative personalities of each category.

with the control of commercial banking, three methods have been followed. In some countries these functions are simply entrusted to administrative departments of the government, for instance, the Bank Inspectorates in the Scandinavian countries. Sometimes the control is entrusted to the central bank of the country, as in Argentina. The third solution is to entrust the controlling functions to a special board. The actual situation depends upon the manner in which the board is composed. In Germany, for instance, the supervisory board consists of the president of the Reichsbank (appointed by the Führer) and of some cabinet ministers. Practically, it is a purely official board, analogous to an administrative department.

In Switzerland the Banking Commission is appointed by the Federal Council, that is, by the government. But once appointed it is free from government interference, although its expenses are borne by the government. The Commission may be compared to the independent government agencies in the United States.

In Belgium the Banking Commission is also appointed by the government. The government has a free choice of the president and of two members out of six; two members must be chosen out of a list of candidates nominated by the controlled banks, and two out of a list of candidates nominated by the central bank and the Institute of Rediscount and Guaranty.¹⁵ The aim of these provisions has been to provide a board which would not be entirely controlled by the government and which would escape political prejudices. Some people think that bankers play an excessive role in the designation

¹⁵ The expenses of the Banking Commission are covered by a levy on the controlled banks, by a contribution of the central bank, and by a fee on the registration of security issues.

of members of the Commission, although no member may be a banker. Others believe—not without reason—that actually political considerations have not been excluded.

It appears that the best solutions are to be found in the system of really independent agencies, free from political interferences. But, after all, ideal solutions are hard to obtain merely by organizational devices. The actual working of any system rests, in the last analysis, on the state of mind of the public, on the degree of control by public opinion, and on the sense of responsibility of political and business leaders.

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