In international historiography the monetary and financial policy of small nations is often discussed only marginally, if not entirely neglected. Our book, published last summer, tries to fill that gap as far as Belgium is concerned.

This does not mean that ours is a pure Belgian story. Small countries cannot really dictate a monetary policy of their own. It is always embedded in a broader international context: In our case the monetary policy of the allies and of the occupying forces in Belgium. In our present paper we will give a brief overview of some aspects of that policy, focusing on its international interdependence.

The story starts with the description of the years preceding the War. The Great Depression of the Thirties was still overshadowing the international economy at a moment when the threat of a second world conflict became a worrying reality. In Belgium the political chaos and the obstinate policy of neutrality by King Leopold III and his Secretary of State Paul-Henri Spaak paralyzed any attempt of a military preparation.

The principle of neutrality was not just ‘une idée fixe’ of the King and his entourage, it was a strict rule imposed upon the Belgian nation by the great European powers at the declaration of the Belgian independence back in 1830. Belgium was to be a buffer-state in Western Europe and therefore it had to follow a strict policy of neutrality.
It was no surprise, therefore, that the German invasion in May 1940 became a *Blitzkrieg*, the King and his army surrendering after 18 days of hopeless resistance.

During the first days of the invasion the Belgian government, the administration and a large part of public institutions, including the National Bank of Belgium, i.e. the central bank of the country, fled in panic to France, *inter alia* with all the National Bank’s assets and stock of banknotes and the printing material. It was the beginning of a chaotic peregrination through France, following the French government who was also fleeing in disarray to the south of the country, hardly ahead of the advancing German army.

After the French-German armistice of June 1940 most members of the Belgian government wanted to return to Belgium, convinced that a general Peace Treaty would follow soon. But four of them, believing that Great Britain would never gave up the battle, moved to London, declaring themselves the official Belgian government in exile.

Georges Janssen, the governor of the National bank, on the contrary, a man of principle and a real manager, wanted to return to Belgium. He had secured two agencies of the Bank, one in France and one in London, and he was convinced that, at this critical moment, his country needed him much more than a government in exile. He needed, however, the permission to leave the Belgian government and moreover he needed a firm promise of the Germans, that once in Belgium he could resume his function of governor of the National Bank. As soon as he had confirmation on both sides, he left for Brussels mid-July 1940.

Meanwhile the four ministers of the Belgian Government in exile had arrived in London. They were welcomed without great enthusiasm. British military, politicians and the establishment as a whole had not forgotten the frustrating neutrality policy of King Leopold III, his refusal to take refuge in Great Britain and certainly not the surrender of the Belgian army at the end of May 1940.
Belgium, however, had two important assets: the raw materials of its colony in central Africa and nearly 250,000 kg of the Central Bank’s gold reserves in the vaults of the Bank of England. Governor Janssen had transferred, before the outbreak of the war, one third of the banks gold in safe custody to the Bank of England, one third to the *Banque de France* and one third to the Federal Reserve Bank in New York.

In October 1940 the British Chancellor of the Exchequer had already proposed to Gutt, the Belgian minister of Finance and by far the strongest personality in the Belgian government, to purchase all the Belgian gold deposited at the Bank of England, against payment in sterling.

Gutt had answered that the gold was not property of the government, but of the Central Bank, and, moreover, it was monetary gold to cover the Belgian banknotes. In February 1941, however, the Chancellor invited Gutt again. He explained that the British government needed the Belgian gold urgently to buy weapons in the States, the Americans at that moment still applying the rule ‘cash and carry’. Gutt was able to convince the Director of the National Bank’s agency in London to ‘lend’ the gold to the Bank of England. It was agreed upon that the gold would be paid back in gold in installments after the war. In the course of March 1941, however, the ‘Lend Lease Act’ was passed in the States, enabling the British government to make its purchases in the United States on credit. Shortly afterwards the British government returned the gold to the Belgian National bank.

More important for the British war effort was the British-Belgian agreement of January 1941 stipulating that the British government could buy in sterling at fixed and favorable prices all the raw material they needed. Moreover the Belgian government ceded the Congolese gold production to the bank of England for the duration of the war. The Congolese frank was included into the sterling zone at a fixed and undervalued rate. By these concessions the Belgian government was not solely interested in polishing its image in Great Britain. As businessmen in the colony were seeing it, but Gutt and his colleagues wanted to contribute as best has they could, to the cause of the allies.
As has been said earlier, another third of the National Bank’s gold reserves, about 265,000 kg., had been deposited, before the German invasion, in the safes of the Banque de France, in the south of France. During the military campaign of May-June about 64,000 kg of it had been transferred to the Banque de France in payment of the purchases of French francs by the Belgian refugees. Just before the Armistice of June 1940 the French Navy evacuated the Belgian gold to Dakar in Senegal, against the urgent request of Governor Janssen to transfer it to the United States or to England.

The Germans, learning about the location of the gold, urged the Vichy-government to a so-called repatriation of the Belgian gold. Once in Europe, they would take care of it and send it as a deposit to the Reichsbank in Berlin. At first the governor of the Banque de France refused to collaborate. He was dismissed. Afterwards, the Vichy-government and the newly appointed governor complied to the German demands, in exchange of some German promises.

The return of the gold from Africa to Europe was not an easy task. Because the British fleet was patrolling along the west-African coast, the French authorities decided to take the over land route to Algiers. The gold was sent by train from Dakar to Bamako, a small river port, from where it was transported upstream the Niger to Bourem, in what was then a town in French Sudan.

Once in Bourem the gold was loaded on to trucks of the Compagnie Transsaharienne, which, in scorching heat, had to work their way right across the Sahara to Colomb-Béchar in Algeria. The journey was a nightmare, with burst tires and failed engines. At Colom-Béchar, the gold was transferred to rail for Algiers. The transport from Algiers to Marseilles was a new nightmare. The French, who had declined the German help, because they did not like the idea of German military on Algerian soil, had no more than a few old bomber aircraft available. The last cargo arrived as late as may 1942. In Marseilles, the Germans took over and transported the gold to Berlin.

The Belgian government in exile in London did not appreciate the transfer to Germany of the Bank’s gold reserves and urged the Bank’s agency in London to begin legal proceedings against the Banque de
France in New York. Why New York? The French as well as the Belgians had given in safe custody a part of their gold at the federal reserve Bank of New York. In order to be compensated for the loss in France the Belgian government thought that a transfer of gold from one account to the other at the Federal Reserve in New York would be a simple solution.

John Foster Dulles was asked to defend the Belgian case. He tried to find a compromise between the two parties, but failed, as Gutt proved to be uncompromising. After months of endless discussions the American court suspended the proceedings until 6 months after the War. De Gaulle finally decided, after the liberation of France, to restitute the gold to the National Bank of Belgium.

But let us go back to the even bleaker picture of occupied Belgium. After the surrender of the Belgian army at the end of May 1940, Hitler had installed a Military Government to run the country. General von Falkenhausen, notwithstanding his anti-Nazi sentiments, had been appointed, under pressure of the army, as the Military Commander of the area. Reeder, a moderate member of the Party, was appointed President of the Administration. Both decided, in sharp contrast to the strategy of the Nazi-top in Berlin, not to plunder Belgium straight away, but to promote development of the national economy. In their view such a strategy would not only benefit occupied Belgium, but the Reich as well, as in the long run it would maximize the support of Belgium, an advanced industrialized country at that time, to the German war effort and, later on, it would direct Belgium to become an economic satellite of Germany.

The economic situation of Belgium, immediately after the occupation, however, was catastrophic, as we mentioned already. One million Belgians, including many entrepreneurs and top officials, had fled to France and were only returning very slowly to the country. The material infrastructure of the country, moreover, was seriously damaged and the acute shortage of money generated a complete standstill of economic activity.

The Military Government at first envisaged to set up a Bank of Issue under German control. The Belgian bankers said ‘no’ to such a proposal, remembering all too well the chaos a dual monetary circulation had provoked during and after the First World War. The military Government accepted at the end to install a bank of issue for the duration of the war under control of the Belgian private bankers.
The occupying administration also accepted to withdraw from circulation the *Reichskreditkassenscheine*, a paper money in German marks, introduced by the German army during the invasion to buy goods in the occupied territories. The withdrawal restored the exclusive circulation of Belgian banknotes.

Economic recovery, however, implied more than just monetary stability. Industrial activity had to be revived too. The main Belgian bankers, controlling the heavy industry, had to make now a crucial decision: should they refuse to restart the industrial production, as they had done during the First World War? Or should they reopen their plants? Closing factories not only implied the dismantling of the plants by the Germans, but also a threat to the unemployed workers, who would certainly be sent to the war industry in Germany.

During the First World War the choice had not been so difficult. Unemployed workers could survive, thanks to the Belgium Relief program, a large-scale food program, chaired by Herbert Hoover, who would become President of the States in 1928. Times had changed. Churchill no longer trusted the Nazis, as his former countrymen had trusted the imperial German army. He wanted the blockade of the continent to be complete.

But Belgian agricultural production was still by far insufficient to feed its population. The only solution was to exchange industrial products for food during the occupation. But all borders were closed. Exporting or buying goods on international markets was only possible by consent of the German authorities, in other words by exporting to Germany manufactured goods for food, thus to collaborate to some extent with the enemy.

This was not a minor problem for people in charge of the Belgian economy during the German occupation, inter alia the private bankers, industrialists and some top civil servants, who had stayed in the country during the invasion.
Under the leadership of Galopin, governor of the Société Générale, they agreed upon a policy called ‘la politique du moindre mal’. This was not a straightforward collaboration policy, but an accommodation policy that was accepted by the occupying forces as well as by the Belgian government in London. In exchange of the import of food and raw materials, the Belgian industry would restore up to 60 per cent of its pre-war production, ruling out any production of weapons and other military equipment.

The monetary and financial aspects of the accommodation policy were entrusted by the Military Government to the National Bank and the Bank of Issue, which, since the return of Governor Janssen from France, were working together under his chairmanship. The Military Government had made it clear that all financial settlements should take place within the framework of the German clearing-system, the Belgian franc now being integrated into the Reichsmark zone.

The rate of exchange between the mark and the Belgian franc was a fixed one for the duration of the war, and, of course, in favor of the German mark. All payments from Belgian debtors to German creditors had to be centralized by the Bank of Issue in Brussels and from there transferred to an account at the Deutsche Verrechnungskasse in Berlin, which would pay out the creditors with German paper money. Similarly, all payments from German debtors to Belgian creditors would be centralized at the same Kasse and entered, again at fixed exchange rates, as a credit on the Bank’s account at the Kasse, the Bank being requested to pay out the Belgian creditors with Belgian banknotes.

In principle, the system was based upon a full equilibrium between imports and exports. Initially the clearing-system worked well, the equilibrium between imports and exports being respected. But after the German invasion into the Soviet Union, the so-called operation Barbarossa, which started on 22 June 1941, the clearing-system went out of hand.

The war now had turned into a total war, the Nazi-propaganda calling it a ‘crusade against evil’, defending the values of the West against a pernicious soviet regime. Imports of foodstuffs to Belgium came to a nearly complete standstill, while the export of industrial products from Belgium to the German area continued its normal pace. Moreover, several German procurement agencies, entirely out of control of the Brussels Military Government, entered the Belgian market, including the Black market, buying all what *still* could be found.
Clearing operations were now completely out of Belgian control. The conditions were not set any longer by the lender but solely by the borrower (taking on the form of the provision of a line of credit in such a way that the conditions were not set by the lender but by the borrower). At the end of the occupation Belgian credit at the Berlin bank had risen to 65 billion francs, an enormous amount at that moment. Now the Belgian government in London no longer supported the policy ‘du moindre mal’, but it accused openly the Belgian National Bank, the Bank of Issue and the private bankers of collaboration and of supporting the German war effort.

The National Bank and the private bankers reacted vigorously against what they called an indirect plundering of the country. They even went to Berlin to protest. But the plundering continued. They could have resigned. But what would have happened next? Pro-Germans certainly would have replaced them and things would have been even worse.

Finally, they just tried to refuse payment of questionable transfers. In many cases the Military Government sympathized with the protesters and tried to find a compromise. More often, though, it had to impose the payment. Von Falkenhausen had to be cautious too, as Himmler was trying to convince Hitler that the Military Government in Belgium was too lenient and that it should be replaced by a Civil Nazi-Government, a replacement which indeed took place, but fortunately only one month before the liberation of the country so that it had no impact at all on the Belgian situation. At that moment von Falkenhausen was even arrested and imprisoned in Germany.

A few words about the currency reform, organized by Finance Minister Gutt, shortly after his return from London to Brussels in September 1944, when Belgium was liberated.

The financing of the occupation and the German abuse of the clearing-system had artificially inflated the money supply in Belgium. Gutt’s point of departure was monetarist and inspired by Belgium’s bad experience of price inflation during and after the First World War. The money supply had to be reduced substantially to nearly his volume at the eve of the invasion in May 1940. In Gutt’s view, the reduction would provoke a drastic fall in prices, it would restore the purchasing power of wages and ensure that the post-war devaluation of the Belgian franc could be kept to a minimum.
The reform was prepared for months on end by the Belgian government in exile, in collaboration with the representatives of the Bank in London, and also by a secret cell in the Bank in Brussels. The reform can be reduced to four major steps, the first being the ‘fiat’ of the Americans and the British on the post-war exchange rate of the Belgian franc in preparation of the Bretton woods Conference in July 1944.

The second phase, to be the core of the reform, was realized early October of the same year, by replacing the circulating banknotes by a limited number of new ones and by freezing nearly all bank accounts in Belgium. The result was a drastic shrinking of the money supply from nearly 165 billion francs to 57 billion, compared to 50.5 billion at the invasion in May 1940. The impact on the real economy and the psychological shock it provoked was unparalleled in the country’s history.

The third phase was the gradual relaxation of the deflationary measures, parallel with the revival of economic activity. The fourth and final phase consisted mainly in a series of drastic fiscal laws in order to eliminate all war-profits, as a punitive measure against economic collaboration.

How to evaluate Gutt’s reform? The international press was unanimously positive: especially the smooth transition from a shock therapy to a relaxation was greatly appreciated.

In Belgium criticism prevailed. First of all the deflation did not bring the expected decline in prices because goods remained scarce, the military monopolizing all traffic over seas. Subsequently the purchasing power of wages and salaries was not increased, on the contrary.

An external factor helped soon to solve the problem. In the fall of 1944 General Eisenhower decided that the allied troops should hibernate in Belgium. He wanted to clear Antwerp, the first harbor in the North in hands of the Allies, before starting the final invasion of Germany, the army needing a broad supply base, a big harbor.

But soldiers, especially when out of duty, spend money and troops need services. The Belgian government paid the bills and the National bank issued the banknotes. All this was against Gutt’s plan, but it proved to be beneficial to the country’s economy during the years immediately after the liberation. Deflation, indeed, was followed by a powerful reflation, which procured the necessary oxygen for the Belgian economy.
Some other circumstances promoted the fast recovery of the country. The rapid advances of the allied troops in 1944 had left the industrial infrastructure and the Antwerp harbor virtually unscathed. The harbor, as we already mentioned, was very quickly integrated into the war-effort, generating a large income in sterling and in dollars. Belgium was thus the first country on the continent to put his industry back on track and it benefitted from this lead even with a rather old-fashioned industrial infrastructure.

The international press was impressed by what they called the ‘Belgian economic miracle’. Less than a decade later, however they called Belgium ‘the sick man of Europe’. How did it occur? How was it possible?

In my view, structural factors offer the most plausible explanation. Gutt’s reform was a purely monetary operation without an economic embedment. The reflation, which followed because of special circumstances, concealed in the short run the economic weaknesses of the reform, but, in the longer run, the shortcomings would became evident.

Gutt’s monetary reform ought to have been embedded in a government project of industrial restructuring, as it was in France with the Plan Monnet, in the Netherlands with the Plan Tinbergen, or later in Germany with Erhard’s Plan of ‘Soziale Marktwirtschaft’.

For Belgium, once the first industrial nation on the European continent, back in the nineteenth century, it certainly was a missed opportunity with nefast consequences.