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The Power of Independence: De Nederlandsche Bank 1967-1981: The Role of Independence in Shaping the Power Relation between the Ministry of Finance and De Nederlandsche Bank 1967-1981

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The Power of Independence: De Nederlandsche Bank 1967-1981

The Role of Independence in Shaping the Power Relation between the
Ministry of Finance and De Nederlandsche Bank 1967-1981

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Introduction

In 2017, Klaas Knot, president of De Nederlandsche Bank, argued in *Trouw* to reform the Dutch housing market, pension funds, and tax system. Furthermore, he spoke warmly of implementing measures to combat climate change to make the economy climate neutral.¹ Interestingly, his arguments were presented at a time of a national surplus of 1.3%, although he argued that the government should not overestimate this surplus, as it required this surplus as a buffer for potential future recessions.² Knot's public statements reflect a political goal setting that may constrain the political options available to the government regarding what to do with the state surplus.

Knot held a speech where he argued for more economic policy cooperation in the European Union, even if at the cost of national sovereignty.³ These may not be considered radical statements for a politician, but Knot is not a politician but the president of De Nederlandsche Bank (hereafter: DNB). As such, he should abide by the core value of the bank: "independence".⁴ The idea of an independent central bank is rooted in the principle that if presidents engage publicly with political goal setting, they run the risk of expanding or re-interpreting the definition of independence that stands at the core of most central bank charters. However, decisions made by central banks profoundly affect stakeholders in a variety of ways, and for that reason, their core decisions are still political in nature.⁵ Central banks assign a crucial role to their mandate to justify these decisions.⁶

Central banks' tasks revolve mainly around monetary policy, positioning them between governments and private agents (banks). While governments played a crucial role in providing a monetary status to private agents' debt by guarding private property rights, due to conflicts of interest, this is less easily institutionalized for government debt itself. Because governments have the unique capacity to renege on their obligations, new institutional innovations were necessary to signal their willingness to repay their own debt, to signal creditworthiness to private investors.⁷ To realize this, parts of fiscal and monetary policy governance must be delegated to a trustworthy institution to manage creditors' interests. Ugolini states two strategies to achieve this: the first is "delegating the management of the value of government debt to a public, but fully independent agency, entrusted with the mission to preserve the stability of debt contracts".⁸ The second "consists of delegating the government's borrowing business [...] to a private agency, which will have no incentive to renege on its obligations".⁹ The first strategy integrates monetary policy into the realm of public policy, while the

¹ J. Kleinnijenhuis, "Nieuw kabinet kan niet met geld smijten" in: *Trouw* 30-3-2017.

² Ibidem.

³ T. Bollen, "Hardwerkende Nederlanders dokken voor luie Italianen (en zes andere misvattingen over het Europese coronafonds)" in: *Follow The Money* 15-10-2020.

⁴ <https://www.dnb.nl/over-ons/missie-en-taken/> accessed on: 27-04-2022, see mission statement.

⁵ J. van 't Klooster, *The Political Economy of Central Bank Risk Management* (Groningen 2021) 121.

⁶ Ibidem.

⁷ S. Ugolini, *The Evolution of Central Banking: Theory and History* (London 2017) 175.

⁸ Ibidem.

⁹ Ibidem.

second strategy externalizes its management to the private sector. The goal is similar in both strategies, to ensure governments respect debt contracts and are committed to repaying them. The two strategies do differ in their means to achieve this goal, by configuring a different institutional relationship with the government.

However, the history of central banks does not imply that they followed one strategy for their entire history, and this is particularly true for DNB. The history of DNB is plagued by a continuous balancing between the bank's responsibilities towards the government and the banking sector. Although DNB was established by royal decree in 1814, it was intended, from its outset, to be a private institution, placing it within the externalization strategy of Ugolini. Initially, the banking community was suspicious of a government-sponsored bank and thus shunned investing in it, hoping that the bank would wither away. Only when the bank became inevitable did private investors and bankers invest in the bank, hoping to gain control over the newly formed institution or at least use the bank to gain access to privileged information.¹⁰ DNB's position had to be carefully balanced between private and political interests for most of the nineteenth and roughly the first half of the twentieth centuries.

According to Singleton, the first significant shift in central banks' relation to their respective governments arose during the 1930s and 1940s, when they became less autonomous and were partly integrated within the realm of public institutions under the supervision of governments.¹¹ The second important change was in the 1980s and the 1990s with the implementation of central bank independence, a moment when central banks again became more autonomous and even insulated from government control.¹²

In the case of DNB, the economic crisis of the 1930s did not result in an immediate curtailing of independence through the institutionalization of control mechanisms. Instead, DNB had become more of a bankers' bank during this period and had increased its portfolio of loans to the banking sector and businesses, which, according to Vanthoor, embellished the principally private nature of DNB.¹³ In essence, DNB took to heart that its responsibility lay primarily with the (private) banking sector, placing it under the second strategy proposed by Ugolini, that government debt management was externalized to a private agent.

This relation completely changed with the Bank Act of 1948, whereby the functioning of the bank and its institutional relationship with the government, particularly with the Ministry of Finance and the banking sector, was set in stone. This late institutional transformation places DNB outside the chronological shift proposed by Singleton and positions the Dutch case somewhat outside the general

¹⁰ J. Jonker, *Merchants, Bankers, Middlemen: The Amsterdam money market during the first half of the 19th century* (Amsterdam 1996) 168.

¹¹ J. Singleton, *Central Banking in the Twentieth Century* (New York 2011) 110.

¹² *Ibidem*, 204.

¹³ W. Vanthoor, *De Nederlandsche Bank 1814-1998: Van Amsterdamse kredietinstelling naar Europese Stelselbank* (Amsterdam 2004) 117.

trend framed in Singleton's work. With the Bank Act of 1948, the government bought all the shares of DNB that were in the hands of private shareholders, resulting in the government becoming the only shareholder.¹⁴ Despite this, Fase emphasizes that the government did not want a state-controlled bank but instead a bank that fell outside private control.¹⁵ This signals a transition from the externalization of control to a private institution towards the internalization of control via public policy, as identified by Ugolini. While DNB had *de facto* become a public institution, a new institutional relationship had to be formed guarding the principle of independence. In Fase's view, a central bank is independent when it is not subjected to the government, which he did not see altered with the Bank Act of 1948.¹⁶ Vanthoor is of a different opinion and points out that the Bank Act of 1948 made the government ultimately responsible, and therefore politically accountable, for the Bank's policies,¹⁷ as Article 26 of the Bank Act of 1948 states that: "Our Minister [of Finance] may, after consultation with the Bank Council, give such directions to the Governing Board of the Bank as he thinks necessary for the Bank's policies".¹⁸ This so-called *aanwijzingsrecht*, or *right to designate*, in English, stands central in this thesis.

The second important change in central banks identified by Singleton was during the 1980s and 1990s and was accompanied by increased insulation of central banks from public scrutiny and emphasized the role of individuals.¹⁹

"The most ardent proponents of central bank independence were academic economists and politicians. Central bankers themselves could not afford to participate in what was after all a political debate on the nature of the relationship between the central bank and the state".²⁰

For Singleton, presidents of central banks appear as insulated from the political power play, removed from policy debates, and absent from public scrutiny. In his view, debates on economic and financial policy were left to 'expert' economists and politicians. Even if Singleton's claims seem to fit the case of the Federal Reserve Bank in the United States, his arguments grossly understate the role independence played in the case of European central banks and particularly the case of DNB.

Singleton's claim that presidents of central banks are removed from policy advice, policymaking, and policy debate seems to be incorrect in describing the active role that DNB's presidents played in political debates. For instance, in 1971, the Minister of Finance Witteveen

¹⁴ M.M.G. Fase, *Tussen behoud en vernieuwing: Geschiedenis van de Nederlandsche Bank 1948-1973* (The Hague 2000) 38.

¹⁵ *Ibidem*.

¹⁶ *Ibidem*, 49.

¹⁷ Vanthoor, *De Nederlandsche Bank 1814-1998* (Amsterdam 2004) 178.

¹⁸ R. Bade and M. Parkin, "Central Bank Laws and Monetary Policy" *Working paper, University of Western Ontario* (1988) 6. For original text in Dutch, see: Bank Act 1948, article 26. This can also be found in: Fase, *Tussen Behoud en Vernieuwing* (The Hague 2000) 537-556.

¹⁹ Singleton, *Central Banking in the Twentieth Century* (New York 2011) 204.

²⁰ *Ibidem*.

presented a new bill to parliament to regulate DNB. President Jelle Zijlstra believed that this bill would infringe the independence of DNB and therefore stated: “I will use all means, including publicity, to stop this development”.²¹ Zijlstra threatened to use publicity to curb the plans of the Minister of Finance, stepping away from a position of independence in relation to the central government and using public scrutiny to obstruct a political decision. This can hardly be described as a tactic that aligns with an institution that relies on independence to remain absent from public scrutiny, as Singleton argues. Zijlstra’s statement was also aimed directly at immediate political goal setting, whereby an infringement of the principle of independence became evident, as Zijlstra was primarily interested in defending DNB’s institutional self-interest. The historiographical claim that central bank independence was designed in the 1990s, the moment when it was enshrined into most central bank charters, hides the complexities of the period before, when an intense debate between governments and central banks ensued over the responsibility of each party in terms of monetary policy, political goal setting and ultimately independence.

Considering the *right to designate*, Zijlstra’s threat to look for publicity to stop a specific development²² implies that he did not see himself or DNB subjected to the government, as interpreted by Vanthoor. Zijlstra saw a possibility to push the boundaries of DNB’s charter regarding the *right to designate*. He was, however, not alone in permanently questioning Article 26. The Minister of Social Affairs Albeda publicly questioned the institutional relationship between the government and DNB by stating: “Yes, but actually we are in control, and not De Nederlandsche Bank!”²³ Even Prime Minister Den Uyl questioned DNB president Zijlstra’s role: “Who is actually the boss?” to which Zijlstra bluntly replied: “The Bank is!”²⁴ These are bold statements by politicians and DNB’s president when asserting and defining the power relationship that ruled over the interactions between the government, the Ministry of Finance, and DNB’s president. From these short exchanges, it is clear that Zijlstra enjoyed enormous influence and played an active role in testing the limits of Article 26 as established in the Bank Act of 1948.

To illustrate the point, the relationship between the government and DNB can be compared with the constitutional position of the King in the Netherlands. The King is inviolable, and the government is responsible for his activities. Therefore, the government tightly controls his public appearances and statements. As a result, the King’s inviolability constraints his freedom to act. When considering the charter of DNB, a similar relation is expected because the government is ultimately

²¹ J. Harmsma, *Jelle zal wel zien: Een eigenzinnig leven tussen politiek en economie* (Amsterdam 2018) 294.

²² Ibidem.

²³ Original quote in Dutch: “Ja, maar eigenlijk zijn wij toch degenen die regeren en niet De Nederlandsche Bank?” Source: J. Th. de Smidt, R. H. J. M. Gradus, S. G. A. Kaatee and Joh. de Vries (eds.), *Van Tresorier tot Thesaurier-Generaal: Zes eeuwen financieel beleid in handen van een hoge Nederlandse ambtsdrager* (Hilversum 1996) 439.

²⁴ Original quote in Dutch: “Wie is hier nu eigenlijk de baas? Dat is de Bank!” Source: J. Th. de Smidt, R. H. J. M. Gradus, S. G. A. Kaatee and Joh. de Vries (eds.), *Van Tresorier tot Thesaurier-Generaal: Zes eeuwen financieel beleid in handen van een hoge Nederlandse ambtsdrager* (Hilversum 1996) 442.

responsible and held accountable for monetary policy, even though its management is delegated to the central bank. Since politically, the government would be held accountable for activities by DNB presidents, it is expected they maintain tight control over their actions, especially their public appearances and statements. Somehow, Zijlstra was able to expand the boundaries of the charter by appealing to the “independent” nature of the bank. Seen from this perspective, although *de jure*, the bank was subjected to government control during Zijlstra’s presidency, by asserting “independence” the bank *de facto* could interpret the charter more freely.

Zijlstra was a peculiar case to assess the role of DNB’s independence. He was politically active since 1952, as Minister of Economics, Minister of Finance, and briefly as Prime Minister. However, he was an expert in monetary economics, which likely played an essential role in his nomination as president of DNB in 1967. His nomination also coincided with the broader trend of an increasing role of public officials in shaping the debate regarding the role of the state in the economy, as is argued by Oudenampsen:

“Senior economic policymakers pushed for extensive socio-economic reforms of a highly political nature at a remarkably early stage, while politicians and journalists played a more secondary role and successfully depoliticized the reforms in the public debate as being ‘realistic’, ‘pragmatic’, and ‘no-nonsense’.”²⁵

Due to the economic and monetary nature of the problems experienced in the 1970s, most notably high inflation, and increased government indebtedness due to expansionary finance, technocrats are expected to play an essential role in shaping the policy response.²⁶ Especially during crises, experts enjoy more significant influence, according to Haas:

“Under conditions of uncertainty, epistemic communities play a key role in articulating the cause-and-effect relationships of complex problems, helping states identify their interests, framing the issues for collective debate, proposing specific policies, and identifying salient points for negotiation.”²⁷

Technocracy is, therefore, an effective term to describe decision-making processes in the Netherlands during the 1970s. Instead of leaving politicians to decide on critical socio-economic reforms, economic policymakers reduced complex reforms with varying political results to ‘best-

²⁵ M. Oudenampsen, “Between conflict and consensus: The Dutch depoliticized paradigm shift of the 1980s” published online: 30 March 2020, 4.

²⁶ J.L. van Zanden and R.T. Griffiths, *Economische geschiedenis van Nederland in de 20^e eeuw* (Wijk bij Duurstede 1989) 258.

²⁷ P.M. Haas, *Knowledge, Power and International Policy Coordination: Studies in International Relations* (South Carolina 1997) 2.

outcome' scenarios to be determined by them. In a period in which expertise played a significant role in decision-making, it is expected that DNB, too, played an important role. And perhaps establishing itself as independent was a way for DNB to translate its expertise into political influence.

The basis of the argument to delegate control over monetary policy to technocrats can be found in the abundant economics literature that discusses the reasons for and the merits of granting independence to the central bank.²⁸ Governments and elected politicians have an inflationary bias, leading them to spend more money in the short term, at the cost of long-term stability, to achieve political goals ensuring their re-election. Delegating control over monetary policy to an agent (the central bank) with a strict mandate to achieve the objective of low and stable inflation, thereby taking monetary policy out of the hands of elected politicians, was presented as the institutional fix.

Economic literature has spent a great deal of time researching the effectiveness of the level of independence of the central bank in achieving low inflation. The main conclusion is that the more independent the central bank is, the more successful it delivers low inflation. But more importantly, it also concludes that there is no negative impact of the degree of central bank independence on the level or variability of economic growth.²⁹ Following, institutionalizing independent central banks was presented as a 'free lunch' because low inflation could be achieved without any negative consequences for the economy.³⁰ This research found a causal relationship between the degree of independence of the central bank and the level of inflation. However, its weakness lies in quantifying independence on a small scale, either 1-4 or 1-7; the higher the number, the more independent the central bank.³¹ Because of the small scale, it is susceptible to the numerical values.³² Therefore, it is of the utmost importance that the level of independence is correctly quantified.³³

The most common way to determine the degree of independence of the central bank is by looking at its charter, but this does not always provide a clear answer. For example, Bade and Parkin use this in a multi-country analysis of central bank independence. Their study concludes that DNB is

²⁸ K. Rogoff, "The optimal degree of commitment to an intermediary monetary target" in: *The Quarterly Journal of Economics* 100:4 (1985) 1169-1189; A. Cukierman, "Central Bank Independence and Monetary Control" in: *The Economic Journal* 104:427 (1994) 1437-1448, there 1437.

²⁹ A. Alesina and L.H. Summers, "Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence" in: *Journal of Money, Credit and Banking* 25:2 (1993) 151-162, there 154.

³⁰ Cukierman, "Central Bank Independence and Monetary Control" in: *The Economic Journal* 104:427 (1994) 1437-1448, there 1438.

³¹ Bade and Parkin, "Central Bank Laws and Monetary Policy" *Working paper, University of Western Ontario* (1988); Alesina and Summers, "Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence" in: *Journal of Money, Credit and Banking* 25:2 (1993) 151-162; V. Grilli et al. "Political and Monetary Institutions and Public Financial Policies in the Industrial Countries" in: *Economic Policy* 6:13 (1991) 341-392; S. Eijffinger, M. van Rooij and E. Schaling "Central Bank Independence: a Paneldata Approach" in: *Public Choice* 89 (1996) 163-182.

³² Eijffinger, Rooij and Schaling, "Central Bank Independence: a Paneldata Approach" in: *Public Choice* 89 (1996) 163-182, there 165.

³³ Alesina and Summers, "Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence" in: *Journal of Money, Credit and Banking* 25:2 (1993) 151-162, there 152

“subservient to the government”.³⁴ The argument put forward is Article 26 of the Bank Act of 1948, which gives the Minister of Finance the *right to designate* monetary policy, making him legally responsible and politically accountable for the activities of DNB. Contrary to Bade and Parkin, Grilli et al. argue that DNB enjoys “the highest degree of political independence”.³⁵ DNB cannot be both dependent and independent. Quantifying the independence solely based on the legal charter might not be an adequate assessment.

Rather than revaluing the contradicting conclusions based on the charter, Alesina and Summers use the average of the index by Bade and Parkin and Grilli et al.³⁶ However, if we are dealing with two contradictory meanings, taking the average is not analytically sound. If the wrong level of independence is used throughout the literature, the empirical foundation is incorrect, and its conclusions must be questioned.

While the literature cannot reach a consensus when establishing the level of independence based on the charter, the charter itself also does not pay attention to daily and informal practice. That makes two rather critical analytical gaps in the literature. These also apply to the case of DNB. (1) There is no strong account of how independent DNB was based on the charter. (2) The charter does not include actual practice and therefore ignores how DNB interpreted the rules in the charter as part of their institutional self-interest. The earlier examples of how DNB presidents Knot and Zijlstra deviated from their role as described in the charter questions the difference between *de facto* independence and *de jure* independence. In other words, the law does not adequately explain the practice.³⁷ This opens room for debate on the role of independence in influencing the causality between high central bank independence and low inflation levels.

During the tenure of DNB’s president Zijlstra, the Minister of Finance was legally responsible for the bank’s activities and could dictate its policies. Nonetheless, it appears that Zijlstra was able to bend the rules and act very independently. This means DNB was already *de facto* independent during the presidency of Zijlstra despite the legal charter stating that the Minister of Finance was responsible. The literature that interpreted DNB’s legal charter as DNB being “subservient to the government”³⁸ built its index on the wrong assumption, questioning the core argument for the move towards central bank independence – that the more independent the central bank is, the lower the inflation levels.

³⁴ Bade and Parkin, “Central Bank Laws and Monetary Policy” *Working paper, University of Western Ontario* (1988) 4.

³⁵ Grilli et al. “Political and Monetary Institutions and Public Financial Policies in the Industrial Countries” in: *Economic Policy* 6:13 (1991) 341-392, there 367-368.

³⁶ Alesina and Summers, “Central Bank Independence and Macroeconomic Performance” in: *Journal of Money, Credit and Banking* 25:2 (1993) 151-162, there 154; Grilli et al. “Political and Monetary Institutions and Public Financial Policies in the Industrial Countries” in: *Economic Policy* 6:13 (1991) 341-392; Bade and Parkin, “Central Bank Laws and Monetary Policy” *Working paper, University of Western Ontario* (1988).

³⁷ Cukierman, “Central Bank Independence and Monetary Control” in: *The Economic Journal* 104:427 (1994) 1437-1448, there 1439.

³⁸ Bade and Parkin, “Central Bank Laws and Monetary Policy” *Working paper, University of Western Ontario* (1988) 4.

Therefore, the literature on central bank independence can be strengthened by doing a more in-depth case study that takes *de facto* independence into account. March summarizes the gap very well: “We know more about abstract agents dealing with abstract principals than we do about real bureaucrats dealing with real politicians”.³⁹ In essence, the theory is very well developed, but it has hardly been analyzed in actual practice and with too little attention to the interaction between agents of the central bank and the Ministry of Finance. Incorporating this aspect into the analysis requires a qualitative approach, which has been side-lined by economists.⁴⁰ This thesis aims to contribute to the understanding of the role independence plays in shaping the power relation between the Ministry of Finance and DNB.

Although a qualitative approach has been lacking within the discipline of economics, central bank independence has received attention from some other disciplines. For example, Hielscher and Markwardt argue that the overall institutional quality is the causal explanation for low inflation in an economy and not simply the level of independence of the central bank.⁴¹ Fernández-Albertos also points out that: “Low inflation observed in countries with independent central banks could have less to do with the institutional innovation itself than with more profound structural social and political factors”.⁴² Both these studies emphasize incorporating more variables into the analysis to understand better how to deliver low inflation.

According to this literature, countries with independent central banks might also have a societal interest in achieving lower inflation. The government signals its willingness to contribute to a low inflation policy by granting independence to the central bank. Instead of the level of independence of the central bank causally explaining the negative correlation between central bank independence and inflation levels, it might be only a mediating variable. The causal explanation would be the government’s commitment to contribute to low inflation. To communicate its commitment to private investors, it grants independence to the central bank. If there is a societal interest in achieving low inflation, it is helpful to understand other arguments for why governments would commit to a low inflation policy.

One important aspect to consider is the potentially redistributive consequences of pursuing a low-inflation policy. King distinguishes two ways in which inflation is presented; the first is the more technical, economic approach, which defines “inflation as a problem to be solved through optimal control theory”, very much in line with the technocratic trend observed by Oudenampsen.⁴³ King’s

³⁹ J. March, “Administrative Practice, Organization Theory, and Political Philosophy: Ruminations on the Reflections of John M. Gaus”, in: *Political Science and Politics* 30:4 (1997) 689-698, there 693.

⁴⁰ Van ‘t Klooster, *The Political Economy of Central Bank Risk Management* (Groningen 2021) 19.

⁴¹ K. Hielscher and G. Markwardt, “The Role of Political Institutions for the effectiveness of Central Bank Independence” in: *European Journal of Political Economy* 28 (2012) 286-301, there 295.

⁴² J. Fernández-Albertos, “The Politics of Central Bank Independence” in: *Annual Review of Political Science* 18 (2015) 217-237, there 221.

⁴³ Oudenampsen, “Between conflict and consensus: The Dutch depoliticized paradigm shift of the 1980s” published online: 30 March 2020, 4; M. R. King, *Distributional Politics and Central Bank Independence: Monetary Reform in the United Kingdom, Canada, Australia and New Zealand* (London 2001) 15.

second approach is more political and portrays “inflation as the result of a distributional conflict between groups in society”.⁴⁴ These two options differ in their perception of inflation; the first presents it as a technical issue with a best-outcome scenario – which can therefore be solved by economists – while the second politicizes inflation because it plays a part in a distributional conflict. If the second is the case, then the move towards independent central banks is not a ‘free lunch’, as some literature argues. If certain groups in society are harmed less by higher levels of inflation, and certain groups are harmed more by higher levels of inflation, then the decision to favor a low inflation policy involves a political decision involving a trade-off between different stakeholders.

The literature does acknowledge that individuals play an essential role in shaping the central bank's policy trajectory and hence the policy outcome. Rogoff pioneered the idea of the effectiveness of independent central banks in achieving low inflation by quantitatively trying to prove a causal relationship between the degree of conservatism of the central bank's president and achieved levels of inflation. In Rogoff's view, presidents of central banks have some room to interpret their mandate by including or excluding certain variables from their analysis, thus enjoying agency in delivering a policy outcome. Nonetheless, Rogoff also considers the move toward central bank independence as a ‘free-lunch’ by arguing that society would be better off if it appointed a conservative central banker that would put fighting inflation as his primary target.⁴⁵

More recently, Adolph studied the effects of the career paths of presidents of central banks on their policy choices. Building upon an impressive dataset based on the labor market trajectories of presidents of central banks, from a vast number of countries and over a longer period of time (primarily 1950-2000), he concludes that presidents with a career background, or future career perspective, in finance, are more likely to be inflation averse.⁴⁶ If presidents aspire to work in the financial sector in the future, they are more likely to get a job if previous acts have been in favor of the class interest. Since high inflation hurts future financial income, an interest group is formed to achieve low, stable, and predictable inflation rates. The neutrality of fighting low inflation must be questioned since, as King argued, there might be redistributive effects associated with it, which would put it firmly into the domain of political decision-making. Still, both Rogoff and Adolph's theses focus on the importance of individuals in shaping the strict commitment of the central bank to put fighting inflation as its primary target. If individuals play such an important role, then it becomes increasingly difficult to effectively govern a central bank's activities via a mandate because individual presidents can find ways to reinterpret the boundaries of the charter. Achieving low inflation demands active commitment and policy adjustments by other actors, too. The central bank can play a role in actively steering the other actors into delivering this objective. However, that means the central bank must also

⁴⁴ M.R. King, *Distributional Politics and Central Bank Independence: Monetary Reform in the United Kingdom, Canada, Australia and New Zealand* (London 2001) 15.

⁴⁵ Rogoff, “The optimal degree of commitment to an intermediary monetary target” in: *The Quarterly Journal of Economics* 100:4 (1985) 1169-1189, there 1187.

⁴⁶ C. Adolph, *Bankers, Bureaucrats and Central Bank Politics: The Myth of Neutrality* (New York 2013) 145.

steer the government to adopt the correct behavior, which sits uneasily with the established level of independence and accountability.

For central banks to achieve low inflation, it is necessary to, at times, constrain the government's access to finance and, therefore, potentially hinder the government's ability to pursue a political goal. That implies two things: (1) the central bank must decide when to help finance the government and when to restrict its access to finance, and (2) it means that the central bank itself is not able to deliver low inflation but requires the government to support that goal. The government can voluntarily decide to cooperate with the central bank and cut its spending. But the central bank can also hinder the government's access to finance in other ways (examples of this will be given in chapters 2 and 3). Governments are democratically elected, and central banks typically are not; however, if central banks can constrain and potentially hinder the government, their mandates demand a clear and strict formulation of ultimate responsibility and accountability. This is why the *right to designate* plays a crucial role in DNB's mandate.

If central banks can tie the hands of elected governments, why would politicians decide to delegate control over monetary policy? Crowe asked the same question and concluded that it removes the "intra-coalition conflict over monetary policy from the political arena".⁴⁷ It serves to take conflict over monetary policy "off the table".⁴⁸ The cost of a factional and intra-coalitional battle over monetary policy is politically costly and hinders political progress in other fields. Since monetary policy, especially government indebtedness, has a longer-lasting effect than the time in-between elections, both left- and rightwing governments stand to gain by tying each other's hands in a predictable way, equaling the playfield.

This thesis will research the role independence played in shaping the relationship between DNB and the Ministry of Finance during DNB's presidency of Jelle Zijlstra (1967-1981). Focusing on the interaction between politics and the central bank demands a qualitative approach to central bank independence, something economics literature has largely neglected. The case study of Zijlstra's presidency of DNB will serve as a strong example of how central banks use knowledge, expertise, and stature to bend the level of independence they enjoy. This thesis expands the vast array of literature on independent central banking, which has often ignored the difference between theory and practice by strictly limiting itself to quantifying characteristics formulated in the charters of central banks. Independence is more than just an institutional design; it is a way to govern the relationship between various actors, and its effects, therefore, vary widely.

Nonetheless, to understand the role independence played, an assessment of the level of dependence of DNB must be provided. Therefore, chapter one of this thesis does two things. The first is to establish the government's degree of political control over DNB as formulated in the charter. The

⁴⁷ C. Crowe, "Goal Independent Central Banks: Why Politicians decide to Delegate" in: *European Journal of Political Economy* 24 (2008) 748-762, there 749.

⁴⁸ *Ibidem*.

next step focuses on how politicians dealt with the power relation between the government (in particular the Ministry of Finance) and DNB. The emphasis will be on how politicians reflected on Zijlstra's active role in shaping the power relation between DNB and the government. This will be combined with how Zijlstra himself reflected on this power relation, which he did extensively in his memoirs and other writings. Memoirs are not the most objective source available; however, they do contain some insider knowledge and critical reflections. Comparing its insights with other literature establishes how Zijlstra saw the relation between the government and DNB. This chapter aims to understand the deeper meaning behind the legal charter, what was intended with its design, and how politics perceived the relationship the government and DNB.

The second chapter discusses the perspective of DNB presidents Jelle Zijlstra and his predecessor Marius Holtrop on the responsibilities of the government and of DNB in monetary policy. By focusing on the question 'who is responsible for inflation?'. Dissecting the ideological background of the monetary analysis helps understand how DNB formulated modes of analysis as well as policy responses to monetary questions. Drawing on academic writing by DNB presidents Zijlstra and Holtrop provides an in-depth understanding of their monetary reflections. The role of bank presidents in shaping policy must not be underestimated. The above discussion on central bank independence has greatly emphasized the role of agency, in particular in the work of Rogoff and Adolph.⁴⁹

The third chapter will combine the knowledge from the previous two chapters to see how independence impacted the relationship between the two institutions. Monetary policy demands cooperation between the government, the central bank, and the banking sector. The answer must be sought in the actual practice and internal politics of DNB. Given that statements by central banks can have real-time effects on financial markets, their internal politics are often behind closed doors and relatively secret. However, the historical perspective is less bound by this problem because it is unlikely that statements from 40-50 years ago will impact today's financial markets, allowing me to produce a fuller account of the actual practice.

Unfortunately, there is another problem to deal with when studying the practice of central banking. For example, there was a lot of informal contact between the president of DNB and the Minister of Finance in the form of weekly lunch meetings; sadly, it is almost impossible to write a history of these lunch meetings, for there are no minutes available – and they were probably not even made. The only thing present in the archives was a prepared list of some of the topics discussed in these meetings, but that does not provide an adequate account to establish the role independence played in the relationship between DNB and the Ministry of Finance.

Fortunately, though, because the Ministry of Finance, too, was interested in cooperating with DNB, a study group was formed. The purpose of this study group was to coordinate monetary policy

⁴⁹ Rogoff, "The optimal degree of commitment to an intermediary monetary target" in: *The Quarterly Journal of Economics* 100:4 (1985) 1169-1189; Adolph, *Bankers, Bureaucrats and Central Bank Politics: The Myth of Neutrality* (New York 2013).

and come to an agreed understanding of the roles and responsibilities of both institutions. It was also a way for the Ministry of Finance to learn from DNB and bridge the gap in knowledge between the two institutions.⁵⁰ Precisely because the study group intended to discuss how to coordinate monetary policy, it is expected that the relationship between both institutions was discussed. Given that the members present in these meetings were high officials from both institutions, they must have been important. A complete account of the minutes can be found in the archives, allowing an analysis of their proceedings over a longer time. Knowledge of the first two chapters is required to understand the relevance of the topics discussed in these meetings. The third chapter builds upon the understanding of the first two chapters and works as a means to check whether they played an important role in practice. Applying these insights to the discussions of the meetings held between the study group of DNB and the Ministry of Finance help understand what role independence played in establishing the relationship between DNB and the Ministry of Finance during Zijlstra's presidency of DNB.

The answers from this research help understand the complex relationship between the government and the central bank. Given the complex separation of responsibilities, as well as the number of influencing actors and variables, make the governance of this relationship difficult. Improving our understanding of this is relevant even to this day. Knot's statements at the beginning of this research emphasize the contemporary relevance of a deeper understanding of the role of independence in shaping the relationship between the Ministry of Finance and DNB. Institutionalizing independence has served a specific purpose in steering the governance structure. Understanding how the relationship developed during the presidency of Zijlstra allows us to shed light on the power of agents within this institutional structure.

Central banks across the world are receiving increased political interest since they are responsible for governing a vast amount of capital. Under the guise of "independence", they determine whether or not to put their activities to serve a particular political goal.

⁵⁰ Harmsma, *Jelle zal wel zien* (Amsterdam 2018) 295.

Chapter One: The political independence of DNB

As discussed in the introduction, a considerable amount of research has been conducted on the degree of legal independence of central banks. This led numerous authors to define quantifiable features to determine the *de jure* independence of a central bank. To make sense of the role independence played in the case of DNB, the first step is to look at the legal framework that was established. Adolph provides a useful summary of six points to assess the degree of political control over the central bank:

1. The President's term of office,
2. How much say the government has in the President's appointment,
3. How easily the President may be dismissed,
4. Whether the President may hold other political offices simultaneously,
5. Whether the central bank formulates monetary policy,
6. Whether the central bank has the final say on monetary policy.⁵¹

These points compare well with the broader literature establishing the political independence of central banks. I will now discuss how this relates to DNB, as formulated in the Bank Act 1948. A copy of the legal statute can be found in Fase's appendix.⁵²

Point one is the president's term of office. Article 23 of the Bank Act 1948 states that the president is appointed for seven years.⁵³ General elections of parliament take place at least every four years, which means that under normal conditions, the presidency of DNB is more enduring.

Point two is how much say the government has in the president's appointment. The government appoints the president, but the management and the board of commissioners recommend two candidates. Article 23 clause 1 states that the government will consider the proposed candidates to the extent it deems necessary.⁵⁴ That means the government can also ignore the proposed candidates and appoint a president of its own choice. Therefore, the government theoretically has complete control over the appointment of the president of DNB.

Point three, how easily can the president be dismissed? The president of DNB can be dismissed on two grounds, and these grounds are also applicable to any member of the Bank's board of directors. Firstly, during the joint meeting of the Bank's board of directors and the supervisory board, a proposal of dismissal or suspension of any member of the Bank's board of directors can be

⁵¹ Adolph, *Bankers, Bureaucrats and Central Bank Politics* (New York 2013) 191. In the original text the term "Governor" is used; I have here changed this predominantly Anglo-Saxon term with the equivalent "President", which was more fitting for the Dutch-case. There is no change in the value of the term intended, it is purely for consistency throughout the text.

⁵² Fase, *Tussen behoud en vernieuwing* (The Hague 2000) 537-556.

⁵³ Bank Act 1948: Article 23, clause 1.

⁵⁴ *Ibidem*.

presented to the government. The government then ultimately decides whether to respond to this.⁵⁵ The second option is that a member of the Bank's board of directors who refuses to act upon the *right to designate* of the government can be dismissed.⁵⁶ We have come across the *right to designate* in the introduction. Still, for the sake of reference, it is formulated as follows: "Our Minister may, after consultation with the Bank Council, give such directions to the Governing board of the Bank as he thinks necessary for the Bank's policies".⁵⁷ After the Minister has invoked his *right to designate*, the Bank's board of directors has three days to formulate a response. The Minister of Finance must consider this response but can ultimately still determine whether to accept or reject the response.⁵⁸ As a result, the Minister of Finance legally has the freedom to dismiss any member of the Bank's board of directors if it fails to act upon the directive. Since the Minister can determine the Bank's policies, override the response of the Bank, and even dismiss the member who fails to respond to the directive, the power of the *right to designate* is significant.

Point four is whether the president may hold other political offices simultaneously. In the Bank Act of 1948, it is not specified whether the president of DNB can or cannot simultaneously hold political office. But here, the appointment of Zijlstra as president of DNB in 1967 proves an exciting illustration. The initiative to propose Zijlstra as a candidate for the presidency of DNB came from the sitting president of DNB, Marius Holtrop.⁵⁹ From the perspective of independence from politics, this is somewhat peculiar because Zijlstra had been in politics since 1952 and had held various official positions, not the least that of Minister of Finance. Zijlstra had stepped down from the prevalent political spotlight in 1963 by becoming a member of the First Chamber. Zijlstra enjoyed a public status and was widely regarded as an expert, making him appear politically uncontroversial; therefore, his nomination initially did not meet much opposition.⁶⁰ Instead, Minister of Finance Vondeling, was caught questioning whether Zijlstra, as president of DNB, could resist meddling with politics.⁶¹ Still, the government did not run into problems with his nomination, and in 1966 he was appointed as the next president of DNB, to begin in May 1967.

Things changed when Dutch politics called upon Zijlstra to form an interim government following the fall of the government of Cals in 1966, on a night that has become famous in the Netherlands as the 'Nacht van Schmelzer'. Zijlstra had effectively become Prime Minister while also

⁵⁵ Bank Act 1948: Article 23, clause 4.

⁵⁶ Bank Act 1948: Article 23, clause 5.

⁵⁷ English translation taken from: Bade and Parkin, "Central Bank Laws and Monetary Policy" *Working paper, University of Western Ontario* (1988) 6. Original: Bank Act 1948: Article 26. "In de gevallen, waarin Onze Minister zulks ter coördinatie van de monetaire en financiële politiek der Regering en de politiek van de Bank noodzakelijk acht, geeft hij, de Bankraad gehoord, aan de directie de ter bereiking van dat doel nodige aanwijzingen. Behoudens het bepaalde in het volgende lid, is de directie gehouden die aanwijzingen op te volgen."

⁵⁸ Bank Act 1948: Article 26, clause 2.

⁵⁹ Fase, *Tussen behoud en vernieuwing* (The Hague 2000) 242.

⁶⁰ Harmsma, *Jelle zal wel zien* (Amsterdam 2018) 260.

⁶¹ Fase, *Tussen behoud en vernieuwing* (The Hague 2000) 247-248.

becoming the future president of DNB. Remarkably, as Fase points out, this had not led to rescind Zijlstra's nomination for president of DNB. Only on Zijlstra's initiative was it decided that his appointment had to be turned down.⁶² Later, when a new cabinet was presented, which did not include Zijlstra, he was again nominated as the future president of DNB. However, the Bank attempted to make Zijlstra's appointment conditional upon him promising to not accept other political posts.⁶³ Zijlstra responded with incomprehension. To his knowledge this was never demanded of presidents, however, he did not object on fundamental grounds.⁶⁴ Zijlstra became president of DNB, to begin office in May 1967, days after he had resigned as Prime Minister.

Theoretically, it would be possible for the Prime Minister to simultaneously be the president of DNB, making the whole concept of central bank independence meaningless. Despite no formal restriction to hold both positions, there was some opposition to Zijlstra's nomination because of his 'political character'.⁶⁵ Still, DNB's board clearly adhered to the independent nature of its activities, and demanded its president to reflect this, too. The non-political character of the president of DNB was widely regarded as essential by both politics as well as by the Bank. The interesting question, sadly left unanswered from this account, is whether the Bank was weary of political influence by the government, or that the government was weary of DNB having too much political influence if the president also enjoys political office.

Point five is whether the central bank formulates monetary policy. There are two ways to answer this since the literature divides monetary policy into two interpretations of independence. The first is goal independence, which means that the central bank can formulate its own policy objective. The second is instrument independence, which means that the government determines the policy objective but allows the central bank the freedom to use various instruments to achieve it.⁶⁶ In the case of DNB, the charter stated the following: "The Bank's task is to regulate the value of the Guilder, in such a way that it is most beneficiary for the wealth of the country and stabilize it at that level".⁶⁷ DNB independently set an inflation target and therefore enjoyed goal independence. Determining the inflation target drastically changes the actual level of independence because goal independence allows the central bank to develop its own goals, which will enable it to establish its agenda, and, more crucially, to formulate policy analysis and the subsequent policy responses. Since the charter does not specify what is "most beneficiary for the country's wealth", a lot of room is left for DNB to interpret

⁶² Fase, *Tussen behoud en vernieuwing* (The Hague 2000) 244.

⁶³ *Ibidem*, 246.

⁶⁴ *Ibidem*.

⁶⁵ Harmsma, *Jelle zal wel zien* (Amsterdam 2018) 260.

⁶⁶ For an explanation between goal independence and instrument independence see for example: J. Pixley, "Central bank independence: a social economic and democratic critique" in: *Labour relations review* 24:1 (2013) 32-50, there 41.

⁶⁷ Bank Act 1948: Article 9, clause 1. Original in Dutch: De Bank heeft tot taak de waarde van de Nederlandse geldenheid te reguleren op zodanige wijze als voor 's lands welvaart het meest dienstig is, en daarbij die waarde zoveel mogelijk te stabiliseren. For reference see: Fase, *Tussen behoud en vernieuwing* (The Hague 2000) 539.

this, which involves determining crucial socio-economic trade-offs in society. How DNB did this will be discussed in chapter two.

Point six is whether the central bank has the final say on monetary policy. Article 26 of the Bank Act 1948 states that the Minister of Finance has the *right to designate* monetary policy; hence, DNB does not have the final say on monetary policy. As briefly discussed above, under point three, if the Bank refuses to follow up on an invocation of the *right to designate*, the Minister of Finance can dismiss any of the board's members, including the president. Therefore, the final say over monetary policy ultimately lies with the Minister of Finance.

Considering all points of DNB's legal charter, it must be concluded that the government is legally supreme over the institution, and it enjoys enormous influence in appointing the different board members and directors. DNB enjoys the freedom to set the goals of monetary policy, but here, too, ultimately, the government can disagree with it and give direct orders to DNB that must be followed. If DNB did not adequately respond to the order, the Minister of Finance could invoke the *right to designate* to force DNB to adopt the proposed policies or dismiss those members that failed to react. All points considered the political control over DNB was enormous, but the upper limit of independence is defined by the *right to designate*; it, therefore, demands further reflection.

What was historically intended with the *right to designate*? When the Bank Act 1948 was formed, the sitting Minister of Finance Liefstinck – who also co-wrote the bill - considered the *right to delegate* an *ultimum remedium* which meant that it should only be used as a matter of last resort.⁶⁸ Executing the *right to designate* was a very definitive mechanism and would therefore attract public attention, testing the legitimacy of the power relation out in the open. Because of the substantial implications of executing it, it is possible to seriously damage the relationship between the government and the central bank. As such, it must have indeed operated as an instrument to be used as a last resort.

Perhaps because it was used as an instrument of last resort, Zijlstra could consistently test and push its boundaries. In this light, we must see Zijlstra's remark when he opposed the new bill presented by Minister of Finance Witteveen in 1971 because it would infringe upon the bank's independence: "I will use all means, including publicity, to stop this development".⁶⁹ This suggests that Zijlstra was, in fact, attempting to contest the power relation out in the open, which proves that the *right to designate* was indeed a contentious mechanism of control for the government. Because of its extremity, invoking it would always result in a public debate that would immediately put the government's popularity to the test, something it cannot always risk doing. Zijlstra's threat to use publicity indicates that popular opinion was on his side.

⁶⁸ Vanthoor, *De Nederlandsche Bank 1814-1998* (Amsterdam 2004) 202.

⁶⁹ Harmsma, *Jelle zal wel zien* (Amsterdam 2018) 294.

Still, the power relation was being questioned in several instances. First, Minister of Social Affairs Albeda was caught asking: “Yes, but actually we are in control, and not De Nederlandsche Bank?”⁷⁰ And also by Prime Minister Den Uyl, who asked: “Who is actually the boss?”, to which Zijlstra bluntly replied: “The Bank is!”⁷¹ The issue was also raised in various cabinet formations; Van Agt – the successor to Den Uyl as Prime Minister – said about Zijlstra: “His authority, knowledge, and experience were beyond any doubt”.⁷² And because of his influence on the press and politics, Van Agt considered Zijlstra a “shadow Prime Minister”.⁷³ The level of power that Zijlstra enjoyed was felt by the Minister of Finance and by other members of the cabinet. The fact that different governments noticed this power relation showed that it was not merely directed against a specific policy, for instance, the left-wing and expansionary government of Den Uyl, but also during the more conservative government of Van Agt. Zijlstra voiced his strong opinion on various occasions and across multiple cabinet formations, so the power relation appeared to be a more structural phenomenon. Even though the government had complete political control over DNB, and could dismiss president Zijlstra, if needed, such an intervention would attract public attention and make it a battle of publicity, something that was politically risky. So, while the legal charter clearly states the government’s supremacy over monetary policy, exercising this was much more troublesome.

To what extent did the *right to designate* act as a mechanism to determine the inter-agent interactions between the officials from the Ministry of Finance and DNB? In his memoirs, Zijlstra compared the functioning of the *right to designate* as it operated at DNB with its counterpart across the sea, the Bank of England. Whereas the *right to designate* was the guiding principle of every inter-agent interaction, between the officials of the Bank of England and the Treasury, of every rank, in the Netherlands, it was strictly limited to a discussion “at the highest level”.⁷⁴ In the Netherlands, *the right to designate* was only discussed between the president of DNB and the Minister of Finance. As a result, it could very well be that the *right to designate* played a more prominent role in the interaction between these two individuals, but to answer that, a closer study of the relationship and the interactions between the president of DNB and the Ministry of Finance is required.

Because of the inter-personal working of the *right to designate*, the Minister of Finance and the president of DNB had to be in close and frequent contact with one another. To embellish the informal character of cooperation, the president and Minister of Finance met during weekly lunch meetings.⁷⁵ This informal organization somewhat contradicts the strictness of the *right to designate* and embellishes a more informal cooperation.

⁷⁰ J.Th. de Smidt, R.H.J.M. Gradus, S.G.A. Kaatee and Joh. De Vries (eds.), *Van Tresorier tot Theaurier-Generaal: Zes eeuwen financieel beleid in handen van een hoge Nederlandse ambtsdrager* (Hilversum 1996) 439. Original quote: “Ja, maar eigenlijk zijn wij toch degenen die regeren en niet De Nederlandsche Bank”.

⁷¹ Ibidem, 442. Original quote: “Wie is hier nu eigenlijk de baas? Dat is de Bank!”.

⁷² Harmsma, *Jelle zal wel zien* (Amsterdam 2018) 359.

⁷³ Ibidem.

⁷⁴ Zijlstra, *Per slot van rekening: memoires* (Amsterdam 1992) 213.

⁷⁵ Harmsma, *Jelle zal wel zien* (Amsterdam 2018) 291.

Zijlstra, having been on both ends of the (lunch)table, as Minister of Finance and later, as president of DNB, reflected on the relation between the two, which provides a strong sense of the dynamics. As Minister of Finance, he argues, you encounter an institution, DNB, that in such a critical policy field as monetary policy, can actually do whatever it wants. Furthermore, the Minister of Finance finds his “natural enemies” in his colleagues in government and parliament, with their tendency to overspend. Therefore, DNB, caring about budgetary prudence, is the Minister’s only ally.⁷⁶ Being responsible for the budget, the Minister of Finance must defend the financial position of the government in parliament, for which the support of the central bank is crucial. Therefore, the Minister of Finance has the incentive to rely on the expertise of DNB, emphasize their knowledge and experience, and mobilize their advice as credible guidance.

Even though the Minister of Finance was politically accountable and responsible for monetary policy, parliament did not simply take this for granted and at times demanded greater transparency on the decision-making of DNB, mainly because of the political implications. In 1972, the Second Chamber⁷⁷ requested that the president of DNB should explain in parliament certain policy decisions. In an internal note of DNB, they saw this as part of a more general trend of parliament to demand greater transparency.⁷⁸ This trend is also identified by Van Zanden and Griffiths, who argue that in the late ‘60s and early ‘70s, society began to question the legitimacy of certain socio-political institutions.⁷⁹ This included more interest in the role of DNB.⁸⁰ Zijlstra refused to account for his actions in parliament based on it undermining his “a-political authority that elevated him above partisan politics”.⁸¹ He continues by saying that “leaving the ivory tower” would indicate to parliament that it has the power to dismiss the president, but it does not have that power.⁸² The president of DNB could be dismissed if he failed to act upon the *right to designate*, but that does not mean a vote of parliament could dismiss him. Instead, such a vote should be directed toward the Minister of Finance.

Because of DNB’s charter, monetary policy was the responsibility of the Minister of Finance, who was accountable to parliament and not the president of DNB. In 1966, Minister of Finance Vondeling said: “The president of DNB is inviolable, the Minister of Finance responsible”.⁸³ Since the Minister of Finance is held responsible for the activities of the president of DNB, it is expected that its activities be tightly managed. That would, however, conflict with the meaning of independence, and

⁷⁶ Zijlstra, *Per slot van rekening: memoires* (Amsterdam 1992) 212.

⁷⁷ In Dutch: Tweede Kamer.

⁷⁸ National Archive, The Hague (NL-HaNa), Inventaris van het archief van het Ministerie van Financiën: Generale Thesaurie: Directie Binnenlands Geldwezen (1889) 1954-1995, archival number 2.08.49, inventory number 290, internal memo dated 7-6-1972

⁷⁹ Van Zanden and Griffiths, *Economische Geschiedenis van Nederland in de 20e eeuw* (Wijk bij Duurstede 1989) 67.

⁸⁰ Fase, *Tussen behoud en vernieuwing* (The Hague 2000) 278.

⁸¹ NL-HaNA, Inventaris van het archief van het Ministerie van Financiën: Generale Thesaurie: Directie Binnenlands Geldwezen (1889) 1954-1995, archival number 2.08.49, inventory number 290, internal memo dated 7-6-1972.

⁸² *Ibidem*.

⁸³ Harmsma, *Jelle zal wel zien* (Amsterdam 2018) 291.

here we see why the *right to designate* is an odd mechanism—invoking it *de facto* strips the Bank of its independence. Its application is of such an extremity that it is almost unusable. It did, however, allow DNB to escape public scrutiny. Following this, there is an uneasy institutional balance between accountability and responsibility. Therefore, independence depends more strongly on the personal relationship between the president of DNB and the Minister of Finance. Although formally, the degree of political control over DNB is considerable, the extremity of the mechanism makes it almost useless in daily practice.

Although the *right to designate* was never actually invoked, in 1977, a direct application came closest, according to Zijlstra.⁸⁴ The years leading up to this had already slightly damaged the relationship between the Bank and the government because the government demanded direct financing of its government debt by the Bank. The immediate cause that led to the almost application of the *right to designate* was that the Bank had independently started negotiating with the banking sector on a new mechanism for credit restriction. Prime minister Den Uyl only received word of this via a press-communiqué, instead of being informed by the Bank directly or via the Minister of Finance.⁸⁵ This was a politically sensitive move by the Bank because the credit restriction conflicted with government policy.⁸⁶ The government wanted to increase its spending requiring more access to credit, something which would be obstructed if DNB pressured the credit restriction. In his memoirs, Zijlstra provides two reasons why this had not led to applying the *right to designate*. The first is the Minister of Finance did agree with the policy of the Bank (therefore being less Keynesian than the government in general), and second, the Prime minister did not want to fight an open battle.⁸⁷ Zijlstra's biographer argues that Article 26 had never been used before, making it uncertain terrain that would attract increased public attention, something the government was unwilling to risk because Zijlstra's authority made him tremendously popular and likely to "win" open conflict.⁸⁸

A few years later, in 1980, Zijlstra again sought to escalate a situation by executing a rather bold move, which he called a 'reversed' *right to designate*.⁸⁹ Again, DNB's role in directly financing government expenditure was the issue. Zijlstra had written a letter to Minister of Finance Van der Stee, explicitly stating he would restrict the banking sector's ability to finance the government by imposing credit restrictions.⁹⁰ Parliament got hold of this letter, and parliamentarian Wöltgens said that the Bank is eroding the supremacy of politics in monetary policy by writing letters for the Minister of Finance that can best be described as policy prescriptions.⁹¹ Legally, the letter holds no basis, but it

⁸⁴ Harmsma, *Jelle zal wel zien* (Amsterdam 2018) 291.

⁸⁵ Vanthoor, *De Nederlandsche Bank 1814-1998* (Amsterdam 2004) 276.

⁸⁶ *Ibidem*.

⁸⁷ Zijlstra, *Per slot van rekening* (Amsterdam 1992) 215-216.

⁸⁸ Harmsma, *Jelle zal wel zien* (Amsterdam 2018) 342.

⁸⁹ Zijlstra, *Per slot van rekening* (Amsterdam 1998) 217.

⁹⁰ *Ibidem*, 217-218.

⁹¹ *Ibidem*, 218.

shows to what extent Zijlstra imposed his will and why it is hard to speak of independence when such an active role is asserted.

These examples show that *de facto* independence works much differently than what is expected from the legal framework. The government's legal supremacy does not consider the incredible difficulty of actually executing the *right to designate*. Because of this difficulty, what was essentially a discussion of legal power, became a place to contest political power. Publicity and political support were more important than the objective legal power relation. As such, the role of the central banker could be very considerable, depending on his strength and popularity.

Chapter Two: DNB's perspective on the responsibility for inflation

“For every idea, no matter the extremity, you can always find a professor in economics willing to defend it”.⁹²

In the 1970s, a debate ensued over the government's ability to influence and steer the economy by correcting the potential flaws of the private sector and to what extent this was desirable.⁹³ The above statement, taken from Zijlstra's memoirs, is an ironic reflection on the extremity of the arguments proposed in this debate, and the inconclusiveness and sometimes contradictory nature of the economics profession in dealing with this question. The nature of the question is immediately concerned with the control of the money supply and is therefore aimed directly at the central bank's activities; DNB played an essential part in this debate. Zijlstra, too, played a crucial role in shaping this debate, as becomes partly clear from the book titled: “Moderate Monetarism”,⁹⁴ published upon Zijlstra's retirement as president of the Bank, containing all of Zijlstra's introductions to the annual reports of DNB. The title indicates DNB's position within this highly political and economic debate, which strikes the heart of the institutional relationship between the government and the central bank. The core question underlying this chapter is “who is responsible for inflation?”. This will be assessed primarily through the perspective of the academic and intellectual contributions of two presidents of DNB, Jelle Zijlstra and his predecessor, Marius Holtrop, to understand how they saw the Bank's position within the debate on the role of government intervention in the economy.

Emphasizing the theoretical contributions of DNB's presidents does not immediately respond to how DNB conducted monetary policy. However, the influence of central bank presidents must not be understated. Both Rogoff and Adolph draw policy-level conclusions based upon behavior of presidents of central banks.⁹⁵ In both their works, the degree of conservatism of the president is seen as a major factor in determining the overall direction of policy of the central bank. Furthermore, monetary policy is a continuous response to economic circumstances, making it difficult, if not impossible, to program all the possible reactions to specific economic conditions in advance, leaving room for presidents to decide on the course of action. The purpose of this chapter is not to discuss DNB's monetary analysis, but rather, to understand how DNB's presidents thought of the relationship between DNB and the government, more specifically on the question: “who is responsible for inflation?”.

⁹² Zijlstra, *Per slot van rekening* (Amsterdam 1998) 211.

⁹³ M. 't Hart, J. Jonkers and J.L. van Zanden (eds.), *A financial history of the Netherlands* (New York 1997) 166.

⁹⁴ Original in Dutch: “Gematigd Monetarisme”, title of the book: Zijlstra, *Gematigd Monetarisme: 14 jaarverslagen van de Nederlandsche Bank N.V. 1967-1980* (Leiden 1985).

⁹⁵ Rogoff, “The optimal degree of commitment to an intermediary monetary target” in: *The Quarterly Journal of Economics* 100:4 (1985) 1169-1189; Adolph, *Bankers, Bureaucrats and Central Bank Politics: The Myth of Neutrality* (New York 2013).

Zijlstra's academic work, already at an early stage of his life, expanded upon theories developed by Holtrop. In particular, Zijlstra's dissertation was a direct contribution to Holtrop's dissertation.⁹⁶ Fase, too, argues that Zijlstra largely kept the monetary philosophy of Holtrop intact.⁹⁷ However, Zijlstra's presidency of DNB coincided with significant shifts in the general socio-economic context and was, therefore, more likely to have steered critical institutional changes. Zijlstra's academic work, published before and during his presidency of DNB, provides key insights into DNB's perspective on the government's role in the economy.

Holtrop discussed the "relative responsibilities of governments and central banks in controlling inflation".⁹⁸ He formulated responsibility as follows: "Responsibility for a change in the economic situation can only be ascribed to a person, institution or authority, who is the direct cause of the change, or had the powers to stop it".⁹⁹ In Holtrop's view, the government or the central bank could be held responsible if it directly caused inflation or if it had the powers to stop it. Still, the origin of inflation is not so easily established. It depends on an in-depth interpretation of the economic theory and a calculation of economic activity, which, by and large, was executed by DNB which made it the second-biggest producer of statistics after the Central Bureau of Statistics (CBS).¹⁰⁰

DNB's charter does not define an inflation target but leaves this open for DNB to determine; it is formulated as: "The Bank's task is to regulate the value of the Guilder, in such a way that it is most beneficiary for the wealth of the country, and to stabilize it at that level".¹⁰¹ It, therefore, matters how DNB defined the causes of inflation and how this influenced the parameters of its monetary analysis, thereby impacting policy analysis and policy responses. With this broad formulation in the charter, DNB enjoys significant freedom of interpretation.

Given the enormous number of uncertainties in dealing with monetary policy, the central bank must decide upon controllability versus transparency of the objective. The economy is an aggregate of innumerable individual acts, and inflation is one of the effects of this process; as such, it must be questioned to what extent the central bank has direct control over inflation. Therefore, it must balance between establishing a clear goal, adhering to a transparent inflation target, and the degree of controllability in achieving this. As Cukierman points out, it can decide on a range of goals, targeting the monetary base or directly determining an inflation target.¹⁰² The difference between these two

⁹⁶ Zijlstra, *De Omloopsnelheid van het Geld en zijn betekenis voor Geldwaarde en Monetair Evenwicht* (Leiden 1955).

⁹⁷ Fase, *Tussen behoud en vernieuwing* (The Hague 2000) 262.

⁹⁸ M.W. Holtrop, "De Relatieve Verantwoordelijkheid van Overheid en Centrale Bank voor de Beheersing van Inflatie" in: *De Economist* 108:5/6 (1960) 305-334.

⁹⁹ Holtrop, "De Relatieve Verantwoordelijkheid van Overheid en Centrale Bank voor de Beheersing van Inflatie" in: *De Economist* 108:5/6 (1960) 305-334, there 306.

¹⁰⁰ Fase, *Tussen behoud en vernieuwing* (The Hague 2000) 149-151.

¹⁰¹ Article 9, clause 1. Original in Dutch: De Bank heeft tot taak de waarde van de Nederlandse geldeenheid te reguleren op zodanige wijze als voor 's lands welvaart het meest dienstig is, en daarbij die waarde zoveel mogelijk te stabiliseren. For reference see: Fase, *Tussen behoud en vernieuwing* (Den Haag 200) 539.

¹⁰² Cukierman, "Central Bank Independence and Monetary Control" in: *The Economic Journal* 104:427 (1994) 1437-1448, there 1442-1443.

extremes is in the transparency of the objective versus the level of controllability of that same objective. The monetary base is the outstanding net liabilities of the central bank from the government¹⁰³ and is a very controllable amount because the government and the central bank can together determine what is desirable and can work to achieve that. Although it is highly controllable as an objective, its effects on the inflation rate – the goal – are highly unpredictable. The effect will take a while, and the exact impact is highly unreliable because of many uncertainties. When this approach is taken, there is more direct control over the mechanism applied, but the transparency in the goal pursued is lacking.

When, however, the focal point is the level of inflation, the goal is much more transparent, as it clearly signals to the market what is intended with its policy. The trade-off is that several variables influence the inflation rate, over which the central bank only has indirect control.¹⁰⁴ So the first area where DNB enjoys some freedom of interpretation is determining its focal point; does it focus on controllability or transparency?

DNB can determine its monetary target, its benchmark, anywhere on a range between the two extremes just mentioned. Money has an established hierarchy, focusing on its nearness to the monetary base; these are often referred to as M1, M2, M3, etc.; the lower the number, the closer it is to the monetary base. Zijlstra explains that DNB's monetary analysis was focused on M2 and is composed of: cash held by individuals and companies, including deposits on demand (usually money deposited at banks) and longer-term deposits, including short-term loans given by non-banks to public authorities.¹⁰⁵ These are all the forms of money that DNB sought to integrate into their monetary analysis. These forms of money directly concern household spending, and the closer they are to this, the further they are from direct control by the central bank. Ultimately, inflation is the monetary expression of a social process resulting from countless individual decisions on an everyday basis. DNB only had a few mechanisms to influence this indirectly; some will be discussed later in this chapter.

One of the more theoretical ways to approach monetary policy is formulated in Fisher's famous quantity theory " $MV=PT$ ".¹⁰⁶ The formula plays an essential part in understanding monetary policy; Zijlstra spent quite some time studying the gaps in this formula, primarily in his dissertation.¹⁰⁷ Here, Zijlstra critiques the formula because it shows nothing more than a mathematical equation or equilibrium; it therefore only shows the outcome of a process - which is inevitably mathematically

¹⁰³ P. Korteweg, "Over de beheersbaarheid van de geldhoeveelheid in Nederland" in: *De Economist* 121:3 (1973) 273-299, there 277.

¹⁰⁴ Cukierman, "Central Bank Independence and Monetary Control" in: *The Economic Journal* 104:427 (1994) 1437-1448, there 1442-1443.

¹⁰⁵ Zijlstra, 'Monetary Theory and Monetary Policy a Central Bankers view' in: *De Economist* 127:1 (1979) 3-20, there 15.

¹⁰⁶ For reference: M=money supply, V=velocity of money, P=price level, T=number of transactions.

¹⁰⁷ Zijlstra, *De Omloopsnelheid van het Geld en zijn betekenis voor Geldwaarde en Monetair Evenwicht* (Leiden 1955).

even - but it ignores the underlying metamorphosis in the money supply. As Zijlstra argues, during these metamorphoses, the form of money changes, altering its potential effects on the economy, allowing for all sorts of disruptions.¹⁰⁸ Zijlstra's economic views here are very salient because it changes the perspective of money from something static into something that carries within it a dynamic potential that must be considered.

Recognizing that economic activity is a series of changes that take time to develop, Zijlstra adds an extra layer of analysis to Fisher's quantity theory by distinguishing between *ex-ante* and *ex-post* analysis. *Ex-ante* is the period before equilibrium is restored, and *ex-post* is when equilibrium is restored. The quantity formula of Fisher only describes the *ex-post* situation. Adding the *ex-ante* into the analysis emphasizes the different metamorphoses money undergoes before it arrives at a more stable *ex-post* position. As Zijlstra explains, if someone decides to hoard cash, then M (the total money supply) declines because money (temporarily) leaves circulation. Considering Fisher's formula, an increase in M must mean that either V, P, or T change proportionally to achieve the mathematical stability of the equation. The result is that changes in prices or income must occur. However, as Zijlstra points out, because someone has decided to hoard money, this does not mean that the money has left circulation forever.¹⁰⁹ In other words, the potential effect is still in the economy, but it remains latent. Therefore, Zijlstra argued that companies and households' liquidity is an indeterminacy, or instability, in the system because hoarded money can at some time again become money in circulation. He called this indeterminacy the "monetary latitude", which became the focal point of DNB's monetary analysis.¹¹⁰

Holtrop provides a theoretical case study that neatly illustrates the fundament of DNB's monetary analysis while also reflecting the policy choices that underlie it. As Holtrop argues, big business does not care if its liquid reserves are in the form of a current account balance, a short-term bank deposit, or treasury bills.¹¹¹ Therefore, if a business decides not to invest its money but instead to save, all these three forms should be considered the same hoard. If the firm chooses to buy treasury bills directly from the government, this is regarded as a deflationary move.¹¹² The business now owns treasury bills instead of money, which is harder to spend in the economy. Money, therefore, left circulation and no longer carries immediate purchasing power. As a result, the money supply has decreased, and the move is considered deflationary.

¹⁰⁸ Zijlstra, *De Omloopsnelheid van het Geld en zijn betekenis voor Geldwaarde en Monetair Evenwicht* (Leiden 1955), 5-6.

¹⁰⁹ Ibidem, 152-153.

¹¹⁰ Zijlstra, "Monetary Theory and Monetary Policy a Central Bankers view" in: *De Economist* 127:1 (1979) 3-20, there 9.

¹¹¹ For clarification, considering government debt, there are different durations at which these are brought to market. Treasury bills are usually somewhere between 3 – 12 months duration. Treasury notes are somewhere between 2 – 5 years.

¹¹² M. W. Holtrop, "The Method of Monetary Analysis used by The Nederlandsche Bank", in: *De Economist* 104 (1956) 657-673, there 665.

While the business has lost purchasing power, the government gained purchasing power. As such, the mode of analysis shifts to a new actor. If the government decides to spend all this acquired money in the economy, the initial deflationary move becomes monetary neutral. Although the “M” in $MV=PT$ initially declined, it increases by an equal amount if the government decides to spend all it has received. However, Zijlstra emphasized the importance of a difference between *ex-ante* and *ex-post* and this situation critically changes the *ex-ante*. In this situation, monetary neutrality is not ‘given’ but depends on the government consciously deciding to act inflationary – balancing out the deflationary move of the business. Singling out the government’s move implies that the government is actually acting inflationary, criminalizing it as the ‘culprit’, even if it simply responded to a given situation. Therefore, it matters how many steps DNB considered when assessing whether an action was deemed to be inflationary or deflationary. Simply because the economy is a complex aggregate of innumerable acts by all individuals in society, it is much easier to focus on the government’s ‘visible hand’, thereby creating an analytical bias towards the government.

If monetary neutrality is the objective, the government must spend all newly acquired cash, in response to business ‘saving’ or ‘hoarding’ money. Even though the amount of money remained equal, the economic potential of money has changed. At a later stage, the business can decide to call upon its savings to invest in a particular activity and thus demand its money back from the government. But, as Holtrop’s thought experiment continues, the government, having acted monetary neutral, has already spent the money that the business now demands and thus faces a liquidity issue. To repay its loan to the business, it must fall back on the banking sector to meet its liabilities.¹¹³ Having now borrowed the money from the banking sector to repay its debt with business, the money will be spent twice. The first time by the government because it was expected to act monetary neutral, and the second time by the business because it has now decided to invest its hoarded/saved money.

In the above example, it becomes clear that it is difficult to establish “Responsibility for a change in the economic situation” and to determine “who is the direct cause of the change or had the powers to stop it”.¹¹⁴ Even though in this example, it is possible to oversee and identify the cause, as mentioned before, innumerable acts happen simultaneously in the economy and are therefore much harder to track. Zijlstra’s contribution to the monetary analysis of DNB seeks to resolve this issue.

Zijlstra’s solution to the analytical question of responsibility for inflation was to identify moments that have the potential to spur inflation. Financial assets that are fixed for a long-time bear relatively little risk of igniting inflation. Liquidity, therefore, became the prime mode of analysis because the more liquid the asset, the more readily available it is to act as money in transactions, and the more likely it is to drive inflation. In his example, Holtrop argues that the situation was monetary

¹¹³ Holtrop, “The Method of Monetary Analysis used by The Nederlandsche Bank”, in: *De Economist* 104 (1956) 657-673, there 665.

¹¹⁴ Holtrop, “De Relatieve Verantwoordelijkheid van Overheid en Centrale Bank voor de Beheersing van Inflatie” in: *De Economist* 108:5/6 (1960) 305-334.

neutral because the inflationary acts were counteracted by deflationary actions and vice-versa. He would warn: “Even if no actual monetary disturbance has taken place, a potential one has been created”.¹¹⁵ Pursuing monetary neutrality demands an active role of the government to counteract the inflationary or deflationary moves by market actors. Given the nature of government-backed assets, they are perceived as highly trustworthy. They are valuable collateral in inter-bank lending and have a completely different function in society than a riskier business loan. Zijlstra attempted to incorporate these risks into the monetary analysis of DNB by carefully weighing the composition of credit instead of simply considering the total money supply.¹¹⁶

Having established the theoretical background of Zijlstra’s view on inflation shows that he emphasized the role of liquidity as the unstable variable igniting inflation. The remaining question in order to answer who is responsible for inflation, or who has the powers to stop it, is by analyzing DNB’s role in controlling liquidity in society.

Considering the level of controllability, DNB had mechanisms to exercise influence over the amount of liquidity in the economy, which were not specified in the Bank Act of 1948, but were added in 1952, with the Act on the Supervision of the Credit System. It authorized DNB to issue rules on capital-asset ratios and liquidity ratios of banks.¹¹⁷ It also allowed DNB to implement credit ceilings and selective credit control on banks.¹¹⁸ The law was temporary and got replaced in 1956, which – according to Vanthoor – replaced the more direct control via the imposition of liquidity ratios and credit restriction with a more informal and cooperative character.¹¹⁹ The more informal character embellished the culture of discussion and cooperation organized in *gentlemen’s clubs* that had been customary. In this regard, DNB should be seen as a *primus inter pares* of the banking sector; it did not dominate the banking sector, it was an intermediary between the government and the banking sector.

The culture of discussion and cooperation was also informally institutionalized because DNB engaged in meetings with representatives of the banking sector and not the government. The notes from the lunch meetings held between the Minister of Finance and the president of DNB are unfortunately not well documented, still, one clear passage is on point here. It shows Zijlstra rejecting a demand by the Minister of Finance to hold a tri-partite discussion between the Ministry of Finance, DNB, and the banking sector, on the grounds that the president of DNB should always be completely free to discuss matters with the other banks on the basis of trust, without a representative of the Ministry of Finance present.¹²⁰ Interestingly, the Minister of Finance requested such a discussion

¹¹⁵ Holtrop, “The Method of Monetary Analysis used by The Nederlandsche Bank”, in: *De Economist* 104 (1956) 657-673, there 665.

¹¹⁶ Zijlstra, “Monetary Theory and Monetary Policy a Central Bankers view” in: *De Economist* 127:1 (1979) 3-20.

¹¹⁷ Hart, Jonkers and Van Zanden (eds.), *A financial history of the Netherlands* (New York 1997) 184.

¹¹⁸ *Ibidem*, 187.

¹¹⁹ Vanthoor, *De Nederlandsche Bank 1814-1998* (Amsterdam 2004) 216.

¹²⁰ NL-HaNA, Inventaris van het archief van de Directie Financieringen (Generale Thesaurie) van het Ministerie van Financiën 1962-1989, archival number 2.08.58, inventory number 107, notes on the lunch-meeting between the Minister of Finance and the president of DNB, held on 16-10-1974.

because parliament would hold him accountable for the outcome of a debate on banking supervision, even though he had to rely on DNB to come to an agreement with the banking sector. For Zijlstra, DNB was clearly responsible for conducting banking supervision in cooperation with the banking sector, not the government. Just as with the discussion of the *right to designate* in the previous chapter, we find a conflict between responsibility and accountability. While DNB was responsible for monetary policy, the government was held politically accountable and, therefore, at times demanded greater influence in contesting the responsibilities. This uneasy separation of responsibility and accountability resulted in a continuous contesting of independence since the government demanded greater power in decision-making for which it was held accountable.

Similar to the functioning of the *right to designate* as an *ultimum remedium*, so, too, could the Minister of Finance step in whenever DNB was unsuccessful in striking an accord with the banking sector regarding banking supervision or a credit restriction. Instead of a *gentlemen's agreement* between the banking sector and DNB, the matter could be written into law by the Minister of Finance and to be voted on by parliament.¹²¹ Still, it was customary for banking supervision to be conducted based upon the aforementioned *gentlemen's agreements*.

Considering influence over monetary policy, DNB has one crucial mechanism of control over the banking sector, relating to its “privileged” position of being the lender-of-last-resort or that of being the banker’s bank. Whenever the banking sector found itself in need of liquidity, DNB could decide to temporarily grant money to the bank, taking some assets as collateral and demanding payment for this, the discount rate. “Banks became more dependent on the Nederlandsche Bank, and from the mid-1970’s it has been customary for them to be in the red with the Nederlandsche Bank. [...] If the banks are in the red the Nederlandsche Bank has a handle on them”.¹²² In other words, only when the banks are in need of liquidity can DNB determine whether or not to help them out with its discounting policy. As Barendregt and Visser argue, during the 1970s, the banks were increasingly reliant on DNB, which meant DNB had more direct control over monetary policy and, therefore on, the inflation rate.

DNB had two strategies to control the inflation rate in the economy, one is by emphasizing the government’s active role in counteracting inflationary or deflationary acts in the economy, and the other is by imposing credit restrictions on the banking sector, either directly or as result of a *gentlemen's agreement*. Since the banking sector became more dependent on DNB for access to liquidity, it is expected that DNB could exert a greater influence over inflation in the economy without relying on the government acting compensatory. However, Zijlstra emphasized the potential inflationary effects of a form of money, and, given the trust-worthy nature of government debt, these

¹²¹ M.W. Holtrop, *Monetary Policy in an Open Economy: Its Objectives, Limitations, and Dilemmas* (New Jersey 1963) 36.

¹²² J. Barendregt and H. Visser, “Towards a new maturity, 1940-1990” in: Hart, Jonker and Van Zanden (eds.), *A Financial History of the Netherlands* (New York 1997) 152-194, there 188.

were often used as collateral in inter-bank lending. As a result, government's budgetary deficit increases the number of government debt circulating in the economy, which, according to Zijlstra's monetary analysis, dramatically increases the potential of an inflationary tendency. The government, by its nature, already impacts the credit composition in the economy by increasing the circulation of liquid assets. Even if the government does not spend its acquired credit, it still changes the balance of fixed versus liquid assets, increasing the likelihood of inflation.

The liquid circulation of government debt in the economy is an important argument in the discussion on the government's role in steering and influencing the economy. However, the government can also exert influence on the inflation rate in other ways, as Zijlstra pointed out in a discussion on the role of monetarism. Zijlstra defined 'pure' monetarism as: "The central bank should simply adhere to an even rate of expansion of the money supply. This, as opposed to fine-tuning, is more likely to aid general economic stability".¹²³ In the monetarist view, "the control of the money supply is both necessary and sufficient for an effective macroeconomic control of the national economy".¹²⁴ Zijlstra himself was not a 'pure' monetarist but instead argued that: "controlling the money supply is necessary but not sufficient".¹²⁵ In the view of Zijlstra: "fiscal policy [taxation] and wage and price developments cannot be dispensed with or ignored. In theory, but in theory alone, it can be maintained that control of the money supply is sufficient".¹²⁶ Therefore, Zijlstra clearly emphasized the government's accommodative nature in managing monetary policy but he also believed that incorporating wider socio-economic aspects were necessary for adequate control over inflation.

Zijlstra was indeed a "moderate monetarist", as the book's title containing all his introductions to the annual reports of DNB suggests.¹²⁷ However, his monetary theory took a more administering stance towards the role of the government in the economy. As such, he put a greater emphasis on the role of the government than on DNB's own role in controlling monetary policy via *gentlemen's agreements* with the banking sector. Based on the academic works by Zijlstra, he understated DNB's own role in managing inflation and overstated the role of the government. The next chapter will see how this theory worked out in discussions between the Ministry of Finance and DNB on the cooperation and responsibility of the monetary policy.

¹²³ J. Zijlstra, "Monetary Theory and Monetary Policy a Central Bankers view" in: *De Economist* 127:1 (1979) 3-20, there 3.

¹²⁴ Zijlstra, "Central Banking with the Benefit of Hindsight" in: *De Economist* 130:2 (1982) 161-175, there 169.

¹²⁵ Ibidem, 171.

¹²⁶ Ibidem, 170.

¹²⁷ Zijlstra, *Gematigd Monetarisme: 14 jaarverslagen van de Nederlandsche Bank N.V. 1967-1980* (Leiden 1985).

Chapter Three: The responsibility for monetary policy: a discussion of the study group of the Ministry of Finance and DNB

For monetary policy to be effective, the government and the central bank must cooperate toward achieving the same goal. The previous chapter analyzed how DNB's presidents Holtrop and Zijlstra perceived the government's role in monetary policy. However, DNB itself also had mechanisms to influence monetary policy. Following, a balance had to be found in the compensatory behavior of the government and of DNB. Since both institutions can counteract each other's acts, canceling the effects, close cooperation between the government and DNB was required. A combined study group was formed with high-ranking representatives of both institutions, who met regularly to strengthen the cooperation between both parties. These were crucial meetings. As Harmsma claims, it was a way for the Ministry of Finance to learn from DNB and bridge the knowledge gap.¹²⁸ This chapter will analyze the cooperation regarding monetary policy and understand the role independence played in developing the responses to monetary problems.

Crucial to this story is the relationship between the *right to designate*, which established the legal supremacy of the Ministry of Finance over DNB, and the relative freedom of DNB to determine monetary policy. The formulation of the *right to designate* was extremely broad¹²⁹ and therefore does not explain the separation of power on the various policy levels aside from the ascribing the final responsibility for monetary policy to the Ministry of Finance. This chapter attempts to clarify the separation of powers and responsibilities between the two institutions to provide a more nuanced interpretation.

Beginning with the legal charter, the *right to designate* formulated in Article 26 is extremely broad: "Our Minister may, after consultation with the Bank Council, give such directions to the Governing Board of the Bank as he thinks necessary for the Bank's policies".¹³⁰ It does not tell us in which instances the government had the right to invoke it and when it did not. However, establishing a working-relation demands a clear separation of powers and responsibilities for both parties involved. Vanthoor argues that Article 26 could only be invoked when DNB enjoyed "discretionary authority"

¹²⁸ Harmsma, *Jelle zal wel zien* (Amsterdam 2018) 295.

¹²⁹ For reference: "Our Minister may, after consultation with the Bank Council, give such directions to the Governing Board of the Bank as he thinks necessary for the Bank's policies". English translation taken from: Bade and Parkin, "Central Bank Laws and Monetary Policy" *Working paper, University of Western Ontario* (1988) 6. Original: Bank Act 1948: Article 26.

¹³⁰ English translation taken from: Bade and Parkin, "Central Bank Laws and Monetary Policy" *Working paper, University of Western Ontario* (1988) 6. Original: Bank Act 1948: Article 26. "In de gevallen, waarin Onze Minister zulks ter coördinatie van de monetaire en financiële politiek der Regering en de politiek van de Bank noodzakelijk acht, geeft hij, de Bankraad gehoord, aan de directie de ter bereiking van dat doel nodige aanwijzingen. Behoudens het bepaalde in het volgende lid, is de directie gehouden die aanwijzingen op te volgen."

which did not conflict with a formulated power of the Minister of Finance.¹³¹ In other words, Article 26 could only be invoked when the Bank was responsible for something and not when the government itself was responsible for it. This type of legislation is based on administrative law; by clearly stating that the government delegated control, the Bank could only act when it was explicitly granted responsibility.

Theoretically, this makes the *right to designate* virtually unrestricted in its implication and, as Vanthoor argues, could even go so far as to force DNB to finance the government directly. Forcing DNB to finance the government directly would contradict the purpose of granting independence to a central bank, as the literature points out that the extent to which the central bank is expected to finance the government directly is the most common constraint on an effective independent monetary policy conducted by a central bank.¹³² In this sense, the extent to which the *right to designate* could be invoked to force DNB to finance the government directly contradicts independence. Central to the discussion in the study group was, therefore, the extent to which DNB was expected to help finance the government.

Precisely because the *right to designate* was a compelling medium to exert power, an *ultimum remedium*, it was hard for the government to apply it. In the words of Adolph: “Even when the government has some power to legally override the bank, threatening a veto could damage the central bank’s credibility”.¹³³ If it were the government’s goal to establish monetary credibility by delegating control to an independent agent, then overriding the central bank would contradict the reason for delegating control in the first place. Since the government is responsible for policy and thus for establishing law, it can grant independence to the central bank and remove the independence. Establishing a trustworthy relationship in which the mandate is taken seriously is crucial for the successful cooperation in monetary policy and the study group discussed precisely that.

Because the main issue was the extent to which DNB could be forced to finance the government’s debt, it is good to begin the analysis by briefly checking the legal charter of DNB to see what the legal requirements were provided for DNB in financing the government. The Bank Act 1948 was broadly defined. Only Article 20 directly deals with government finance, stating that DNB was required to finance the government with interest-free loans, up to fifteen million guilders. This was not significant for monetary policy; its purpose was to help the government with some day-to-day money for doing transactions, basically acting as the government’s bank. The amount was increased to 150 million guilders in 1955, which is still insignificant to monetary policy.¹³⁴

Given that the Bank Act of 1948 only depicted a broad framework, it was necessary to draft a more narrowly defined working relation. The study group began by considering the prior arrangements

¹³¹ Vanthoor, *De Nederlandsche Bank 1814-1998* (Amsterdam 2004) 202-203.

¹³² Alesina and Summers, “Central Bank Independence and Macroeconomic Performance” in: *Journal of Money, Credit and Banking* 25:2 (1993) 151-162, there 153.

¹³³ Adolph, *Bankers, Bureaucrats and Central Bank Politics* (New York 2013) 193.

¹³⁴ Fase, *Tussen Behoud en Vernieuwing* (The Hague 2000) 552.

between DNB and the Ministry of Finance, starting with the *code of conduct* established in 1952. The *code of conduct* gave an orderly separation of powers between the government and DNB in the money market. In short, this meant that the treasury would not conduct open-market operations, and it would be limited in issuing money.¹³⁵ This put heavy restrictions on the government's activity because, in effect, the government would be limited to issuing new debt only to repay existing debt, therefore never increasing real debt. Seen from the perspective of monetary policy, this ensured the government did not increase the total money supply above what was already existing.

The *code of conduct* thus made clear that DNB would never be forced to support inflationary financing of the government and therefore put a clear boundary on the *right to designate*.¹³⁶ These arrangements were not formally set in the charter but were developed outside of it, essentially shaping the actual degree of independence. Although the government had political control over the bank, these arrangements put restrictions on the government's budgetary freedom. However, the keyword is 'inflation', as the government and DNB agreed that DNB did not have to finance the government when it was considered 'inflationary'. As a result, discussing when something was or was not considered inflationary was crucial in determining DNB's role in financing the government.

As seen in the previous chapter, DNB emphasized debt duration to determine its potentially inflationary effects on the economy. The shorter the duration, the more likely it was to circulate as money. As a result, the government and DNB agreed that the government should altogether refrain from lending money in the money market (short-term money) and instead only finance itself via the capital markets (long-term money). As DNB argued, the government was the most significant player in both markets and therefore had a potential conflict of interest.¹³⁷

Interestingly, DNB justified this argument because of pressure from the banking sector, which consistently directed criticism at the government's conflict of interest. They went so far as even to question the unfair coordination between the government and DNB.¹³⁸ In this instance, independence refers to being "impartial", but it also showed DNB had to balance two responsibilities. If DNB too closely cooperated with the government, the banking sector would lose confidence in DNB. If DNB closely collaborated with the banking sector, the government could question its "independence".

Cooperation between DNB and the Ministry of Finance was essential. Zijlstra also captured this: "No monetary policy can deliberately aim at controlling the total money supply unless the

¹³⁵ NL-HaNA, Inventaris van het archief van de Nederlandsche Bank N.V.: Afdeling Geld en Kapitaalmarkt, Afdeling Buitenland, 1940-1992, archival number 2.25.70.24, inventory number 24197, Rijksmarkenovereenkomst 23-6-1958.

¹³⁶ Ibidem.

¹³⁷ NL-HaNA, Inventaris van het archief van de Nederlandsche Bank N.V.: Afdeling Geld en Kapitaalmarkt, Afdeling Buitenland, 1940-1992, archival number 2.25.70.24, inventory number 24197, Samenvatting verdeling taak Bank en Schatkist.

¹³⁸ NL-HaNA, Inventaris van het archief van de Nederlandsche Bank N.V.: Afdeling Geld en Kapitaalmarkt, Afdeling Buitenland, 1940-1992, archival number 2.25.70.24, inventory number 23953, letter from Coljé 4-6-1973

government adapts its behavior to the same end”.¹³⁹ In a letter from DNB addressed to the Ministry of Finance, DNB argued that two captains on one ship could not work, most certainly not when one of the captains has the powers to determine the course.¹⁴⁰ But, as DNB goes on, this objection is less problematic when the government also commits to combatting inflation, mainly when it involves a purely monetary problem, for example, abnormal capital imports.¹⁴¹ It becomes clear that DNB was demanding the government play an active role in controlling the money supply. This perspective aligns with the monetary analysis as developed in the previous chapter.

The government’s role in controlling the money supply was discussed in almost every study group meeting. DNB consistently proposed and pushed the government to keep its balance constant actively.¹⁴² That meant DNB could not conduct monetary policy independently when the government kept contradicting its policy. Therefore, DNB pushed for an agreement to make the government act monetary neutral. This meant the government must play an important role in monetary policy because DNB expected it to compensate for monetary changes. It was not DNB that had to adjust its behavior and actively manage the liquidity in society via *gentlemen’s agreements* with the banking sector. Instead, DNB depended on the government to compensate for monetary changes by actively adjusting its behavior.

Even though the government was legally supreme, DNB exerted force on the government to steer it in its desired direction. This might be reasonable when the outcomes do not involve trade-offs and therefore have a redistributive effect. Some literature definitely argues that monetary policy has redistributive effects. For example, Hung and Thompson show that for 23 OECD countries from 1960 to 2009, workers’ power had a more significant impact on the inflation rate than money growth.¹⁴³ This sheds new light on the monetarist orthodoxy that inflation is always and everywhere a monetary phenomenon, as famously argued by Milton Friedman. Adhering to strict norms of monetary growth was then not neutral but an important ‘scientific’ argument in a polemic of redistributive politics. Hung and Thompson, therefore, question the truth in the causal relation of the negative correlation between central bank independence and inflation. Perhaps, DNB played a role in institutionalizing redistributive politics in favor of money-power over labor power. If labor was indeed strongly unionized and collectively powerful, then higher wages could compensate for increased inflation,

¹³⁹ Zijlstra, “Monetary Theory and Monetary Policy a Central Bankers view” in: *De Economist* 127:1 (1979) 3-20, there 16.

¹⁴⁰ NL-HaNA, Inventaris van het archief van de Nederlandsche Bank N.V.: Afdeling Geld en Kapitaalmarkt, Afdeling Buitenland, 1940-1992, archival number 2.25.70.24, inventory number 24232, verslagen van de vergaderingen van de gemengde werkgroep van het Ministerie van Financiën en De Nederlandsche Bank o.l.v. de Thesauriër-Generaal, nummer 5, gehouden op 20-9-1972.

¹⁴¹ Ibidem.

¹⁴² NL-HaNA, Inventaris van het archief van de Nederlandsche Bank N.V.: Afdeling Geld en Kapitaalmarkt, Afdeling Buitenland, 1940-1992, archival number 2.25.70.24, inventory number 24232, verslagen van de vergaderingen van de gemengde werkgroep van het Ministerie van Financiën en De Nederlandsche Bank o.l.v. de Thesauriër-Generaal, nummer 12, gehouden op 13-6-1973.

¹⁴³ H. Hung and D. Thompson, ‘Money supply, class power, and inflation: monetarism reassessed’ in: *American sociological review* 81:3 (2016) 447-466, there 459.

effectively balancing each other out from the perspective of the working class. This would be at the cost of rent-seeking behavior because high inflation erodes the value of fixed-money income and, therefore, decreases future-money income streams' value. The extent to which DNB takes a neutral position in a redistributive debate between labor and capital should be questioned, as the banking sector is the customer of DNB.

DNB, at times, made it relatively clear to the Ministry of Finance where its interests lay. For example, in the study group, in a discussion between Oort – the treasurer-general¹⁴⁴ – and Kessler, the representative of DNB, the latter proposed that the banking sector be assured an income to compensate for a decline in revenue resulting from a credit restriction.¹⁴⁵ Oort argued that this was politically unacceptable because this would mean free money for the banking sector.¹⁴⁶

The background for discussing the credit restriction was an increase in the liquidity quote, which meant liquidity grew faster than national income. According to DNB, the reason was that the private sector financed itself with short-term credit, thereby significantly increasing the amount of liquidity circulating. DNB's imposition of a credit restriction restricted the government's ability to refinance its debt, thereby restricting its budgetary capacity. In this example, monetary policy and government finance cannot be seen as separate fields but must be seen in unity. Imposing a credit restriction on the private banking sector also limits the government's freedom to act. Oort also recognized this and argued that DNB was trying to restrict the government from financing on the money market and thus financing itself with short-term money. At the same time, the private sector was the problem. As Oort points out, the government was not allowed to finance itself inflationary, but the private sector could continue because DNB did not prevent this.¹⁴⁷ So, it is impossible to portray monetary policy as simply a contract between two parties. The degree of independence is also determined by the degree of control DNB had over the banking sector.

DNB had powers over the banking sector and could demand from them more long term financing. Instead, it chose to penalize the government. By not acting against the private sector, the government was restricted. If there was only so much growth of money accepted, and the private sector consumed a more prominent part, less was left for the government. Sticking to the strict norms of monetarism, as discussed in the previous chapter, results in a discussion of scarcity because, anything the private sector takes, the public sector cannot. By not acting against the inflationary financing of the private sector, DNB was restricting the freedom of government policy. Even though the *code of conduct* was an agreement that the government would not force DNB to finance the

¹⁴⁴ The highest state-official from the Ministry of Finance.

¹⁴⁵ NL-HaNA, Inventaris van het archief van de Nederlandsche Bank N.V.: Afdeling Geld en Kapitaalmarkt, Afdeling Buitenland, 1940-1992, archival number 2.25.70.24, inventory number 24232, verslagen van de vergaderingen van de gemengde werkgroep van het Ministerie van Financiën en De Nederlandsche Bank o.l.v. de Thesauriër-Generaal, nummer 21, gehouden op 10-5-1974.

¹⁴⁶ Ibidem.

¹⁴⁷ Ibidem.

government inflationary, this was only part of the story. DNB allowed the private sector to act inflationary while restricting this freedom for the government. DNB clearly took a stance favoring the private sector over the government, which, in light of the *right to designate* is interesting.

That means that DNB was playing a huge role in government policy. For instance, in 1974, the government proposed a stimulus plan which required 4 billion guilders. In the study group, Oort asked if this could be financed inflationary or to what extent it could and had to borrow this on the capital market.¹⁴⁸ Kessler (DNB) argued that this would increase the government's need for finance up to 5% of GDP, which he saw as too high.¹⁴⁹ He argued further that, at that point in time, there was too much credit available, and the interest rates rather low. The government should thus not amplify the already inflationary trend. In his view, it was not a lack of credit that was hindering the economy, but, instead a tax system that was hampering investment.¹⁵⁰ As a follow-up, Ittersum (Ministry of Finance) asked whether monetary expansion at all contributes to employment.¹⁵¹ In the view of DNB, this was not so, and instead, Kessler expressly warned against the dangers of monetary expansion. He argued that DNB ran the risk to step beyond its mere monetary task and into the political economy realm.

Later, in 1975, Kessler argued in the study group that the government should significantly increase its demand on the capital market to increase interest rates. Oort believed an increase in the interest rates would not be an issue, but it would be a problem if this were deliberate government policy. If, however, the rise in interest rates was the result of foreign investors, that would be acceptable.¹⁵² Oort argued that it was acceptable for the government to not do anything about it if something external happens. However, deliberately increasing the interest rate via government policy would not be in the government's interest, as that would increase the cost of borrowing money. The increased cost would mean an increase in revenue for the banking sector, at the cost of the government's budget. Again, an interesting argument by DNB showing that it promoted the financial sector's interests, sometimes at the cost of the government's budgetary freedom.

¹⁴⁸ NL-HaNA, Inventaris van het archief van de Nederlandsche Bank N.V.: Afdeling Geld en Kapitaalmarkt, Afdeling Buitenland, 1940-1992, archival number 2.25.70.24, inventory number 24232, verslagen van de vergaderingen van de gemengde werkgroep van het Ministerie van Financiën en De Nederlandsche Bank o.l.v. de Thesauriër-Generaal, nummer 25, gehouden op 8-11-1974.

¹⁴⁹ NL-HaNA, Inventaris van het archief van de Nederlandsche Bank N.V.: Afdeling Geld en Kapitaalmarkt, Afdeling Buitenland, 1940-1992, archival number 2.25.70.24, inventory number 24232, verslagen van de vergaderingen van de gemengde werkgroep van het Ministerie van Financiën en De Nederlandsche Bank o.l.v. de Thesauriër-Generaal, nummer 25, gehouden op 8-11-1974.

¹⁵⁰ NL-HaNA, Inventaris van het archief van de Nederlandsche Bank N.V.: Afdeling Geld en Kapitaalmarkt, Afdeling Buitenland, 1940-1992, archival number 2.25.70.24, inventory number 24232, verslagen van de vergaderingen van de gemengde werkgroep van het Ministerie van Financiën en De Nederlandsche Bank o.l.v. de Thesauriër-Generaal, nummer 25, gehouden op 8-11-1974.

¹⁵¹ Ibidem.

¹⁵² NL-HaNA, Inventaris van het archief van de Nederlandsche Bank N.V.: Afdeling Geld en Kapitaalmarkt, Afdeling Buitenland, 1940-1992, archival number 2.25.70.24, inventory number 24202, verslagen van de vergaderingen van de gemengde werkgroep van het Ministerie van Financiën en De Nederlandsche Bank o.l.v. de Thesauriër-Generaal, nummer 27, gehouden op 25-4-1975.

Interestingly, in 1976, it was discussed in the study group that national income had increased by 12,5%. Simultaneously, the growth of liquidity was also 12,5%. According to the monetary analysis under Zijlstra, liquidity growth should be seen from the perspective of national income growth.¹⁵³ In this case, the situation was ‘neutral’. In response, Oort thought it necessary for the government to increase its inflationary finance. This was met with criticism by Den Dunnen (DNB) and referred to Germany’s success in almost entirely bringing down the government’s deficit. Something he saw fit for the Netherlands, too. Van Ittersum (Ministry of Finance) said that the government was still in need of over four billion guilders, but DNB was complicating this by restricting the market.¹⁵⁴ Since the liquidity growth equaled the increase in national income, the prevailing situation hardly induced inflation, still, DNB imposed a credit restriction on the banking sector, thereby, again, restricting the government’s access to finance.

While discussing the economic forecast of 1977, Oort argued that the government wanted to increase its budget, and this would require a monetary expansion. The Bank argued that if the government wanted to finance this expansion inflationary, the private sector should compensate for this with a deflationary move. The purpose of the government was to increase demand in the economy. If the private sector had to compensate for this with a deflationary movement, that would mean a decline in overall demand from the private sector. The overall demand stimulus by the government would be counteracted by an equal deflationary impulse from the private sector. Therefore, making the demand stimulus useless.

Economically speaking, what happened was a deadlock or a stalemate. Because the ‘logical’ solution to a decline in demand is to increase demand, in this example, via government means. But from the monetary perspective, this entails problems, and it has to be compensated so that nothing can be done to the situation. This introduces the need for a decision, or better, a trade-off. That also means that ‘independence’ is perhaps the wrong term. Because independence only makes sense if it is a ‘neutral’ policy objective. But as seen here, situations can arise when monetary policy alone does not provide the answer. And it can therefore not be independent nor insulated from a more comprehensive policy discussion.

Realizing this problem, Oort directly criticized Kessler because he never voiced his objections to the government program and the resulting government deficit in prior discussions. Only now, when discussing how to finance the program, was Kessler hesitant.¹⁵⁵ Kessler replied that the Bank could not

¹⁵³ Fase, *Tussen Behoud en Vernieuwing* (The Hague 2000) 262.

¹⁵⁴ NL-HaNA, Inventaris van het archief van de Nederlandsche Bank N.V.: Afdeling Geld en Kapitaalmarkt, Afdeling Buitenland, 1940-1992, archival number 2.25.70.24, inventory number 24202, verslagen van de vergaderingen van de gemengde werkgroep van het Ministerie van Financiën en De Nederlandsche Bank o.l.v. de Thesauriër-Generaal, nummer 33, gehouden op 31-5-1976.

¹⁵⁵ NL-HaNA, Inventaris van het archief van de Nederlandsche Bank N.V.: Afdeling Geld en Kapitaalmarkt, Afdeling Buitenland, 1940-1992, archival number 2.25.70.24, inventory number 24202, verslagen van de vergaderingen van de gemengde werkgroep van het Ministerie van Financiën en De Nederlandsche Bank o.l.v. de Thesauriër-Generaal, nummer 34, gehouden op 9-7-1976.

dismiss its monetary responsibility based on social-economic considerations.¹⁵⁶ The bank's language suggests that independence was a technocratic defense line, hiding behind a veil of abstracted expertise as if it were 'not up to them' to decide. Even though choosing to take that strategy is a decision and therefore not neutral or a passive act of nature. It was a conscious decision to argue that it was not up to them, even though the Bank restricted the government's freedom to act.

This was only the forecast discussion; sometime later, when the period was reality, it was also discussed in the study group. Kessler took a strong stance by saying that the liquidity shortage of the government must be lower and argued that this was the monetary responsibility of the Minister of Finance.¹⁵⁷ Oort decisively responds by saying that, even if that were the case, the Minister of Finance could not simply act upon a demanded monetary outcome without considering the resulting consequences in the real economy.¹⁵⁸ Again, a decision had to be made regarding a trade-off. Either do what made sense from the monetary perspective or what made sense from the political and socio-economical perspective. DNB was decisively arguing for monetary neutrality, which was expected from the institution whose charter explicitly states its responsibility for it, its sole purpose for existing. Again, it must be stressed that monetary policy alone could not solve the government's problems.

In 1977, the situation changed, changing the power relation between DNB and the Ministry of Finance. A problem has arisen where demand for mortgages has increased. DNB was wary that these mortgages were not used simply as long-term capital investments but also included a part for consumptive needs, estimated at 25% of the value of the mortgages. Therefore, these might potentially have a significant impact on the inflation rate. As DNB argued, the problem was that these mortgages were being sold by institutions that were not under the control of DNB.¹⁵⁹ An important aspect to consider is to what extent DNB was even able to control inflation rates in the first place. This also posed an interesting question of whether to expand the realm of institutions under DNB's supervision, in order to increase its level of control.

The discussions in the study group portray DNB as an activist institution and show that monetary policy comes into conflict with government policy. In such a scenario, priorities and

¹⁵⁶ NL-HaNA, Inventaris van het archief van de Nederlandsche Bank N.V.: Afdeling Geld en Kapitaalmarkt, Afdeling Buitenland, 1940-1992, archival number 2.25.70.24, inventory number 24202, verslagen van de vergaderingen van de gemengde werkgroep van het Ministerie van Financiën en De Nederlandsche Bank o.l.v. de Thesauriër-Generaal, nummer 36, gehouden op 25-11-1976.

¹⁵⁷ NL-HaNA, Inventaris van het archief van de Nederlandsche Bank N.V.: Afdeling Geld en Kapitaalmarkt, Afdeling Buitenland, 1940-1992, archival number 2.25.70.24, inventory number 24202, verslagen van de vergaderingen van de gemengde werkgroep van het Ministerie van Financiën en De Nederlandsche Bank o.l.v. de Thesauriër-Generaal, nummer 36, gehouden op 25-11-1976.

¹⁵⁸ NL-HaNA, Inventaris van het archief van de Nederlandsche Bank N.V.: Afdeling Geld en Kapitaalmarkt, Afdeling Buitenland, 1940-1992, archival number 2.25.70.24, inventory number 24202, verslagen van de vergaderingen van de gemengde werkgroep van het Ministerie van Financiën en De Nederlandsche Bank o.l.v. de Thesauriër-Generaal, nummer 36, gehouden op 25-11-1976.

¹⁵⁹ NL-HaNA, Inventaris van het archief van de Nederlandsche Bank N.V.: Afdeling Geld en Kapitaalmarkt, Afdeling Buitenland, 1940-1992, archival number 2.25.70.24, inventory number 24202, verslagen van de vergaderingen van de gemengde werkgroep van het Ministerie van Financiën en De Nederlandsche Bank o.l.v. de Thesauriër-Generaal, nummer 40, gehouden op 14-10-1977.

responsibilities should be clear to all parties involved. Even though the Minister of Finance was ultimately responsible for monetary policy, given its *right to designate*, DNB enjoyed sufficient freedom to operate. At times, the government realized that DNB was able to restrict the government's access to credit, primarily via credit restrictions imposed on the banking sector. Because of the credit restrictions, the government could not finance itself in the market. This is the opposite of what Grilli et al. argue because they denote as independent, a central bank that has no responsibility for bank supervision.¹⁶⁰ For DNB, in the period discussed, the fact that it had control over the banking sector was actually a fundamental way for them to steer the government's course.

Although the information found in the study group is not conclusive as to the daily practice of central banking, it did depict the play of power between the institutions. In doing so, it sheds light on the importance of agency in monetary policy, as the institutional framework portrays a different hierarchy with the Minister of Finance being ultimately responsible.

At all times, the government could legally override DNB and dictate its preferred monetary policy. Despite DNB actively contesting the government, and actively restricting the government's freedom, the *right to designate* was never executed.

Central bank independence then becomes a very conflicting construct. The government must provide independence to the central bank's mandate, but for independence to deliver its intended goal, at times, the central bank must override government policy. In a way, the government provides an institution with the power to override the government. It cannot entirely be captured within a prescribed mandate when what policy is considered legitimate. Leaving a lot of room for individuals to determine this within a given context.

In contrast to 'independence' popularly depicted as 'impartial', it is clear that monetary policy is immediately concerned with trade-offs. And, DNB, as an important advisor to the government, was also an institution with its own customers, the banking sector. Furthermore, it does not only provide monetary policy advice to the government, but it also has mechanisms to enforce that policy. That gives it a dual character. It had to balance between its public and its private nature. This balance is an important aspect in considering the role of central bank independence in determining redistributive politics within society.

¹⁶⁰ Grilli et al. "Political and Monetary Institutions and Public Financial Policies in the Industrial Countries" in: *Economic Policy* 6:13 (1991) 341-392, there 370.

Conclusion

I have analyzed the role independence played for DNB during the presidency of Jelle Zijlstra (1967-1981). The legal charter of DNB stated that the Minister of Finance could execute his *right to designate* monetary policy, making the government ultimately responsible for monetary policy. Despite the legal supremacy of the government in monetary policy, DNB mobilized its expertise as a means to operate independently of the government.

In the first chapter of this thesis, I have argued that the legal charter of DNB ensured a great deal of government control over the bank; for example, the president of DNB was appointed by the government. Zijlstra has served as Minister of Finance and even as Prime Minister days before formally taking office as president of DNB, making him a very politicized candidate. Due to his expertise in economics and public finance, his nomination was not seriously contested. Precisely because he was a prevalent figure with years of experience in politics, he enjoyed an influential position that allowed him to, at times, directly counteract government policy. Zijlstra's popular appeal and his public status as an expert made it difficult for the government to invoke a powerful mechanism such as the *right to designate*, making the mechanism relatively useless.

Chapter two discussed the extent of DNB's freedom to determine its monetary analysis, providing the analytical framework with which monetary policy was formed. The core question underlying it was "who is responsible for inflation?". By drawing on the writings of two presidents of DNB, Holtrop and Zijlstra, I argued that they greatly emphasized the government's responsibility in igniting and combatting inflation. For Zijlstra, liquidity became the focal point of the monetary analysis, and since government debt circulates as liquidity in the economy, public finance had to be tightly controlled. Zijlstra expected the government to actively counteract either inflationary or deflationary tendencies in the economy. However, this largely ignored DNB's role as supervisor of the banking sector, which meant that it could also regulate the liquidity in society by restricting the banking sector's lending capacities or forcing banks to hold more considerable reserves with DNB. It is hard to speak of independence when the institution itself plays an active role in managing it. As a result, DNB's monetary analysis overstated the effects of government policy on inflation and understated its own influence.

Chapter three focused on the development of the relationship between the Ministry of Finance and DNB by studying the discussion in the study group on various monetary issues. On several occasions, government demand for extra debt was met with fierce criticism by DNB, emphasizing the inflationary effects of this behavior. DNB's dual responsibility towards the government and the banking sector led DNB, at times, to directly contest government policy and act in the interest of the banking sector. Whenever two entirely legitimate options were available from the monetary point of view, DNB favored the banking sector, thereby stepping beyond the role of independent advisor and acting as an agent serving a particular interest group.

DNB mobilized independence to argue that it has no responsibility to consider socio-economic aspects but solely monetary phenomena. Independence was used as an argument by DNB not to take responsibility for its policy's broader socioeconomic effects. It explicitly relied on its mandate to strictly consider the monetary policy an insulated field. However, in doing so, it did at times contrast government policy. The government had to consider wider socio-economic effects and had the responsibility to take care of its citizens, and was ultimately responsible for monetary policy. It could at any time execute its *right to designate* if it did not approve of DNB's methods, but it chose not to.

The answers from this research have shown how expertise can be mobilized to assert an "independent" position, regardless of its redistributive effects. Oudenampsen's claim that experts played an important role in pushing for "extensive socio-economic reforms of a highly political nature"¹⁶¹ seems to hold, and DNB likely played an essential part in it.

As this research has shown, establishing independence in a charter alone does not make a central bank independent. The case of DNB showed that even though it was formally subjected to the government, it enjoyed significant freedom of operation, therefore appearing almost independent. Zijlstra enjoyed enormous agency in shaping DNB's monetary analysis, directly influencing monetary policy. The argument was entirely based upon its monetary analysis; therefore, changing the analysis directly affects the policy response. Suppose we combine this with Adolph's conclusion that a central banker's career perspective influences its stance on inflation. In that case, it becomes even more challenging to build a charter that embeds independence because agents maintain room to interpret the rather loosely formulated charters.

These conclusions contribute to the broader literature on central bank independence, most notably Hielscher and Markwardt's judgment that the overall institutional quality is the causal relationship between central bank independence and low inflation.¹⁶² It also contributes to the conclusion of Crowe that granting independence to the central bank removes an intra-coalitional conflict over monetary policy.¹⁶³ These conclusions do contradict the more economics oriented literature, such as Alesina and Summers, Rogoff, Eijffinger et al., Bade and Parkin, and Grilli et al., as it questions the causal relationship between central bank independence and low inflation by arguing that independence cannot simply be established, but demands a political-societal commitment to a low inflation policy.¹⁶⁴ Low inflation cannot be achieved by merely handing over the responsibility to a central bank but requires the government to adopt its behavior towards attaining that goal accordingly.

¹⁶¹ Oudenampsen, "Between conflict and consensus: The Dutch depoliticized paradigm shift of the 1980s" published online: 30 March 2020, 4.

¹⁶² Hielscher and Markwardt, "The Role of Political Institutions for the effectiveness of Central Bank Independence" in: *European Journal of Political Economy* 28 (2012) 286-301.

¹⁶³ Crowe, "Goal Independent Central Banks: Why Politicians decide to Delegate" in: *European Journal of Political Economy* 24 (2008) 748-762.

¹⁶⁴ Alesina and Summers, "Central Bank Independence and Macroeconomic Performance" in: *Journal of Money, Credit and Banking* 25:2 (1993) 151-162; Grilli et al. "Political and Monetary Institutions and Public Financial Policies in the Industrial Countries" in: *Economic Policy* 6:13 (1991) 341-392; Bade and Parkin, "Central Bank Laws and Monetary Policy" Working paper, University of Western Ontario (1988); Rogoff, "The optimal degree

Therefore, the economics literature that researched the causal relationship between central bank independence, based on its charter, and achieving low inflation, is based on a tautology. Governments signal a willingness to commit to a low inflation policy by granting independence to the central bank. As a result, the degree of independence of the central bank acts as a mediating variable. It is, therefore, not the causal explanation, as that depends on a government's ability to adapt its behavior in accordance with the goal. For that to happen, a broader socio-political interest must favor low inflation. Low inflation is then not the sole achievement of the central bank but reflects a societal commitment to it. Central bank independence is a mediating variable in the causal relationship between high independence and low inflation; the wider socio-political interest and government commitment are causal explanations.

Central banks play a vital role in the economy, and for most, independence is still their core value. Nonetheless, their role is becoming increasingly politicized; for example, they are expected to adjust their mandates to help finance a sustainable future, making it relevant to question the relationship between politics and central banks.

of commitment to an intermediary monetary target" in: *The Quarterly Journal of Economics* 100:4 (1985) 169-189; Eijffinger, Rooij and Schaling "Central Bank Independence: a Paneldata Approach" in: *Public Choice* 89 (1996) 163-182.

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