

## Nout Wellink: Wim Duisenberg's legacy as President of the Netherlands Bank

Speech by Dr Nout Wellink, President of the Netherlands Bank and Chairman of the Basel Committee on Banking Supervision, at the inaugural event for the Willem F Duisenberg Fellowship, Amsterdam, 28 February 2008.

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I am honoured to be here today, at the inauguration of the Willem F. Duisenberg fellowship, and to have the opportunity to introduce to you Professor Tito Boeri, who will give the first Duisenberg lecture. DNB encourages the initiative to continue this successful fellowship, and we are privileged that it has been given the name of DNB's former president Wim Duisenberg. I have many lively memories of Wim Duisenberg, some dating back more than 30 years.

Today I would like to take a closer look at the period when Duisenberg was president of the Nederlandsche Bank, the years between 1982 and 1997. Viewing back, from the current period of financial turmoil, those years may seem remote and relatively quiet. However, there was some turmoil at that time as well, and I think that our experience of that time remains relevant today.

When Duisenberg became president of DNB in the early 1980s, the world economy was in a bad shape. The Bretton Woods system of fixed exchange rates had collapsed and the world had been shocked by two oil crises. The advanced economies were entering a deep recession. In the Netherlands, the economy suffered from what became known as the "Dutch disease". Essentially, it meant that we were living beyond our means, financed by the income from natural gas. As a consequence, the public sector expanded rapidly, including the social security system. Moreover, the wage share of national income exploded, and competitiveness of the Dutch business sector deteriorated. To top off all this, in 1982, inflation was very high, around 6%, the budget deficit was 9% of national income, and unemployment rate was almost 8%, more than doubled from two years earlier. Altogether, the economic situation was rather depressing, at the start of Duisenberg's presidency.

After the collapse of the Bretton Woods system in 1971, Dutch monetary policy remained directed at the exchange rate of the guilder. A strong currency was regarded as the best guarantee against imported inflation. Since Germany had a strong anti-inflation record, Dutch exchange rate policy amounted to keeping a stable exchange rate against the DM. The Netherlands was the first country to adopt this policy, and Duisenberg had already defended it strongly when he was Minister of Finance (73-77).

During Duisenberg's entire presidency, the Netherlands was a participant in the ERM, the exchange rate mechanism of the European Union, that had started in 1979. Throughout the first turbulent phase of the ERM, until 1983, the guilder remained the strongest currency in the ERM. In 1983 the guilder was devalued for the second time, and last time ever. The devaluation in 1983 was against the advice of Duisenberg, and for years the loss of confidence by the financial markets was felt through higher interest rates. In the end, this episode strengthened Duisenberg in his resolve to defend the exchange rate, even if significant interest hikes were required. By acting like that, Duisenberg quickly restored credibility in the markets, and in the course of that proved that credibility is achieved by action, not by words.

Still, politicians were not always convinced that the exchange rate had priority over the interest rate. In 1992, for example, another Minister of finance (Kok, in 1992) indicated that an interest rate increase was undesirable. Duisenberg took the unusual step not to follow Germany in raising the headline rate, but instead raised a less important rate (*beleningsrente*). It was accompanied by a press communiqué, indicating the Bank's

dedication to fight inflation through a strong guilder. This illustrated Duisenberg's ability to avoid a public conflict about interest rates, a conflict that certainly had negatively affected the exchange rate.

A major test of the ERM and the Dutch exchange rate policy, came in 1992 and 93, when speculative attacks caused several crises. In this phase the guilder-DM rate was the only exchange rate that was not under attack. The guilder-DM peg appeared to be the most credible and tightest bilateral exchange rate within the ERM. Looking back, this can only be explained by the credibility of Dutch exchange rate policy in the previous years.

The process towards Economic and Monetary Union, which started in the 1970s, was in full progress during Duisenberg's presidency. In the 1980s capital markets gradually became less restricted, culminating in 1990, with the start of stage I of the EMU. On many occasions, Duisenberg explained that free capital flows were in the interest of The Netherlands. As a small, open economy, the Netherlands could only benefit from international cooperation, free trade and free capital markets. Duisenberg advocated the opinion that integration of monetary policy was the inevitable reply to this liberalization of European money and capital markets.

Returning again to the start of Duisenberg's presidency, the high inflation and interest rates in that period had a serious effect on the real estate market. In the early 1980s several mortgage banks ran into trouble. In 1983 one of them, the Tilburgsche Hypotheekbank, became insolvent. This mortgage bank crisis was a serious test for the new prudential supervision regime of DNB, the Wtk of 1978. Duisenberg indicated firmly that supervision could only minimize the probability of failures, not exclude them. He showed that this tough policy line could be complemented by careful steering towards a private sector solution. Two of the mortgage banks could be rescued by other institutions, which benefited all stakeholders, including the creditors. Ultimately, 95% of the liabilities of the failed Tilburgsche Hypotheekbank could be paid off.

Duisenberg took a clear stand with respect to budgetary policy. Starting with his first annual report, Duisenberg has always maintained that DNB would not support an expansionary budgetary policy that would result in unsustainable deficits. A view like that was not at all obvious in the 1970s and 80s. Between the second world war and the 1970s, Dutch economic policy had been of a Keynesian nature, with scope for activist, counter-cyclical budgetary stimulus. Early 1980s, the consensus view changed gradually towards a more restrictive budgetary policy. With patience and perseverance, Duisenberg continued to explain the adverse economic consequences of a high budget deficit. His main argument was the upward effect on interest rates, which reduced private investment and economic growth. Also, Duisenberg had the view that the Dutch welfare state could not be supported in the long run if budgetary policy would not change its course. Finally, Duisenberg argued, international coordination of economic policy required a budgetary situation that is under control and on a sustainable path. In a sense, he gave early arguments for the Stability and Growth Pact, that was signed in 1997.

Duisenberg's view on economic policy was completed by respecting the crucial role of employers and employees in setting wages and labour costs. Next to stable exchange rates, low inflation and low capital market rates, wage moderation was central to improve the financial health of the private sector. That would lay the foundations for an improved investment climate, supporting labour demand. Here, the central bank had little more instruments than to use its weight and try to influence the private sector. The famous Wassenaar agreement of 1982, was supported by DNB, because it offered scope for restoring profitability of the business sector.

At the end of Duisenberg's presidency, some concluded, rather optimistically, that a Dutch miracle had replaced the Dutch disease. The Dutch economy had experienced a successful recovery that can be ascribed to many factors: monetary and budgetary stability, as well as wage moderation and structural changes in labour and product markets. It is safe to say that

Duisenberg contributed to all of these factors. When one would try to summarize the legacy of Duisenberg's DNB presidency, I think the first central theme is his aim for stability. He achieved that stability by a persistent policy and staying the course. Frequently, he had to defend this kind of policy line, for example regarding interest rate adjustments in view of the exchange rate. In Dutch he described this kind of policy as “stug”, translated as stiff or tough. “Stug” has the subtle connotation that he did not expect much initial cooperation in his policy line towards stability.

Another central theme for Duisenberg was his relentless focus on the benefit of the Dutch society. This may sound self-evident for a policymaker, but Duisenberg interpreted this differently from a politician. He demonstrated that a central banker should look at the long term costs and benefits. To give an example, at the time when politicians were celebrating the proceeds of natural gas production – 6% of GDP in 1981 – Duisenberg stressed that this was only temporary and warned that painful adjustments would be necessary in the long term.

The last central theme that characterizes Duisenberg's presidency is his European focus. With respect to economic policy, Duisenberg continuously stressed that an “Alleingang” would be catastrophic for the economic well-being of nations. An integrating world, with all its complexities and risks, required international cooperation and coordination. Duisenberg was aware as well, that a single monetary policy would not always match with local developments. His message is that the remaining channels to adapt to country-specific shocks should be safeguarded and strengthened. That is the main reason for his strong support for sustainable public finances and flexible labour markets. Duisenberg's strong support for international coordination, combined with his global view, earned him much support, and were highly valued when he was the first president of the European Central Bank.

Let me now conclude, by introducing the speaker of today's main lecture, Professor Tito Boeri. Professor Boeri has been appointed three months ago as the first Duisenberg Fellow. He is currently at Bocconi University in Milan, where he also acts as Director of the Fondazione Rodolfo De Benedetti. Professor Boeri is a research fellow at two outstanding international institutes for applied economic research: the Centre for Economic Policy Research (CEPR) in London and the IZA (Institut zur Zukunft der Arbeit) in Bonn. His main research topic is the labour market, but he has also published on immigration, social security, pension systems and transition economics. Professor Boeri has published in top-rated economic journals, while also having worked with organizations like the OECD, the European Commission, the International Monetary Fund, and the Italian Government. This indicates that Professor Boeri has the rare, but, in my opinion, invaluable mix of being both skilled in academic research and in applied, policy oriented activities. Today, we will have the opportunity to benefit from this, as he will speak, in the first Willem F. Duisenberg lecture, about “The disappearance of mass unemployment in Europe”.