Serie Research Memoranda

The post-war Dutch financial system

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THE POST-WAR DUTCH FINANCIAL SYSTEM

by H. Visser
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Introduction

Before the war, the various kinds of financial institutions all had their well-defined market segments. The commercial banks catered for business firms and well-off individuals, the agricultural banks were mainly active in rural areas, the savings banks collected the savings of the average citizen, the postal giro system and the Amsterdam municipal giro system took care of an important part of the payments mechanism and the mortgage banks also had their own market niche, on the liabilities side at least. Insurance companies inhabited as it were another planet. The postwar period started off with the demarcation lines between the institutions still pretty well intact. The late fifties, though, saw the beginning of a process of diversification and expansion which, in the nineties, shows no signs of abating and which has changed the financial scene beyond all recognition. The number of separate financial institutions has fallen dramatically and demarcation lines between market segments are no longer respected. We will describe the process of diversification and increase of scale, sketch the development of the payments system and the role it played in the movement to larger units and wind up describing how prudential supervision and monetary policy reacted to the changing environment.

The scramble for savings

The dawn of the post-war period found the commercial banks in an extremely liquid position, which Mr Lief tinck's monetary policy did nothing to reduce. As business firms had little need for trade credit, being quite liquid themselves, and the banks considered medium and long-term investment credit not their bailiwick they had no choice but to invest in government debt. It was not until 1954 that the credit supply of the commercial banks was again at the pre-war level in real terms and only in 1956 the private sector overtook the public sector in the banks' credit portfolio (Van der Werf 1988 p. 213).

Dutch banks, apart from Nederlandsche Middenstands bank (NMB, Netherlands Bank for Small to Medium Size Enterprises) and the agricultural cooperative banks, had traditionally only been interested in granting short-term credit. NMB for that matter only granted medium-term credit to Small to Medium Size Enterprises (SMEs) under government guarantees. In order to fill the need for longer-term investment credit, the government founded Herstelbank or Recovery Bank in 1945, which also paid out war damage recompense. Its share capital was f 300 million, more than the share
capital of the then five big commercial banks combined. The State took f 151 million and the remaining f 149 million was taken up by other investors, including commercial banks and institutional investors, who had to be lured by a State guarantee on dividends. Still, with the memories of the unhappy involvement in long-term credit in the early 1920s still comparatively fresh and fearing that Herstelbank was one more step on the way to a socialist economy, the banks and the institutional investors participated only reluctantly (Posthuma 1955 p. 25). Herstelbank proved to play a useful role, but as commercial banks became more involved in medium-term credit and restrictions on stock and bond issues were lifted, the need for the services of Herstelbank diminished. Originally set up for a period of 25 years, it was in 1962 transformed into the Nationale Investeringsbank (National Investment Bank, NIB), seeing its capital reduced to only f 100 million. In the 1970s NIB channelled government aid to ailing business firms and in the 1980s it developed into an investment bank, ending its independent life in 1988 when Amro Bank bought all its shares. Herstelbank and other banks in 1951 founded the Export-Financieringsmaatschappij (Export Finance Company), which provided longer-term export loans and was quite a success, because export credit could be insured against risks with the Nederlandsche Credietverzekerings-Maatschappij (Dutch Credit Insurance Company), also established in 1951.

The steadily increasing demand for investment credit and export credit was not fully met by Herstelbank and Export-Financieringsmaatschappij. Banks began in the early 1950s to provide this kind of credit, at first through specialized daughter companies, but as these had to fund themselves with relatively expense bonds, the banks took over medium-term lending themselves, using their cheaper term deposits. In order to keep any mismatch between assets and liabilities resulting from increased medium-term lending within manageable proportions, the commercial banks in the late 1950s became interested in attracting private savings, which were relatively cheap compared with bonds. A squeeze on the banks' liquidity ratio also contributed to the banks' need for savings deposits. Firstly, net receipts from abroad, an important source of liquidity creation during the fifties, dried up in the sixties, as did inflationary finance by the government, and secondly, nominal national income started to rise steeply after the 1964 wage explosion. This made for an increase in the circulation of note and coin, putting the banks' balances with DNB under pressure (see the section on monetary policy below). But there were additional reasons for the banks to actively try to attract savings. Credit control that only allowed increased lending if it was matched with increased funding through longer-term borrowings or share capital also fanned the banks' thirst for savings (see the section on monetary policy below). For another thing, the fast and continuing increase in real per capita income for the first time made the great mass of private individuals interesting as a potential clientele for the commercial banks.
The quest for savings deposits spurred the banks on to develop an extensive branch network and generally to move into retail banking, which some had already done on a small scale in the 1950s, providing consumer credit. If the banks were to succeed in

Table 1. Shares of different groups of banks in the market for savings.

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<td>RPS</td>
<td>32</td>
<td>24</td>
<td>18</td>
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<td>16</td>
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<td>Savings banks</td>
<td>29</td>
<td>28</td>
<td>25</td>
<td>17</td>
<td>16</td>
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<tr>
<td>Agricultural banks</td>
<td>37</td>
<td>39</td>
<td>42</td>
<td>41</td>
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<tr>
<td>Commercial banks</td>
<td>1</td>
<td>8</td>
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Source: Bosman 1989 p. 42.

attracting savings deposits, they had to offer other services as well, which they began to do on a large scale in the mid-1960s. Prominent amongst these was the provision of salary payments into bank accounts, which absolved employers from the need to pay out their workforce in note and coin. The banks also entered the market for mortgage loans, and in 1967 offered interest on demand deposits and provided cheques which were guaranteed up to a certain sum, in an attempt to draw clients away from the postal giro system or prevent them switching allegiance. Also, these services helped to keep the money within the bank circuit and prevent it leaking away through withdrawals of note and coin. A further service was the introduction of Eurocheques in 1974, which could be used for payments abroad.

Not surprisingly, the ones to suffer from this decision of the commercial banks to tap the savings market were the savings banks, including Rijkspostspaarbank (RPS), the government savings bank (see Table 1). These banks could be seen as institutional investors, because their raison d'etre was to provide opportunities to save and their investment or credit activities were subordinate to the liabilities side of the balance sheet. Savings banks usually were small outfits whose scope was local or at the most regional and who hardly competed amongst each other (RPS was another matter, being part of the Ministry of Transport and having the counters of the post offices at its disposal). Being non-profit institutions, usually in the guise of foundations, they were not subject to profit taxes. As against this, they were restricted as to the kind of activities they were allowed to engage in. In particular, loans to business enterprises were forbidden territory.
Thanks to the aggressive behaviour of the commercial banks, the quiet in this cozy market niche was disturbed around 1960, never to return. The savings banks now had to compete head-on with the commercial banks for the savings of the non-rich. The consequences for the savings banks were far-reaching. For one thing, given the penchant of consumers for one-stop shopping, in financial markets no less than in other markets, the savings banks had to broaden the variety of financial services they offered. Also, this meant that the commercial banks in effect dictated the interest rates that the savings banks could offer, which forced them to revise their investment policy.

As for the increased variety of financial services, savings banks first offered their clients the opportunity to use their savings deposits to pay rent, taxes, electricity bills etcetera but soon offered full-fledged payments services. Forced by the competition from the commercial banks and the postal giro system, they became in effect money-creating banks. Earlier the high cost of frequent currency payments had made big institutions come to an agreement with the Nederlandse Spaarbankbond (Savings Banks Union) to pay pensions into people’s savings accounts. A government department offered this option in 1949, the Dutch railways followed in 1951 and when state old age pensions for all over-65 were introduced in 1957, recipients could opt for receiving it through their savings bank (Buning 1957 p. 99).

Savings banks traditionally invested in bonds and granted credit to the government. With the increased competition for savings, coupled with an increased volatility of interest rates in general, the savings banks were confronted with the need to adjust credit interest rates with increasing frequency, while debit rates were fixed for considerable periods of time. This situation called for investments with a more variable rate of interest. As the way to business credit was blocked, mortgages offered an attractive alternative. Even if interest rates on mortgage credit could not be adjusted as frequently and as easily as the rates on overdrafts, they were not fixed for 25 or even 40 years, as was the rate on government bonds. For the members of the Nederlandse Spaarbankbond collectively the percentage of total assets invested in mortgage loans increased from 16.1 in 1950 to 16.7 in 1960, 22.0 in 1970 and 44.2 in 1980 (Eizenga 1985 pp. 18-19). Given the steadily increasing public sector borrowing requirement, this was not for want of new government issues. Even the reduction in the maturity of government bonds to as short as seven years in the inflationary climate of the 1970s was not sufficient to stem this movement. Probably customer relations had as much to do with it as interest rate risk, though.

To sidestep the ban on commercial bank activities and in order to provide their clients with a number of services they could not themselves separately provide at a reasonable price, a number of savings banks jointly with the German Westdeutsche Landesbank Girozentrale and the commercial bank Mees & Hope, who opted out after two years, founded the Bank der Bondsspaarbanken (BdB) in 1971. This was
registered as a commercial bank and did foreign business and stock trading, partly on behalf of the saving banks; it also granted credit to business firms and acted as a kind of central bank for the savings banks. In particular, it acted as the clearing institute for payments between clients of savings banks and also as a broker in the market for private placements.

Increase of scale

The survivors

Although the number of banks had been eroding slowly but surely after the war, the only important merger before 1964 was the one between Amsterdamsche Bank and Incasso-Bank in 1948. Then the European Common Market was launched in 1958. This led to mergers between business firms and in their wake to a huge increase in the demand for medium-term credit by big customers. The banks were more or less forced to follow developments in the non-bank business sector, just as they had been around the First World War. Medium-term credit outstanding grew from ₤ 114 million in 1960 to ₤ 5513 million in 1970 (Hoffmann 1971 p. 481; monetary policy played a role as well, see below). So Amsterdamsche Bank in 1964 joined forces with Rotterdamsche Bank to form Amro Bank and Nederlandsche Handelmaatschappij or NHM and Twentsche Bank merged into Algemene Bank Nederland or ABN, which in 1967 again was joined by Hollandsche Bankunie or HBU. This merger wave culminated in the take-over in 1975 of the merchant bank Pierson, Heldring & Pierson or PHP by Amro and the merchant bank Bank Mees & Hope or BMH by ABN, though both banks continued operating as separate entities. Of the 126 provincial banks (that is banks whose head office was not in Amsterdam or Rotterdam) that existed in 1946 only 17 were left in 1985, and no one was still independent (Van der Werf 1988 p. 229). For the big banks takeovers were a means to penetrate the urbanizing countryside. The process was accelerated by the failure of the small Teixeira de Mattos bank in 1966, which led to a flight of deposits from small banks to the bigger banks, which were seen as more safe.

Meanwhile, international activities had been gaining importance. Although a number of Dutch banks traditionally had had a large overseas business, in particular the ABN forerunners NHM (in Asia) and HBU (in Latin America), internationalization entered a new phase after the European currencies had been made convertible at the end of 1958. The banks became more and more involved in activities in international money and capital markets. In the 1960s and early 1970s international cooperation in banking consortia and in syndicates which extended loans to multinational enterprises and less-developed countries, became quite popular. The 1973 oil
crisis, which led to huge amounts of money in the hands of oil-exporting countries seeking employment, provided a boost to this kind of international lending but at the same time planted the seeds of its decline, which was sparked off by the debt crisis of the early 1980s. The banking consortia were not very successful anyway. A consortium could, for instance, open an office in some country, where all participating banks could serve their own clients. But what if such an office succeeded in attracting new customers; how to divide the spoils? Furthermore, the participating banks in a loan syndicate perhaps too easily expected the syndicate leader to take care of investigating the soundness of a loan (Frentrop 1987). The disappointing experience with loose cooperation constructs led internationally to a shift in interest from consortia to mergers and takeovers.

With the increasing openness of financial markets in the world, and most of all the rapidly approaching integrated European financial market, the Dutch financial world became convinced that Dutch banks, even the big ones, were too small to hold their own against the international competition. A few of the smaller banks were taken over by foreign banks (Slavenburg’s by Credit Lyonnais and Nederlandsche Crediet Bank by Chase Manhattan) but the experience has not been an entirely happy one for the buyers, as the banks in question had been on the brink of collapse. This will not have whetted the appetite of foreign bankers for a takeover of a Dutch bank. Attempts at cross-border mergers (between Amro and the Belgian Generale Bank in the late 1980s) proved abortive, and so the Dutch banks turned to each other and to the financially powerful insurance companies. This was made possible by the lifting of the ban on close cooperation between banks and insurance companies as of the first of January 1990 and by the monetary authorities’ attitude toward bank mergers having become significantly more lenient.

In October 1989 NMB merged with Postbank, though both banks retained their own separate branch networks. Postbank was the result of a merger between the postal giro system or Postcheque- en Girodienst or PCGD and RPS in 1986 after PCGD already had absorbed the Amsterdam municipal giro system in 1979. Though PCGD had stolen a march on the banks by introducing computers and offering attractive payment facilities around 1962/63 (see the section on the payments mechanism below), the banks caught up and made inroads in PCGD’s and RPS’s territory. PCGD and RPS were not free to offer similar services to the banks when the latter developed retail banking. Legal impediments stood in the way, and for any policy change the Minister had to give his consent, or even laws had to be changed. Slowly but surely, though, PCGD and RPS broadened their product variety, intensifying their cooperation in the process until in 1972 they presented themselves to the public as one integrated financial institution. But till 1970 they were, for instance, not allowed to follow the banks and offer interest on demand deposits, and not until 1982 they were able to buy and sell foreign exchange and sell holiday packages or offer
overdraft facilities to business firms. It had been clear for some time that PCGD and RPS had to evolve into a full-fledged bank if they were not to perish. After years of discussion, the second bill to establish Postbank as an independent firm was introduced in 1984 and Postbank started work in 1986. The first bill, introduced in 1977, had been based on the idea that a privatized Postbank was necessary to increase competition in the banking industry, an idea which did not go down well with that industry. Now the forerunners of Postbank had traditionally invested in public debt and had difficulty in entering the more lucrative market for business loans, whilst NMB was interested in Postbank's large share in the market for savings deposits and also in growth for its own sake, in order to be better able to survive in the post-1992 world. Postbank could make use of NMB's expertise in a number of fields, including stock investment. Its investment fund, launched in 1990, succeeded in attracting quite a few people who had never invested in stocks before. In 1991 NMB-Postbank merged with the Nationale-Nederlanden insurance group to become ING-Bank (Internationale Nederlanden Groep Bank) in 1992, amongst other things in order to be able to become a global player, NMB Bank having entered the international market in the mid-1970s. The government, which during the war had taken a 86 per cent share in NMB's capital, had been gradually divesting, but after the merger of NMB and the fully state-owned Postbank had a 50 per cent stake in the new combine and has continued divesting since. In September 1991 Amro and ABN merged in order to be able to hold their own on global markets, and in the process cut costs by reducing the number of branch offices. The Dutch banking scene is now dominated by three giants, the third one being Rabobank. This is the central organization of the agricultural cooperative banks, formed in 1972 through a merger of the two then existing central organizations. These two, one of them strongly Roman-Catholic, had more or less carved up the country between them but were increasingly unable to avoid serving the same neighbourhoods. Consequently, they had come under pressure to merge from local banks which saw themselves pitted against each other. Also, a merger was called for in order to cut costs and still retain the dense branch network necessary for attracting savings (de Vries 1973 pp. 207, 223-4). As the agricultural population has been shrinking over the decades, the agricultural cooperative banks have also turned to the urban market and have extended their services to non-agricultural firms, in particular SMEs. Rabobank in 1990 took a 100 per cent interest in the Interpolis insurance company, which in 1991 merged with another insurance company, Avéro Centraal Beheer Groep.

One may wonder what made mergers between banks and insurance companies so appealing to those involved. For banks, insurance companies are attractive because they have large amounts of money available, so that funding will become cheaper and more funds become available for large-scale medium and long-term investments.
Moreover, an alliance with a wealthy insurance company may help improve a bank's standing on the capital market, again making for lower funding costs. For another thing, it was felt that bank share prices were relatively low. Mergers with insurance companies were seen as a means to avert raiders. Finally, teaming up with insurance companies would give the bank access to a large range of insurance products, which could be offered to a bank's clients in order to make available a full range of financial products and keep its work force busy. For insurance companies, alliances with banks mean that a large number of sales outlets became available, with costs lower than with independent intermediaries or own agents (Böttcher 1990). As insurance polices become more standardized and fierce competition eats into profit margins, the importance of a large number of outlets, even if not all staffed with insurance specialists, has been increasing. Also, there was a well-founded fear that banks might develop their own insurance products.

The problematic standing of some banks' shares on the capital market and the related low share prices were a legacy of the difficult times experienced in the early 1980s, when the banks were saddled with bad debt resulting from the post-second-oil-crisis slump. This contributed to disintermediation. First-class borrowers were able to attract funds directly from investors at lower interest rates than the banks and therefore bypassed the banks (cf Eijgenhuijisen, Koelewijn and Visser 1987 p. 52). The banks reacted to this loss by introducing new services, generating commission instead of interest income.

Still struggling

For the savings banks life has become difficult. Savings banks have traditionally been quite small. When they became exposed to the chill winds of competition small-sized operations no longer were viable and a process of concentration set in. One-stop shopping meant that savings banks had to develop into financial supermarkets and in order to satisfactorily help their clients they had to resort to automation. The high set-up costs of automation and the scale economies involved are one reason for concentration. A related reason was, and is, that new technical developments work against banks with only a local or regional presence. Bank clients wish to have access to cash dispensers all over the country, for example. As a result, out of the hundreds of savings banks that even in 1960 still existed (266 in fact), few remain. Through mergers, two large-scale operations have been formed, Verenigde Spaarbank or VSB, which teamed up with the AMEV insurance company in 1990 and jointly with the Belgian insurance company formed Fortis Groep, and SNS Bank. AMEV had been feeling a need for its branches abroad to cooperate with banks and the lack of know-how in this area had made itself felt. For VSB a merger was attractive because it would enable the bank to broaden its product range and, perhaps more important,
because it was seen as a fast way to expand to regions of the country not previously covered (Gerards and Schipper 1989). With two relatively big organizations and only a handful of smaller savings banks left, no separate role was left for BdB. SNS Bank, which had a majority share to start with, absorbed it in 1991.

The savings banks have lost their role as the principal refuge for nickel-and-dime savers. They have to compete on equal terms with other financial institutions, which implies that they should not be given special privileges. Savings banks had been exempt from profit tax. As from 1969 a new law restricted the exemption and a 1984 law altogether abolished it, albeit with a transition period of 13 years. Against this, they have entered the commercial overdraft loan market, however cagily. Their natural habitat is made up of SMEs, non-profit organizations and the professions, but it has proved far from easy to wrest a slice of this market from well-established competitors who have more know-how. Mortgage loans may help to reduce interest rate risk, overdraft loans are much better in this respect of course. Also, overdraft loans may help prevent extreme fluctuations in a bank's liquidity position. If salaries are paid into the accounts of a bank’s customers at the end of every month it is better to have the business firms that pay the salaries and are the beneficiaries of return flows of money during the next monthly period as clients as well. Over a month total liabilities of a bank are much more stable in such a situation, and on average a smaller fraction of assets has to be held in liquid form. The savings banks face an additional disadvantage vis-à-vis the commercial banks in that private clients are not yet charged for the costs of running the payments system and savings banks have a disproportionate percentage of private clients as against business clients. The end result is a sorry tale of steadily declining market shares. While the savings banks have been trying to develop into full-fledged commercial banks, others launched new attacks on their (and the other banks') savings reservoir, making life even more difficult for them. The Robeco investment company founded its Roparco daughter in 1981. Roparco offers a relatively high interest rate whilst savers can dispose quite freely over their money instead of giving up disposability for a certain period or having to pay a penalty in case of withdrawing money. Roparco has been able to offer such favourable terms because, though registered as a commercial bank, it only accepts payments into its accounts or withdrawals from its accounts through accounts that people hold with other banks. Its operating costs are consequently low.

One way to survive is to offer products that others don't. An interesting phenomenon in this respect is the development of ethical banking. Algemene Spaarbank voor Nederland (ASN) distinguishes itself by the ethical norms it applies in its investments (bonds and private placements). It does not invest in firms doing trade with countries with a poor human rights record or in firms that produce weaponry. ASN is one of three banks connected with the trade union movement who in 1990 combined with two insurance companies to form the Reaal Groep, a group that lacks coherence and
was left again in 1992 by one of the banks. Another ideological bank is Triodos Bank, which bases itself on anthroposophic ideas and aims at stimulating new kinds of initiatives, such as ecologically sound investments.

The victims

If savings banks have been reduced in number and fight a bitter battle for survival and commercial banks have merged and combined with insurance companies, mortgage banks had no choice but to throw in the towel in the early 1980s. Mortgage banks specialize in granting credit with mortgages as security. Apart from own funds, they initially funded themselves exclusively by issuing mortgage bonds, from the 1950s on supplemented by private placements. Mortgage bonds used to differ from other bonds in that they were issued on tap, which enabled the mortgage banks to immediately adjust their credit interest rates to changes in market conditions and the volume of their borrowing to the volume of their lending. They were not subject to the so-called calendrier or calendar, a kind of waiting list for bond issuers administered by DNB with a view to preventing disruptions of the bond market which was in force from 1946 till the deregulation of the Dutch capital market in 1986 (cf the section on monetary policy below). Furthermore, in contrast to other bonds, under an agreement with the Vereniging voor de Effectenhandel (Stock Brokers Association) mortgage bonds can be sold directly by the issuers to the public through their own branches or through commercial banks, bypassing the Stock Exchange. Against this, mortgage banks were not allowed to attract funds from the public for periods shorter than two years.

The first ten years or so after the war were disappointing for the mortgage banks, as the housing market was subject to rent controls and dominated by government-financed housing corporations and local councils. Things brightened up when the government, in an effort to stimulate home-ownership, as of the 1st of June 1956 began to grant subsidies to owner-occupiers of new-built houses and enabled local authorities to provide mortgage guarantees. This last measure made it possible for financiers to lend up to 90 per cent, instead of 65 or 70 per cent, of the building costs. Though providing a fillip to the activities of the mortgage banks, this measure sowed the seed of later difficulties. The availability of government guarantees meant that specialized knowledge of the housing market was no longer a prerequisite for survival in the mortgage loan business. Home owners who defaulted on their debt payments would be bailed out by the government and nothing was gained by the financier if he had an accurate idea of the value of a house in the case of foreclosure. As it happened, this made it attractive for other banks to enter the home loan market and so contributed to the ultimate foundering of the independent mortgage banks. It should be noted that, apart from mortgage banks operating in the real estate sector, there
have been ship mortgage banks, which in 1971 were accepted as members of the Association.

With their loan business to home owners thriving, in the 1960s some of the big mortgage banks, to wit Friesch-Groningse Hypotheekbank or FGH and the Westland and Utrecht mortgage banks (after their merger in 1969 the Westland-Utrecht Hypotheekbank or WUH) started to branch out into various real-estate activities, including property development, investment for their own account and, in the case of FGH, real estate agency. Such activities could not be financed through mortgage bonds, as these had to be backed by mortgages. It was hoped that this diversification would bring a measure of risk-spreading, but these hopes were dashed when the real-estate crunch came around 1980. This followed after a boom which had started in 1975 and was fuelled by high inflation, lagging interest rates and high inflation expectations. All this had made real estate look like a safe investment and made prices soar. When the boom burst and both demand for and prices of real estate fell precipitously in 1979 and the following years mortgage banks felt the crunch of increased competition. Commercial banks and savings banks had the edge on interest rates, as they could fund themselves with relatively cheap savings deposits. Life insurance companies and pension funds, also active in housing finance, did not have to pay high interest rates to attract funds either. To pile on the agony, the mortgage banks lost their monopoly of issues on tap. As from 1981, commercial banks have been allowed to issue bankbrieven, which are bonds issued on tap by banks. Initially these were restricted to a total of f 500 million a year for all the commercial banks together, but as from 1987 no restrictions apply. The commercial banks naturally have been more interested in selling their own product than in selling a similar product issued by mortgage banks. Worst of all, the mortgage banks got bad publicity as it emerged that they had overexpanded and had to shed personnel and reduce the number of branch offices. Mortgage bonds could only be sold at increasingly higher yields as compared to other bonds, if indeed they could be sold at all. WUH attempted to safeguard funding by selling mortgage loans to the Algemeen Burgerlijk Pensioenfonds (ABP, the civil servants' pension fund), which would bring in slightly over f 3 billion over the period 1981 through 1983. High supply of WUH mortgage bonds in the secondary market depressed prices in 1981, increasing effective yields to dizzying levels. DNB initiated a safety net in order to maintain orderly market conditions. This failed to prevent losses, in large part from the property development sector, cumulating and in 1982 DNB lifted its ban on banks and insurance companies buying into mortgage banks ABP supplied subordinated loans and, more important, the Nationale-Nederlanden insurance company acquired preference shares, both to the tune of f 150 million. DNB helped finance a foundation specially set up in 1983 to take over bad loans from WUH. Nonetheless, further aid proved necessary and in 1986 WUH became a wholly-owned daughter of Nationale-Nederlanden. Similarly, FGH had to be rescued
by a financial injection from RPS in 1983 and by further participations in 1986 from Postbank and the Aegon insurance company. After new losses had been run up in 1986, Aegon took over FGH in 1987. Postbank opted out because it still was a government agency and was not allowed by the Minister of Finance to become heavily involved in a private mortgage bank: the conservative liberal party and the christian democrats in Parliament feared that foreign investors would react negatively to a takeover by a state bank (Mulder 1987 p. 64).

The big two among the independent mortgage banks found a safe haven with insurance companies. No such luck befell Tilburgsche Hypotheekbank, a small outfit that had made big loans to borrowers of dubious reputation and had taken recourse to counterfeit surveys of real estate in order to justify their loans. As a collapse of Tilburgsche would severely damage the whole industry, the big three, FGH, WUH and Rabohypotheekbank after some prodding by DNB furnished Tilburgsche with an f 18 million subordinated convertible loan. But to no avail. Nobody was interested in taking over the Tilburgsche and in August 1983 it was declared bankrupt. The healthy parts of the estate were then bought by the Ennia insurance company, which later became part of Aegon.

The biggest mortgage bank, Rabohypotheekbank, which came into being in 1975 through a merger of Boerenhypotheekbank and Raiffeisenhypotheekbank, was little affected by the trials and tribulations of other mortgage banks. For one thing, they had restricted themselves to the core business of mortgage banks. Also, they had less difficulty selling their mortgage bonds and attracting private placements than other mortgage banks, because of the high repute of the Rabobank group of which they were a part and which guaranteed their liabilities. They took over Nederlandse Scheepshypotheekbank (Dutch Ship Mortgage Bank), which with mortgage bonds in disrepute faced insurmountable difficulties in funding themselves, in 1986. As the other remaining independent mortgage bank, Friesch-Hollandsche Hypotheekbank, had already been taken over by the AMEV for the same reason, this marked the end of the era of independent mortgage banks.

None of the independent mortgage banks proved able to weather the storms of the early 1980s. Even without the shocks in the real estate market around 1980 it is doubtful whether the independent mortgage banks could have survived much longer than they actually did (cf Koelewijn 1987, Voute 1989). In a capital market where the government left increasingly diminishing space for other borrowers, funding became increasingly harder and more expensive and there is little reason to believe that the mortgage banks would have been able to hold their own not only against the government as a big borrower, but also against the commercial banks, cooperative banks and savings banks, which had the advantage of cheap funding through savings deposits, while the commercial banks also intruded into the territory of tap-issued bonds. The loss of their sheltered niche on the capital market combined with
increased competition on the home loan market, in particular from other banks and RPS with their extensive branch networks, could hardly have failed to turn their profits into losses.

The payments mechanism

In the passage on the concentration movement among savings banks the importance of technological developments in the payments mechanism was already hinted at. The payments mechanism was for a long time a subject on which the banks and PCGD carefully avoided to come to an agreement. Already before the war attempts had been made by the banks to introduce a payments system that would provide a cheaper alternative to payments by cheque, which were subject to stamp duty. On a small scale this Bankiersgiro (Bankers’ Giro) started functioning in December 1937, but it did not really pull off. The system was cumbersome and payments took quite a time to effect, because there were no less than 25 clearing banks in the system. Participating banks channelled payments through these banks and they in their turn cleared any remaining balances via DNB, once a day. In 1944 Kas-Vereeniging started another system, and so the Netherlands entered the post-war period with no less than five separate payments systems, each using their own forms, and run respectively by DNB, PCGD, the Amsterdam Municipal Giro System, Bankiersgiro and the Kas-Vereeniging’s giro. Attempts at holding consultations between PCGD and the Bankers’ Association on unifying the forms had something of a ritual dance, a very slow one at that, and came to grief. The banks were not very forthcoming and PCGD on its part wished to retain the system where banks, in order to be able to make payments on behalf of their clients, had to keep balances on accounts with PCGD (Wolf 1983 p. 42). In the meantime business firms started to make increased use of PCGD, because automation had made it possible for them to send large numbers of payment orders on punch cards or magnetic tapes. On top of that, PCGD had introduced pre-punched giro credit slips, which clients of firms and other organizations only had to sign and which simplified bookkeeping a great deal. Especially after a number of municipal services had strongly advised the public to shift to this method of payment, the banks started to make haste (Wolf 1983 p. 43). After all, the number of accounts held with PCGD increased threefold between 1960 and 1970, from less than 800,000 to 2.5 million, doubling again over the next decade (Peekei and Veluwenkamp 1984 p. 14).

1967 saw the establishment of Bankgirocentrale (bank giro centre or BGC) by the commercial banks and the agricultural cooperative banks, who were in 1969 joined by the savings banks. BGC processes all giro payments between the several banks and those between the participating banks and Postbank. After payments have been effected, remaining claims of banks on each other are settled via the banks’ accounts
held with DNB. This clearing takes place once a day. At the time, such a system only existed in Sweden. At last progress was also made in making life for the public easier. After eight years of laborious negotiations, the banks and PCGD came to an agreement to introduce common pre-punched giro credit slips (Wolf 1983 p. 63).

Remittances were made without charge. The banks initially even provided stamp-free envelopes, if only because the postal giro system had been traditionally doing the same. Against the costs of running the payments mechanism the banks received the interest returns on loans outstanding, but as the paper work is quite labour intensive and interest on loans is uncertain and fluctuating, the costs were more and more felt as a burden. This was a major reason for some of the smaller banks to pull out of the retail market around 1990. As from 1990 the banks have been introducing charges for their payment services, but ever so slowly because of the concerted opposition from both consumer and business organizations (even if charges on payment accounts are low in comparison with other European countries, cf Jongepier 1991). DNB by contrast strongly supports the banks in this respect, out of concern with their financial health.

Even if PCGD via Postbank has become part of a commercial bank, the postal giro system and BGC have not yet been integrated. Payments from accounts held in one system to accounts held in the other are possible, but time-consuming. One integrated system would of course be preferable. The then Minister of Finance, Dr Duisenberg, in 1975 gave orders to investigate how to integrate the two payment systems, but it will probably take till the turn of the century before integration will be effected.

The developments described all served to increase the attractiveness of bank money vis-à-vis currency. A further step along this road has been the introduction of EFTPOS (Electronic Fund Transfer at Point of Sale). This has only been spreading slowly, though, because business firms tend to consider the costs charged them too high.

Supervision

Unlike some other countries, such as Belgium and Germany, in the Netherlands the central bank is charged not only with monetary policy but also with prudential supervision. Monetary policy is concerned with keeping the value of the guilder steady, both in terms of other currencies (in practice the Deutschmark) and in terms of purchasing power. Prudential supervision is concerned with protecting the banks' creditors. After the war, supervision was still based on a 1932 regulation, which did not give DNB much grip on the banks. This changed after the Wet Toezicht Kredietwezen (WTK), based on the 1948 Bank Act, came into force in 1952. It authorized DNB to issue rules on capital-asset ratios and liquidity ratios. A third branch of policy
was so-called structure policy, aimed at preventing too mighty financial combines coming into existence. In particular, banks and insurance companies were not allowed to hold significant amounts of each others shares. The difficulties in the mortgage bank sector in the early 1980s led to the first weakening of this principle, and with the approach of the integrated European financial market it was to all practical purposes discarded in January 1990. The only restriction now is that banks and insurance companies should remain separate legal entities, but there are no objections from the monetary authorities to banks and insurance companies being in one holding. With both banks and insurance companies in the same holding, DNB remains responsible for prudential supervision on the banking leg and the Verzekeringkamer (Insurance Chamber) for supervision on the insurance leg. This is quite different from prudential supervision on banks. With insurance companies, it is not capital-asset ratios that count, but the relationship between income and future obligations on the one hand and own capital on the other. It is to be expected that DNB and the Verzekeringkamer will have to cooperate ever closer in the future in order to redress or prevent unfair competition, as banks sell insurance policies and insurance companies sell banking products, in particular mortgage loans.

National rules as to supervision are more and more shaped or even superseded by those of international agencies. In 1989 the EC passed the Second Banking Directive, to which national laws have to be adapted as of the first of January, 1993, at the latest. This guideline opens up all national financial markets of the member states to the financial institutions of all member states. A credit institution from a member state after that date may open a branch office or provide cross-border services in any other member state. It may offer the same kind of services abroad as it is entitled to offer in its home market. Each EC country will be responsible for prudential supervision of those banks that have their headquarters in that country, applying the common capital-adequacy standards, whilst monetary supervision is the province of the country where a subsidiary is active.

International developments forced the Dutch monetary authorities to give up their opposition against close ties between banks and insurance companies. They have also been opposed to banques d'affaires, i.e., banks heavily involved in non-bank firms through share ownership, again out of a concern about concentration of power. WTK 1978 stipulated that banks should not hold more than five per cent of the share capital of another firm, and then only temporarily, unless given special permission. Also, a bank is not allowed to invest more than 20 per cent of its own capital in non-financial firms. DNB had already made an exception in order to enable the banks providing capital to SME's. In 1980 the banks got general permission to take a minority share in SME's, to a maximum of f 2.5 million and in principle for no longer than five years, in 1986 extended to f 4 million and ten years respectively. The
provisions of the Second Banking Directive are likely to force the Dutch monetary authorities to further soften their stance.

Prudential supervision cannot mean that the central bank guarantees creditors that banks will never fail. That would put a premium on irresponsible behaviour by bank managers: if a risky venture succeeds, the spoils are for the bank shareholders and managers, if a venture goes sour, the central bank and ultimately the tax payer has to pay up. There is thus a moral hazard problem in prudential supervision. The Dutch solution, introduced in 1979 with the revised WTK, is that deposits or other registered claims of individuals, foundations and associations are guaranteed up to an amount that is reviewed every three years (ƒ 40,000,- per individual or institute in the 1989-1991 period and again for the next three years). Unlike the American system, this is a mutual guarantee system. If a bank fails to redeem claims on it, the rest of the Dutch banking system will compensate the victims. Again unlike the American system, the Dutch solution appears to avoid the moral hazard problem while at the same time providing full protection to small depositors. Big depositors and business firms should be able to avoid risky banks and if they are lured by high credit interest rates offered by little-known financial institutions, they must suffer themselves if such a bank fails. This fate befell a few Dutch municipalities when the obscure Amsterdam American Bank closed its doors in 1981. Prudential supervision does not imply a guarantee by DNB to creditors of financial institution. Legal action by creditors of failed financial institutions (Amsterdam American and Tilburgsche) against DNB therefore were bound to come to grief.

Though the system is satisfactory from the point of view of moral hazard and protection to depositors, the distribution of the burdens is perhaps not entirely fair. First of all, cautious banks have to pay for the careless ones, which can hardly be avoided without changing to another system (for instance, an insurance system with premiums dependent on the perceived risk of assets). More seriously, Dutch banks suffer if a Dutch daughter, even if itself perfectly sound, of a foreign bank has to close its doors as a result of a failure of the mother (de Leeuw 1992). New European directives are likely to solve this problem as of 1994.

Over the years, DNB has extended its supervision to other sectors than the commercial banks. WTK 1952 charged DNB with the task to supervise the savings banks and prudential supervision was introduced in 1954, when DNB issued directions on required liquidity, followed in 1958 by directions on capital-asset ratios. Before 1954 there had already been a degree of self-regulation by the Spaarbankbond. This apparently was up to the standards required by DNB, for it was agreed that the Spaarbankbond would henceforth supervise the savings banks on behalf of DNB. DNB did not take over until 1 January 1990, with the Spaarbankbond still helping to collect data from its members. WTK 1978 brought the mortgage banks within the compass of DNB's control, effective from the 1st of January, 1980.
onwards they had exercised a form of self-regulation, over and above supervision from RPS. When in 1928 the Centrale Beleggingsraad (Central Investment Council) was formed in order to supervise investments on behalf of a number of government agencies, RPS was charged by this council with supervision on mortgage bonds, which they had already done since 1905 on their own initiative. This state of affairs formally ended only in 1952 (de Knocke van der Meulen 1981 p. 36).

Monetary policy

Minister of Finance Pieter Lieftinck opted for a rather *dirigiste* policy immediately after the war, aimed at keeping interest rates low, and with it the cost of investing and the burden of the government debt. This could succeed because the capital market was strictly controlled. Even all bank loans over f 50.000,- had to be okayed by DNB. DNB's status itself was to be changed shortly. Firstly, in 1948 it was nationalized, even if it retained the legal guise of a limited liability company. Secondly, the 1948 Bank Act, which defined the tasks and the powers of DNB, was passed, with the instruments at its disposal to be spelled out later in the WTK (1952, revised in 1956 and 1978). Article 9 charges DNB with safeguarding, as far as possible, the value of the guilder, both in terms of purchasing power, i.e., the internal value of the guilder, and in terms of its price expressed in foreign exchange, i.e., the external value of the guilder. But how should it go about fulfilling these tasks? Traditionally, central banks tried to defend the internal and/or the external value of their currency by influencing the money supply or credit conditions through the discount window and open-market operations. WTK 1952 gave DNB additional instruments, such as the imposition on minimum liquidity ratios, credit ceilings and selective credit control (all of which had been deployed prior to WTK 1952 coming into effect, on the basis of special arrangements). Directly after the war, with the banks superliquid - they were awash with Treasury bills, as Mr Lieftinck in his concern for low interest rates made no haste in consolidating the Government's floating debt -, there was little scope for discount policy. In the period 1952-4 the State took measures to decrease the liquidity of the banks, through lengthening the term of the bills to a maximum of twelve years. 1954 saw the introduction of cash ratios. DNB could compel the banks to keep an interest-free deposit with DNB as a percentage of their liquid liabilities, to be revised every month. In this way, credit expansion by the banks could be kept within bounds. Later on, in 1956 and 1957, with balance-of-payments deficits and a continuing increase in bank note circulation (both of which were a drain on the banks' liquid assets), the banks became more dependent on DNB and as from 1979 it has been customary for them to be in the red with DNB, even if during the 1960s the banks' liquidity position was improving through inflationary finance by the government and private sector
balance-of-payments surpluses (van der Werf 1988 p. 211, 215). If the banks are in the red DNB has a handle on them. In 1958-60, though, the balance of payments on the money account was comfortably in the black. DNB did not want to impose higher cash ratios, because that would induce the banks, which had built up a considerable volume of foreign assets, to repatriate these assets, i.e., sell them to DNB. In the circumstances, DNB preferred the banks to hold foreign assets, rather than see its own foreign currency reserves grow, for reasons of international monetary cooperation. This meant DNB had to give up exclusive reliance on indirect measures, i.e. manipulation of the discount rate and the cash ratio, for direct measures, such as credit ceilings (de Haan et al. 1981 pp. 78-81). Without abandoning the discount rate as an instrument of monetary policy, during the 1961-72 period DNB relied mostly on various forms of direct credit control. By and large these implied ceilings on short-term credit expansion (overdraft loans and loans for periods shorter than two years), in 1965 complemented by a rule for the expansion of the volume of longer term loans (two years and over) not to exceed the growth of longer-term liabilities (de Roos and Renooij 1980 p. 181 ff). This rule meant that the creation of (broad) money through medium and long-term credit would be neutralized by a fall in the money supply through shifts from money and near-monies into savings deposits, longer-term time deposits and bonds.

The problem with direct controls is that they are not in conformity with market forces. In particular, it was felt that credit ceilings, limiting credit expansion by individual banks to some percentage increase over the credit volume of a previous period, stifled competition. It proved difficult to fit the rapidly increasing number of foreign banks into the system (Renooij 1979 p. 11). Also, near-banking, i.e. short-term credit granting between non-banks, was in this way stimulated, reducing the impact of monetary policy measures. WTK 1978 therefore created the opportunity for DNB to extend its monetary supervision to the liquidity-creating activities of non-banks (i.e., the issue of short-term debt), but not without a Government ordinance. Furthermore, as the dividing lines between the various financial institutions became blurred, DNB extended its grip over those institutions whose debt had been assuming a more liquid character: the savings banks in 1969, PCGD in 1970 and RPS in 1973. Note that this concerns monetary policy, not prudential supervision.

Required liquidity ratios were re-introduced in 1973 but phased out again in 1977 in favour of credit ceilings. These ceilings differed from the earlier ones in that DNB did not fix an upper limit to the volume of credit, but to the volume of liquidity creation through credit granting, be it short-term or long-term. If a bank hit the ceiling, it could always increase its lending, provided it also managed to attract new long-term funds, such as savings deposits. Any increase in the volume of (broad) money was in that way compensated by the fall brought about by converting (broad) money into less liquid form. The end result would be an increase in long-term interest rates.
The shift to salary payments in hard cash to payments into giro and bank accounts that took place in the 1960s led to changes in the composition of the (narrow) money supply (see Table 2). Any increase in the currency supply makes the banks more dependent on DNB, for if the public wants notes or coin, the banks have to buy these on their behalf from DNB and their balances held with DNB fall (coins are issued by the Ministry of Finance but brought into circulation by DNB, before 1993 for small denominations by the post offices; shifts by the public from bank money into coins involve payments by the banks into the account which the Government holds with DNB). A falling share of currency in the money supply eases the pressure on the banks' balances with DNB and so lessens DNB's hold on them. This is what the banks were achieving in the 1960s. Various cash reserve instruments are available, though, to keep them in the red and enable DNB to control short interest rates.

Table 2. Bank money and currency, 1955 - 1990.

<table>
<thead>
<tr>
<th>Year</th>
<th>Currency as per cent of national income</th>
<th>Bank money as per cent of the (narrow) money supply</th>
</tr>
</thead>
<tbody>
<tr>
<td>1955</td>
<td>14.4</td>
<td>19.2</td>
</tr>
<tr>
<td>1960</td>
<td>12.8</td>
<td>15.7</td>
</tr>
<tr>
<td>1965</td>
<td>12.0</td>
<td>14.0</td>
</tr>
<tr>
<td>1970</td>
<td>9.0</td>
<td>14.5</td>
</tr>
<tr>
<td>1975</td>
<td>7.5</td>
<td>16.8</td>
</tr>
<tr>
<td>1980</td>
<td>7.2</td>
<td>14.3</td>
</tr>
<tr>
<td>1985</td>
<td>7.5</td>
<td>16.3</td>
</tr>
<tr>
<td>1990</td>
<td>7.8</td>
<td>18.7</td>
</tr>
</tbody>
</table>

Source: DNB Annual Reports.

For a large part of the post-war period, DNB attempted to control the domestic price level through manipulation of the (broad) money supply and the rate of exchange through manipulation of the short interest rate. It was thought that the control of the money supply would have a greater impact on long-term rates of interest than on short-term rates. The credit ceilings were indeed aimed at influencing long rates and with it spending. Short rates then remained available for regulating short-term international capital movements and consequently could be used for weakening or strengthening the guilder in foreign-exchange markets. To these ends, DNB maintained, or even created, a strict division between short-term credit markets and (long-term) capital markets. Developments in either market should not in any appreciable
degree spill over into the other one. Short-term bond issues therefore were forbidden, as were bullet loans (loans that are fully redeemed at one fixed date), which, when the redemption date draws close, tend to be used as money market paper. Nor could commercial paper and negotiable certificates of deposit find favour with DNB.

After the final breakdown of the Bretton Woods system of fixed-but-adjustable parities in 1973, after having tottered and been patched up in 1971, the rate of exchange more and more assumed pride of place in monetary policy. Besides, international capital movements exploded, increasing the interest-elasticity of capital flows to very high values indeed. All this meant that the use of the interest-rate instrument in the attempt to stabilize exchange rates elicited increasingly large capital inflows and outflows, which worked out in notable rises and falls of the domestic money supply and make an independent money-supply policy illusory. On top of that, the liberalization of financial markets in the world marched on. The Netherlands, with its large sector of international firms, its important financial community and its concern for the future of Amsterdam as a financial centre, could not afford to remain in slow lane and 1986 saw the abolition of the restrictions on the issues of debt instruments. The artificial separation between the short-term credit market and the capital market is a thing of the past and DNB has effectively given up its attempts to control the money supply. Exchange-rate policy now occupies centre stage and a stable price level is largely dependent on price developments in the countries whose currencies are pegged to each other and to the guilder in the European Monetary System. Nonetheless, a money-supply or credit-supply policy cannot entirely be dispensed with, because too high a rate of domestic credit creation would cause capital exports, either direct or via a fall in interest rates, leading to a fall in the foreign-exchange reserves of the central banks and the commercial banks. Ultimately confidence in the stability of the guilder would be damaged and investors would launch an attack on the guilder. As an aside, maintaining confidence has also been the reason for DNB to prefer the short-term interest rate as an instrument for exchange-rate policy to direct interventions in the foreign-exchange market, which are thought to be more apt to make the market nervous, i.e., make it expect exchange-rate changes (den Dunnen and de Wilde 1991 p. 13).

Over the years, DNB’s monetary policy, supported by a largely non-inflationary (i.e., monetary neutral) fiscal policy and, some would add, by incomes policy, has been quite successful in maintaining the external value of the guilder, even if the inflation record has been less impressive (see Table 3). True, in 1949, when the pound sterling was devalued by 30.5 per cent vis-à-vis the American dollar in September 1949, the Netherlands followed suit with a devaluation of 30.2 per cent, upping the par value of the dollar from f 2.65 to f 3.80. It is a moot point whether this large a devaluation was really necessary, and DNB would indeed have settled for a devaluation of about
Table 3. Inflation rates 1950-90.

<table>
<thead>
<tr>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Netherlands</td>
<td>3.3</td>
<td>5.4</td>
<td>8.4</td>
<td>1.9</td>
</tr>
<tr>
<td>Belgium</td>
<td>2.4</td>
<td>3.6</td>
<td>7.6</td>
<td>4.4</td>
</tr>
<tr>
<td>France</td>
<td>6.4</td>
<td>4.2</td>
<td>9.7</td>
<td>6.1</td>
</tr>
<tr>
<td>Germany (FRG)</td>
<td>3.2</td>
<td>3.2</td>
<td>5.1</td>
<td>2.7</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>4.0</td>
<td>4.1</td>
<td>14.4</td>
<td>5.8</td>
</tr>
<tr>
<td>United States</td>
<td>2.5</td>
<td>2.8</td>
<td>7.1</td>
<td>3.7</td>
</tr>
</tbody>
</table>


24 per cent (Bakker and van Lent 1989 p. 170, but Lieftinck's policy was to keep Dutch prices low relative to other countries (pressure from the Minister of Agriculture, S. Mansholt, seems to have played a role as well, see van Lennep and Schoorl 1991 pp. 45, 144 nt. 4). The liberalization of European trade in 1950 helped to translate the devaluation into increased exports, at the cost of some upward pressure on the domestic price level. Reasonable inflation rates and mounting current account surpluses in Germany (FRG) and the Netherlands together with the wish to keep imported inflation at bay led to a revaluation of the Mark and the guilder by five per cent in March 1961 (see on this Yeager 1966 p. 418). This caused protests by exporters and a general stir hard to imagine for those accustomed to the violent exchange-rate changes of the post-1973 period. It proved not enough to offset inflation differentials with other countries and can be said to have significantly contributed, through high profits and overemployment, to the 1964 wage explosion. In the post-Bretton Woods era, a number of European countries cooperated in order to narrow exchange rate fluctuations, culminating in the European Monetary System (EMS) in 1979. Within the EMS, which is to all practical purposes a system of fixed-but-adjustable parities, the Dutch policy has been to follow parity changes of the Mark, though the Minister of Finance, H.O.G.R. Ruding, snubbed DNB by only partially following the revaluation of the Mark in March 1983. The poor inflation record of the 1970s was a result of downward real wage rigidity. Wages were fully compensated for the rise of energy prices resulting from the 1973-4 oil crisis, at the cost of falling profits and rapidly rising unemployment. Here incomes policy, or the lack of it, made DNB's task in fighting inflation a hopeless one.

Article 26 of the 1948 Bank Act gives DNB a very high degree of independence from government interference in the field of monetary policy (as apart from the
pegging of exchange rates). If the Minister and DNB disagree and do not succeed in
patching up their differences, the Bank Act provides for a (lengthy) procedure to
bring DNB on its knees. So far, this procedure has not been used. The independence
of DNB is jealously guarded, and not without reason for, as former Bank President
Dr Jelle Zijlstra tells us in his memoirs, politicians and civil servants periodically try
to undermine Article 26 (Zijlstra 1992 p. 212 ff). This independence means, among
other things, that DNB cannot be forced by the Government to finance its deficits.
The 1948 Bank Act stipulates that the Government has the right to demand interest-
free loans from DNB, subject, though, to a ceiling of only f 150 million. If the
Government wants more, it must try to conclude an agreement with DNB. Such
agreements typically restrict borrowing by the State from DNB, i.e. selling Treasury
bills to them, to a small percentage of the total State budget, basically to bridge
seasonal fluctuations in the Government's financing needs.

The aims of stabilizing both the internal and the external value of the guilder are
not necessarily always compatible. Maintaining stable exchange rates when foreign
countries suffer from high inflation inevitably leads to imported inflation, and if one
wants to give priority to stable prices, a floating rate system or periodic revaluations
are inevitable. The Netherlands have been lucky in that its main trading partner, the
German Federal Republic, still haunted by the memory of the hyperinflation of the
early 1920s, made price stability one of its overriding policy objectives. Linking the
guilder to the Mark has therefore been a convenient way to fulfill the tasks set by the
Bank Act.

If and when the European Central Bank becomes a reality, DNB will lose its sway
over monetary policy, which anyway is dictated by the Bundesbank, given the
openness of the economy and the close ties of the Dutch economy with the German
one. What will remain is its task in prudential supervision.

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