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DNB's Approach to Financial Deregulation: How it Increased the Financial Instability

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Citation

Gerharts, M. (2023). *DNB's Approach to Financial Deregulation: How it Increased the Financial Instability*.

Version: Not Applicable (or Unknown)

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Downloaded from: <https://hdl.handle.net/1887/3633850>

Note: To cite this publication please use the final published version (if applicable).



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DNB's Approach to Financial Deregulation

How it Increased the Financial Instability

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MA Thesis

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Date: 2023-06-07

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1. Introduction

After the outbreak of the financial crisis in 2008, the financial sector's stability was strongly questioned. The crisis has highlighted the need for stronger regulation and revealed the negative side of the deregulation process of the late 1970s and early 1980s. The banking sector itself was a significant contributor to the instability in the industry. This thesis, therefore, focuses on how they viewed financial deregulation and, more specifically, how central banks viewed this process. Central banks were supposed to supervise the financial sector but failed to prevent the industry from collapsing. This study, therefore, examines their perspective through a case study of the Dutch central bank – De Nederlandsche Bank (DNB).

The DNB is a bank worth studying because of its remarkable history. It is one of the oldest central banks in Europe, and one of the largest takeovers in the world took place under its watch, which will be discussed in the third chapter (Vanthoor, 2004). Additionally, since 1948 the DNB has been a modern central bank responsible for the well-functioning of the Dutch economy and its monetary policy. Therefore, DNB's perspective on deregulation is a good starting point to gain more insight into how the financial sector became unstable and led to the 2008 financial crisis.

The inability of central banks to prevent a crisis in the financial sector illustrates the limits of their role and has led to criticism from various quarters (Westerhuis & van Zanden, 2018). In the aftermath of the 2008 crisis, there has been criticism and questions from academic circles and within society. People started looking for a 'culprit' to blame. Populists, whose electoral support increased significantly after the crisis, blamed bankers and regulators for the outbreak, believing that bankers had endangered the financial system and that financial regulators had allowed this to happen (Goodhart, 2011). Consequently, central banks, acting as financial market regulators, have often been blamed for the outbreak of the crisis. But is this perspective justified? Are central banks the real culprit to blame? Were they aware of the instabilities created by the deregulation process?

Even though the financial sector has played a critical role in the financial crisis, the literature does not provide precise answers or justifications from the perspective of the financial sector. Most research has been done by economists, business scholars and other academics who have mainly focused on the origins of the crisis, trying to understand how it could happen. New insights could be gained by understanding the perspective of the financial sector itself, which

can help reframe the debate on deregulation and explain the crisis in a new way. This thesis attempts to provide this insight, using the Dutch central bank as a case study.

To give a complete and accurate picture of the DNB's perspective, it is necessary to look at the developments DNB has undergone before the outbreak of the 2008 crisis. One academic debate significantly impacted the central bank's developments during that time, namely an academic debate between three schools: the Keynesian school, the Neoliberal school and the Modern Free Banking school (MFB). This debate was centred on the existence of the central banks and how they should be organised. Due to the complexity of the topic and the academic debate, this thesis has presented an overview of the debate in a separate chapter before narrowing the focus to DNB. In order to understand the influence of this debate on DNB and its approach to financial deregulation, the research question is: “Which academic school has had the most influence on DNB's approach to financial deregulation in the period 1948-2007?”

Sub-Questions

The sub-questions are arranged thematically and, to a large extent, chronologically to provide insight into how DNB reacted to the deregulation process and how this fits into the academic debate discussed in the forthcoming theoretical chapter. This chapter focuses on two main topics: (de)regulation of the financial markets and the evolving concept of central banking during the researched time. The research period covered in this thesis date back to 1948 when the Banking Act transformed DNB into a modern central bank and ended on the eve of the 2008 financial crisis.

This thesis considered three main events that significantly impacted the financial deregulation process and the behaviour of central banks. The first event is the shift from Keynesianism to Neoliberalism, which could have affected DNB's perspective on financial deregulation. After the Second World War, Keynesianism became the dominant economic perspective. Governments have often gained more control over the financial sector, and politicians, rather than central banks, set monetary policy (Goodhart, 2011). For a long time, this was the prevailing economic perspective. However, the oil crisis and the subsequent period of stagflation changed this, and Neoliberalism became the dominant perspective. Neoliberalism emphasises free market mechanisms, and as a result, many markets have been deregulated. The financial sector was also deregulated, significantly impacting central banks' functioning. The academic debate is fundamental to understanding this shift in economic perspective and DNB's subsequent behaviour towards deregulation. To determine which school influenced DNB the

most, the first sub-question is: “To what extent did the academic debate influence DNB’s perspective on financial deregulation during the shift from Keynesianism to Neoliberalism?”

European integration, which has also affected the financial sector, is the second event highlighted in this paper. With the establishment of the European Coal and Steel Community (ECSC) in 1951, Europe created its first supranational body, and member states had to cede some of their sovereignty to the High Authority (Treaty establishing the European Coal and Steel Community, 1951). Whether European integration influenced DNB's views on deregulation and whether DNB had different views on this is examined in the second chapter based on the academic debate. Therefore, the second sub-question is: “In line with European integration and the establishment of the European Central Bank, which academic school was most dominant in DNB's approach to financial deregulation?”

The financial deregulation in the 1970s and 1980s contributed to the creation of banks that have become too big and too powerful. Therefore, the last event discussed in this thesis is the emergence and rise of the so-called ‘Too Big To Fail’ (TBTF) banks. Financial deregulation contributed to this development, and TBTF banks contributed to financial instability and the subsequent financial crisis of 2008. ABN Amro, a well-known international bank in the Netherlands, was one such bank that encountered severe problems during the financial crisis and was eventually nationalised (Ministerie van Algemene Zaken, 2014). Despite central banks' primary role in stabilising the economy, they had allowed banks to become TBTF, further increasing financial instability. This chapter, therefore, questions the very existence of central banks. To understand central bank behaviour during this development and to determine its legitimacy, the third sub-question is: “Which academic school was most dominant in DNB’s approach to financial deregulation looking at the emergence of Too Big To Fail banks?”

Methods

In order to give an accurate picture of DNB’s development and perspective regarding the deregulation process, this thesis focuses on documents concerning the DNB in the National Archives and DNB’s own archives. Descriptive inventories and annual reports of the DNB for the period 1814-2004 are kept at the National Archives, while the more recent files are kept at DNB’s archives and are consulted until the financial crisis outbreak.

DNB's behaviour is examined over a long historical period, which allows us to see if its perspective on deregulation has changed and how this corresponds with the academic debate. Therefore, not only archival material will be used to answer the research question, but also the within-case method, a small-N comparison, causal narrative and historical methods are used.

Primary and secondary literature will be used for the last two methods. Some examples of primary sources are newspaper reports from the time and interviews with people involved.

A significant secondary source for this thesis is *De Nederlandsche Bank 1814-1998, Van Amsterdamse kredietinstelling naar Europese stelselbank* [The Dutch Central Bank 1814-1998, From Amsterdam Credit Institution to European System Bank]. DNB commissioned the book for its 190th anniversary, providing a good insight into the development of the central bank and the economic background in which DNB operated (Vanthoor, 2004). However, it is worth noting that the book was written in 2004, before the financial crisis. It is, therefore, crucial to interpret the book in the light of this temporal context.

2. The academic debate on central banks

In today's world, we tend to take for granted the existence of a modern central bank that manages a country's monetary policy. However, this is a relatively recent phenomenon (occurring only 150 years ago) and has been the subject of many academic debates (Doroftei, 2013). Nowadays, academics still question the usefulness of banking supervision, monetary policy, and the central bank's lender of last resort role. Especially after the 2008 financial crisis, the debate has renewed, also in light of the deregulation process. Central banks have been part of financial deregulation, for example, by loosening their restrictions, which ultimately increased the instability in the sector that led to the outbreak of the crisis. The inability of central banks to prevent the sector from sliding into crisis showed the limits of their role and fuelled the debate on central banks (Westerhuis & van Zanden, 2018).

This paper aims to understand the perspective of central banks before the crisis and whether it is justified to consider them as culprits. Therefore, this thesis seeks to understand how central banks viewed the deregulation process, drawing on a particular academic debate on central banks that dates back to the twentieth century and has made a significant contribution to the perspective of central banks. The debate is between three different schools: the Keynesian school, the Neoliberal school, and the Modern Free Banking school (MFB). All three schools have different views on central banks and how they should be organised, as well as different perspectives on the process of financial deregulation. It should be noted that this chapter primarily serves as an introductory overview of the academic debate and the three different schools of thought to familiarise the reader with the subject before focusing on the specific case of DNB. The following chapters will provide a more in-depth exploration of the debate, focusing on the themes relevant to each chapter.

The Shift in Political Approaches

In order to contextualise the different schools of thought, it is essential to look at the different political approaches that prevailed during the research period. Therefore, this research will briefly examine the two approaches, Keynesian and neoliberal economics, before delving into the academic debate.

The Keynesian Perspective

The English economist and philosopher John Maynard Keynes challenged the neoclassical *laissez-faire* doctrine of the inter-war period and its long-term perspective. Keynes argued that the doctrine's emphasis on the long run was irrelevant to society and took too long, famously

remarking, “In the long run, we are all dead” (Keynes, 1923, p. 80). The Great Depression of the 1930s revealed the inadequacy of *laissez-faire* economics, as market mechanisms failed to cope with the impact of the depression, which devastated the world economy (Wheelock, 1992). As a result, the need for government intervention to stabilise the economy was highlighted (Crotty, 1980). Filho and Terra (2012, p. 25) summarised Keynes’ perspective quite well in their article, stating that “... capitalism should depend on the visible hand of the State, so as to regulate the socioeconomic dysfunctions deriving from the market.”.

From a Keynesian perspective, it became essential to break the cycle of economic depression and restore prosperity through government intervention. In other words, the state must intervene through fiscal policy to keep the economy going and prevent it from deteriorating (Madra & Adaman, 2014). As a result, the focus shifted to the demand side of the economy, meaning that instead of cutting spending and raising interest rates when an economy is in decline, governments should invest in the economy to ensure that it continues to function and restore prosperity (Filho & Terra, 2012).

After the end of the Second World War, the Keynesian economic perspective became dominant. The adoption of Keynesian policies has led to a significant increase in the global GDP (Ravenhill, 2017). The period from 1946 to 1971 is, therefore, often referred to as the “Golden Years” or the “Keynesian consensus” due to the rapid reconstruction and subsequent sustained economic growth with full employment and minimal inflation (Singer, 1990, p. 236). The economy has become increasingly important due to the growing interdependence of the global economy and increased international competition, although it remains tightly regulated (Horwitz, 1986). This led to a backlash against the prevailing Keynesian perspective and precipitated the rise of Neoliberalism.

The Neoliberal Perspective

In the late 1960s and early 1970s, criticism of the Keynesian perspective was widespread due to a period of stagflation, a combination of high inflation and high unemployment, aggravated by the 1973 Oil Crisis (Eatwell, 2011). The Keynesian theory could not explain this, leading to ineffective solutions. As a result, neoliberalism emerged as the more dominant perspective. The rise of neoliberalism is debated among scholars, but the general perspective is that it goes back to the market-based conception of the public interest (Horwitz, 1986).

Most neoliberal thinkers emphasise economic freedom, believing this would ensure countries' competitiveness and efficiency, and advocate a complete return to individual freedom with no exceptions. Most neoliberal policies are based on unlimited competition through

deregulation, opening markets, and reducing the state's role. For example, the French philosopher and historian Paul-Michel Foucault stated, “Liberalism must produce freedom” (Foucault, 2008, p. 64). However, most economic freedoms were curtailed in favour of more social freedoms during the Keynesian era. Foucault believed the emergence of Neoliberalism was the way to “resolve a constitutive tension of liberalism” (Madra & Adaman, 2014, p. 694).

The academic debate on central banks

Having briefly summarised the different economic perspectives that emerged during the research period, it is now appropriate to move on to the academic debate on central banks, which we can contextualise even more effectively. The three different schools coexisted, but, as we shall see, one prevailed more during some time than the others. The next session will provide an overview of their views on central banks and financial deregulation.

First, the Keynesian school, which dominated from 1945 to the 1970s, strongly advocated extensive regulation of the financial sector by central banks and other government agencies, arguing that free market mechanisms failed to achieve economic equilibrium, as demonstrated by the Great Depression (Bernstein, 2001). Therefore, Keynesian scholars believed that central banks should be owned by the government rather than by private shareholders, as they had to act purely in the interests of society (Bibow, 2002). Moreover, a central bank is not only a lender of last resort that intervenes in times of crisis but should also be involved in the financial sector on a day-to-day basis to maintain the financial system's stability, according to the Keynesian school. From their perspective, it is the “duty of any central bank to guarantee the smooth functioning of the payment system.” (Rochon & Rossi, 2007, p. 552), advocating for a strong central bank that is actively involved in society.

In the late 1970s and early 1980s, Neoliberalism became the dominant economic perspective, giving way to financial deregulation in response to the new competitive threats that emerged during this period. The world became more interconnected, leading to challenges posed by globalisation, technological change, and the rise of new economic powers. Deregulation was seen as a means of enhancing market competitiveness and adaptability in these changing conditions. It represented a revival of competition at a new level to deal with the new threats (Horwitz, 1986). The Keynesian school, in contrast, strongly opposed this development and warned of the dangers of instability in the sector since the Great Depression had already shown the adverse effects of unrestricted competition.

Joseph Stiglitz, a Keynesian academic, challenges the proponents of financial deregulation by arguing that the liberalisation policies “have contributed to global instability”,

which hampers economic growth (Stiglitz, 2002, p. 15). Additionally, he argued that the financial deregulation in the United States and other developed countries “encouraged unwise lending”, which “encouraged short-term lending”, which encouraged instability in the sector (Stiglitz, 2002, p. 212). In other words, the deregulation of financial markets led to increased instability and vulnerability in the global financial system.

In line with Stiglitz, the economist Hyman Minsky argued that the “American economy was more unstable in the 1970s and 1980s than in the 1950s and early 1960s” (Minsky, 1986, p. 197). Minsky refers indirectly to the economic shift from Keynesianism to Neoliberalism and the resulting shift in regulation. Moreover, Minsky believed that “financial crises are the result of factors that are internal to the working of our economy.” (Minsky, 1986, p. 51). He foresaw the dangers in the financial sector and even warned of a coming financial crisis due to the more speculative activities and complicated financial products created by deregulation (Minsky, 1986). Minsky and Stiglitz highlighted the negative consequences of financial deregulation, but this perspective was not widely shared at the time, which changed after the outbreak of the 2008 financial crisis.

The second academic school, the Neoliberal school, does not agree with scholars such as Minsky and Stiglitz and argues that competition within the financial sector is necessary to enhance economic growth, emphasising free market mechanisms with a strong focus on competition. During the 1980s, the dominant perspective was that the financial sector was anti-competitive, and innovations were needed (Schenk, 2020). Therefore, deregulation was seen as a tool to promote competition in the sector, which would faster the economy and enhance efficiency. Neoliberals were, therefore, strong advocates of financial deregulation.

Milton Friedman was one of the most influential neoliberals, influencing many political leaders in Western Europe and the United States to adopt deregulatory policies. Friedman argued that free markets are the most efficient system for allocating resources and pleaded that government interventions should be restricted, particularly in the economy. Therefore, financial deregulation should solve the inefficiencies in the financial markets and stimulate further economic growth (Friedman, 1962). In the 1980s, the neoliberals became more dominant. Friedman, along with Friedrich Hayek and Robert Nozick, influenced the President of the United States, Ronald Reagan, and the Prime Minister of the United Kingdom, Margaret Thatcher, the pioneers of financial deregulation, to adopt neoliberal policies. Therefore, the Economist described the three academics as “the theoretical godfathers of the Thatcher-Reagan revolution” (‘The Comeback Man’, 2004, para. 2).

The Neoliberal school strongly advocates financial deregulation, but this does not mean they are against a central bank's existence. On the contrary, they supported central banks, but to a limited extent. For example, Friedman strongly supported *laissez-faire* economics but distanced himself from free banking (Friedman, 1960). The Neoliberal school noted the importance of the existence of a central bank but argued that reregulation was needed to give the sector more freedom to promote economic growth. Instead of a strong central bank, they prefer one that maintains a country's price stability without government involvement.

The last academic school, the Modern Free Banking school (MFB), is the most radical group of all three. They are against a central bank in any form, arguing that central banks, and regulation in general, are absolutely useless. As Gedeon (1997, p. 209) mentioned in his article, central banks “can neither reduce the likelihood and severity of banking crises nor regulate the supply of credit money”, so why do we have one? The perspective of the MFB school is centred on a free banking system, i.e. a financial system without a central bank or any other financial and monetary regulator, and certainly without any form of government intervention (Dowd, 2003).

Unlike the Keynesian school, the MFB school believed government intervention would harm the financial sector (Vanthoor, 2004). They argued that the role of central banks as lenders of last resort, or lenders of *first* resort as it is sometimes called, only exacerbates instability in the banking sector. They also saw a central bank as a political creation rather than an economic necessity, weakening the discipline that competitive markets impose on banks. This is strongly linked to the principle of moral hazard (Gedeon, 1997). The MFB school argued that this would encourage banks to engage in riskier behaviour, given the comfort that banks have with central banks as lenders of last (first) resort. According to the MFB school, central bank protection increases the likelihood that banks will overextend themselves and weaken the sector's stability, leading to a higher probability of banking crises than free banking regimes (Gedeon, 1997). However, opponents point out that riskier behaviour by banks is often driven primarily by the pursuit of higher profit margins (Vanthoor, 2004).

In conclusion, two academic schools favour a central bank, but in a different format, and one school is absolutely against it. In short, the Keynesian school favours regulation and central banking but is against financial deregulation. The Neoliberal school is against regulation but favours both central banks and financial deregulation. Meanwhile, the MFB school opposes both regulation and central banking and favours financial deregulation. The following chapters

will examine whether and to what extent this debate has influenced central bank behaviour in the financial deregulation process. It will also answer whether central banks have always favoured regulation in the financial sector or whether it was one of the regulators, as Robert B. Horwitz (1986, p. 148) put it in *Understanding Deregulation*, who “initiated the deregulation process”.

3. The First Chapter: From Keynesianism to Neoliberalism

The Banking Act of 1948 transformed De Nederlandsche Bank into a modern central bank responsible for the proper functioning of the Dutch financial sector. This development was in line with the prevailing economic perspective of John Maynard Keynes. Under this perspective, the financial sector was strongly regulated and heavily constrained by rules and restrictions. This changed in the late 1970s and early 1980s when the dominating economic perspective changed from Keynesianism to Neoliberalism. As a result, the financial sector had to be deregulated to enhance economic growth and stimulate innovations. This chapter assesses the impact of this radical shift on DNB's perspective on financial (de)regulation, with particular reference to the academic debate mentioned in the previous chapter.

A New Economic Perspective in the Dutch Financial Sector

After the end of the Second World War, the financial sector underwent significant changes due to a new international monetary system, a new economic perspective and the trend towards socialisation. The Great Depression of the 1930s, the worst economic crisis in history, showed the fragility of *laissez-faire* economics with unlimited competition. This, combined with the disastrous consequences of the war, gave rise to Keynesianism as the leading economic perspective. This perspective was enshrined at the Bretton Woods Conference in 1944, establishing the new international monetary system based on fixed exchange rates (De Groot, 2019).¹ As a consequence, the financial sector became strongly regulated with limited competition.

The trend of socialisation influenced the structure of the financial sector and has been driven by three main events: the Great Depression of the 1930s, the German occupation during the Second World War, and the shift in economic perspective towards Keynesianism (Tweede Kamer der Staten-Generaal, 1997). During the reconstruction years, state intervention in the economy was socially supported and generally accepted (Wetenschappelijke Raad voor het Regeringsbeleid [WRR], 2021; Vanthoor, 2004), which was in line with the Keynesian school of thought. As a result of this trend and the other two developments mentioned above, the role of central banks has changed significantly, as most were nationalised after the war.

The Banking Act of 1948 transformed DNB into a modern nationalised central bank (Westerhuis & van Zanden, 2018). From this point, DNB has three main tasks, enshrined in

¹ The dollar was the only currency that could be exchanged for a fixed amount of gold. This meant that other currencies had to be exchanged before obtaining gold from the US Federal Reserve.

Articles 9(1) to (3) of the Banking Act. It had to 1) regulate the value of the Dutch currency, 2) ensure the movement of money in the Netherlands and facilitate payments with foreign countries, and 3) the DNB had to supervise the credit system (Bankwet 1948, 1948). In other words, DNB has to prioritise the community's interest above its own, which marked a significant change from DNB's previous practice of selling shares to private investors and profiting from it (Uittenbogaard, 2014).

The nationalisation of central banks should ensure this, as governments are seen as the guardians of the public interest. The increasing relationship between central banks and governments was a general trend in most Western countries after 1945, with politicians determining central bank policy (Goodhart, 2011). In the Netherlands, it was widely believed that DNB had to act as a "community bank" (Tweede Kamer der Staten-Generaal, 1997, p. 4) and that the value of the currency should be regulated "in such manner" as was "most conducive to the prosperity of the country" (Bankwet 1948, 1948, p. 3). Consequently, all shares became the property of the Dutch state, significantly changing DNB's management structure (Uittenbogaard, 2014). This development significantly changes the relationship between central banks and governments, increasing the state's role in the financial sector.

The government's role is explicitly outlined in DNB's new Banking Act. In Article 26 of the Banking Act, the so-called *aanwijzingsrecht* [right of designation] stipulated that the Minister of Finance could give binding instructions on monetary and financial policy to the Banking Council (Bankwet 1948, 1948). From this point, the responsibility for the central bank's monetary policy was transferred to the Minister of Finance, so the government had primary authority. This development aligns with the Keynesian school, which believes that central banks should act in the best interest of the public good. The ownership of central banks should, therefore, be in the hands of the state and certainly not in the hands of private investors (Bibow, 2002). On the contrary, both the Neoliberal school and MFB school are against the nationalisation of central banks, as they oppose government intervention in the financial sector. However, the nationalisation of DNB should not be overestimated because, despite the state's increased role in the sector, DNB remained an independent organisation. In reality, the Minister of Finance did not have that much power. The former Minister of Finance, Piet Lieftinck, even described the *aanwijzingsrecht* as an "ultimum remedium" that was introduced primarily to put the public interest first (Tweede Kamer der Staten-Generaal, 1997, p. 5).

The Financial Sector in the Golden Years

The period from 1948 to 1973 is known internationally as the Golden Years because of the impressive economic growth and financial stability that prevailed (van Riel, 2016). During these years, there was a strict division between different financial institutions, each with its own role in society. The American economist Woinilower (1991, sec. 4) described this division as a “financial zoo”, with each institution in its own cage. As a result, the competition during the Golden Years was confined to the financial institutions' own cages.

Learning from the Great Depression, central banks have been active in limiting competition in the financial sector. It had become clear that unrestricted competition could create unprecedented problems and lead to financial instability. Therefore, central banks took several measures to discourage competition and limit the size of financial institutions. One such measure was the introduction of capital controls, meaning that banks could only lend a limited percentage of their capital amount. In this way, central banks indirectly encouraged financial institutions to prioritise large and relatively safe customers since the banks would have to bear the resulting financial burden if something went wrong. In other words, banks were exposed to high risks, which made them very cautious, resulting in minimal financial innovation as they had to take precautions (Goodhart, 2011). This prudent behaviour by banking institutions and tightening central bank regulations have contributed to a stable monetary environment during this era.

Unsurprisingly, there were almost no bank failures during this period, as risk-averse behaviour prevailed. Some academics even described the financial sector as “boring” because nothing was happening (Goodhart, 2011, p. 140), to the great dissatisfaction of the Neoliberal school and the MFB school, who favoured the free, competitive behaviour in the sector. On the contrary, DNB favoured the boringness of the sector and was actively involved in maintaining the separation of the ‘financial zoo’. In 1952, DNB was formally given the task of supervising the financial sector with the *Wet Toezicht Kredietwezen* (Wtk) [Credit Supervision Act], which gave the Bank the power to regulate mergers and acquisitions of financial institutions (Stellinga, 2015), as it had to give a declaration of ‘no objection’ when banks wanted to merger (Vanthoor, 2004). Moreover, DNB had a so-called *Structuurbeleid* [structural policy] designed to maintain the separation between financial institutions and draw a line between them and non-financial institutions (Stellinga, 2015). DNB's aim with this policy was to prevent financial institutions from becoming too big and too powerful (Westerhuis & van Zanden, 2018).

It is questionable whether the stable monetary environment is the result of tighter central bank regulation or whether it depends on the sector itself. On the one hand, DNB supervised and structuralised the financial sector with micro-prudential supervision through its structural policy. But on the other hand, the sector and the financial institutions were relatively safe. However, the ending of the Second World War accelerated two significant international developments, which influenced the financial sector: 1) the banking concentration process and 2) the increasing scale and size of financial institutions.

Five financial institutions dominated the Dutch financial sector during the twentieth century, also known as the Big Five.² Initially, these institutions operated locally, but due to the two international trends, they needed to grow, and mergers and acquisitions were seen as the best solution. As a result, they expanded on a national scale (WRR, 2019). Both international trends have been accelerated by increasing European integration, discussed in the next chapter, which has interconnected the financial sector. As a result, competition in the industry has intensified, making it more critical for financial institutions to grow in size and scale. To cope with the increasing pressure on bank size, the Big Five had to merge. Two mergers between the Big Five took place in 1964. The Nederlandsche Handel-Maatschappij N.V. merged with the Twentsche Bank N.V. to form Algemene Bank Nederland (ABN). The Amsterdamsche Bank N.V. and the Rotterdamsche Bank N.V. also merged to form the Amsterdam-Rotterdam Bank (Amro) (De Nederlandsche Bank, 1965).

DNB was wary of the two international trends because it could lead to a concentration of power within a small number of banks (Vanthoor, 2004) but declared ‘no objection’ to the two mergers. The merging banks stressed the positive effects of the mergers, arguing that they were necessary to strengthen their position in international finance, which was necessary to become a significant international player (van Riel, 2016; Vanthoor, 2004). However, DNB was convinced that the best way to ensure stability in the financial sector was to prevent banks from becoming too big and too powerful and was very cautious about developments in the financial sector.

Remarkably, DNB did not express any concerns regarding these developments in its annual report of 1964. On the contrary, it only emphasises the positive effects, such as cost reductions and the changing financial needs of its customers. DNB, for example, noted that internationalisation had taken place in other sectors and that customers, therefore, benefited from international financial institutions (De Nederlandsche Bank, 1965). Indirectly, DNB refers

² The banks included were Amsterdamsche Bank, Incassobank, Nederlandsche Handel-Maatschappij, Rotterdamsche Bank and Twentsche Bank.

to the positive effects of the banking scale process. It also mentioned in the same report that the merging banks were smaller than other “large banks in countries with a similar structure and population size to the Netherlands” (De Nederlandsche Bank, 1965, p. 135).

In the end, DNB did not find any grounds to believe that these two mergers would lead to an unhealthy development of the credit system or a distortion of banking policy (Stellinga, 2015). DNB, therefore, agreed to both mergers and put aside its fears, recognising that this was an inevitable economic trend (Vanthoor, 2004). This could be seen as one of the first signs that DNB's Keynesian policies were beginning to conform to the Neoliberal school. Nevertheless, DNB made it clear that the mergers were a one-off exception to its structural policy and that it would not tolerate further mergers or acquisitions that would accelerate the process of banking concentration or increase the size and scale of institutions (Westerhuis & van Zanden, 2018).

The Shift Towards Financial Deregulation

The financial situation described above was a relatively safe sector because it was mainly anti-competitive, and banks were risk averse. As a result, there was little to no financial innovation, and some scholars argued that the financial sector needed to be more efficient to enhance economic growth (Schenk, 2020). This was in line with the new economic perspective of Neoliberalism that prevailed in the late 1970s and early 1980s. This new perspective led to financial deregulation, which had significant consequences for the financial sector and central banks, including the DNB.

Financial deregulation came mainly from the United States and the United Kingdom, but the Netherlands also had its neoliberal tradition. Neoliberal ideas were strongly promoted when Ruud Lubbers became prime minister of the Netherlands (1982-1994) (Oudenampsen & Mellink, 2019). Not all changes came from abroad; for example, the Netherlands was the first country which liberalised capital controls (Flier et al., 2002). Due to this development, financial institutions became more exposed to the free market forces, increasing the international competition in the sector (WRR, 2016). The cages of the ‘financial zoo’, using the words of Wojnilower, began to be dismantled.

The Big Bang on the London Stock Exchange on 27 October 1986 further accelerated the financial deregulation, which liberalised various measures (Plender, 1986). This had inevitable consequences for the policy of the central banks. In the 1980s, for example, DNB broadened its structural policy and allowed previously prohibited mergers (Vanthoor, 2004). This change in DNB’s behaviour, from more Keynesian policies to more deregulatory measures of the Neoliberal school, was due to the far-reaching international trends. DNB could not keep

up with these trends and, despite its fears, was forced to follow them, as the next chapter will also show.

The former Minister of Finance Onno Ruding explained in an interview that the Big Bang had significant consequences for the Dutch financial sector, arguing that if “we [the Dutch financial sector] had to maintain our [financial] position in the world, we had to follow the English development”. Ruding was a firm believer in the market mechanism in the financial sector, and he also stated that the financial industry for deregulation was “far too restricted” (Van den Hout, 2009). This contradicts DNB's view at the time, which shows that the government's and DNB's perspectives were not always the same. The financial sector had undergone significant changes by shifting from Keynesianism to Neoliberalism, making it considerably more complex and, without a doubt, less ‘boring’. The following two chapters will examine the DNB’s response to these changes.

4. The Second Chapter: The European Integration

The previous chapter showed the impact of the academic debate on DNB's policy and their subsequent behaviour to the financial deregulation of the late 1970s and early 1980s. Although the economic perspective has changed from Keynesianism to Neoliberalism, DNB still largely follows the Keynesian school. However, the financial sector underwent significant changes driven by the profound impact of European integration. The European integration led to the creation of supranational organisations, which impacted the monetary policy of national central banks. As a result, the DNB had to adapt its policy to the European level, especially with the establishment of the European Central Bank (ECB). In addition, the DNB decided to loosen their structural policy in the 1980s, which stood in strong contrast with its previous period. Whether this is in line with DNB's own development or whether the DNB is influenced by advanced European integration will be examined in this chapter.

A small disclaimer must be made beforehand: the academic debate cited in this thesis consists of three groups: the Keynesian school, the Neoliberal school and the Modern Free Banking school. However, this chapter will mainly focus on the first two schools' influence on DNB's perspective, as the MFB school has not explicitly commented on European integration. Their perspective can only be addressed indirectly.

European Integration: The Creation of Supranational Organisations

European integration started right after the end of the Second World War, as Western politicians embraced the notion that a unified Europe would avert the threat of future wars. The United States was also involved in the early stages of this process, requiring European nations to cooperate if they wanted to receive the post-war aid programme, famously known as the Marshall Plan (Vanthoor, 2004). As a result, on 16 April 1948, the Treaty on European Economic Co-operation, signed by 16 European countries, led to the creation of the Organisation for European Economic Co-operation (O.E.E.C.) (De Nederlandsche Bank, 1949).

This development was firmly in line with the Keynesian school of thought. At the Bretton Woods conference in 1944, Keynes stressed the idea of international cooperation. He argued that countries must work together to establish a stable global economic system. During the conference, he proposed a new international monetary system that could prevent economic instability and trade imbalances that had led to the Great Depression. For example, Keynes was a key player in emerging the International Monetary Fund (IMF) and the World Bank (Singer,

1990). It is argued that the “European integration project has followed the broad lines anticipated by Keynes.” (Hirai et al., 2013, p. 125). This paper agrees, arguing that the start of European integration aligned with Keynes's views.

The OEEC was only the beginning of the European integration project, and shortly afterwards, the European Payments Union (EPU) was established to restore currency convertibility in Western Europe. As mentioned in the DNB's annual report, the reason for this was that “only in a multilateral payment system a more or less liberalised international trade is possible” (De Nederlandsche Bank, 1951, p.17). Moreover, the participating Member States should be prepared to take action if the internal monetary balance threatens to become unbalanced (De Nederlandsche Bank, 1951).

DNB was heavily involved in establishing the EPU and was delighted with this development. In one of the reflections of the DNB on the proposed EPU, the President of the DNB, Marius Holtrop, said that “the creation of the E.P.U. is considered to be in the general European interest, and therefore also in the Dutch interest” (De Nederlandsche Bank, 1950, p. 17). This perspective was widely shared in Dutch society (Vanthoor, 2004). One person, in particular, had been of significant influence at the EPU, Suardus Posthuma, a Dutch economist and the director of the DNB. To quote the book written for the 190th anniversary of DNB, S. Posthuma “made history with his drafts for the liquidation plan contained in the EPU Treaty”, and in doing so, he made a significant contribution to further easing the European payments system (Vanthoor, 2004, p. 187). This demonstrates that DNB was heavily involved in the early stages of European integration and had a favourable view of these developments. However, European integration also accelerated certain developments that DNB was wary of, which will be discussed later in this chapter.

In both organisations described above, national organisations retained power, which changed in 1951 with the creation of the European Coal and Steel Community (ECSC). The six countries that signed the treaty (Belgium, France, Germany, Italy, Luxembourg and the Netherlands) had to cede some of their sovereignty to the High Authority. The aim of the Treaty, as stated in its Article 2, was to contribute, through the common market in coal and steel, “to economic expansion, growth of employment and a rising standard of living in the Member States” (Treaty establishing the European Coal and Steel Community, 1951). Again, this was in line with the Keynesian school of thought. Keynes argued in the interwar period for a cooperative system for coal, which, according to Hirai et al., is the “prototype” of the ECSC (Hirai et al., 2013, p. 117). The Neoliberal school, which emphasises free market mechanisms, was also optimistic about

this development, as the common market for coal and steel would increase the competition between states. However, the German economist and politician Ludwig Erhard argued, “A policy of European integration must at all times imply a willingness to ensure a maximum of freedom and liberalization towards outside areas” (Erhard, 1956, p. 205).

The ECSC was the first supranational organisation in Europe, and the Member States had ceded some of their sovereignty to the High Authority. This meant that the national interests of individual countries were subordinated to the common interest. The ECSC was exclusively an economic cooperation organisation for coal and steel, but this changed in 1958 with the creation of the European Economic Community (EEC). This treaty created a supranational body with unlimited scope in the economic sphere between member countries, which was a significant step forward for European integration (Martens, 1991).

Increasing European integration has had significant consequences for central banks, especially with the creation of supranational organisations. The way in which central banks could perform their tasks changed as the monetary policy was transferred from the national to the international level. This was also the case for the DNB, which was initially only concerned with monetary stability in the Netherlands, but now had to shift its focus to the European level (Westerhuis & van Zanden, 2018). With the integration of Europe, the Netherlands, like other Western European countries, has had to adapt and align its policies with international developments.

Europeans Integration: Shaping DNB’s Financial Sector

As described in the previous chapter, DNB's prevailing perspective until the 1970s was that the stability of the financial sector was best ensured by banks that did not become too big and too powerful. Therefore, DNB’s structural policy was to prevent these developments from getting out of hand and to keep the sector on an even keel. The European integration, however, accelerated two developments that DNB was wary of the concentration process and the increasing size and scope of banks. With the creation of the European Single Market in 1958, these two international developments were further accelerated, leading to many international mergers and acquisitions (van Riel, 2016). As a result, the financial sector became more interconnected, and the deep European integration has dramatically increased competition in the industry. Therefore, in 1964, the DNB issued two ‘no objective’ statements on two mergers between the Big Five but emphasised that this was a one-off exception to its structural policy (Westerhuis & van Zanden, 2018).

However, the changes from the late 1970s and onwards pushed DNB to its limits: Should it follow its own perspective, which emphasised stability in the sector, or should it follow international trends? The change in economic perspective from Keynesianism to Neoliberalism played an essential role in DNB's behaviour as the financial sector became more internationalised. As a result, most Western countries opened up their markets and reduced tariff barriers. This new era of internationalisation within the Dutch banking system made the sector more complex. Financial activities were both cross-sectoral and cross-border due to the extensive concentration process and the increasing size of financial institutions (Vanthoor, 2004). During the 1970s, DNB's three main tasks, described in the previous chapter, were mainly determined by these international developments (Vanthoor, 2004).

In the early stages of this development, DNB chose to follow its own line and increase the security of the Dutch financial sector rather than follow international developments. This does not mean that this new era of internationalisation did not influence the DNB. On the contrary, the DNB decided to adapt its policy to the changing financial sector. In 1978, 1982 and 1992, the DNB amended the *Wet Toezicht Kredietwezen* (Wtk) to reflect the changing conditions in the financial sector (Westerhuis & van Zanden, 2018). For example, the 1978 Wtk extended the scope of supervision to mortgage banks. This can be seen as an extension of DNB's structural policy, as DNB has to give a 'no objection' statement to banks wishing to merge with a non-credit institution. In addition, DNB has established liquidity guidelines and solvency requirements to prevent institutions from going bankrupt (Vanthoor, 2004). This shows that DNB first tried to get a grip on international developments and prioritised maintaining stability in the sector before allowing the Dutch financial sector to become more competitive. In other words, the DNB was still mainly influenced by the Keynesian school of thought rather than the Neoliberal school.

A few years later, DNB amended the Wtk again, but this time not to expand its structural policy but to soften it. In 1982, the mortgage banks, which had only been under DNB supervision for four years, were no longer automatically rejected when banks and insurance companies wanted to merge with them. The only condition was that the merger had to contribute to strengthening the mortgage banks' capital position (Vanthoor, 2004). This was a surprising but explainable change in DNB's attitude. In the early 1980s, there was a crisis in the housing market, which had a massive impact on the mortgage banks, and almost all Dutch mortgage banks got into trouble. Therefore, the DNB had no choice but to loosen its structural policy (Westerhuis & van Zanden, 2018). It is important to note that this decision was based on an unstable financial market, and the DNB tried its best to restore stability in the sector.

As a result of the loosening of structural policy, all mortgage banks in the Dutch financial sector disappeared, and most became part of larger financial institutions (Westerhuis & van Zanden, 2018). This thesis, therefore, argues that DNB has partly contributed to the disappearance of the so-called 'financial zoo'. The old segregation between financial institutions disappeared, leading to the formation of universal banks and financial conglomerates, as both the concentration process and the size and scale of financial institutions increased during these years.

As international pressure increased, DNB was forced to adjust its structural policy further. As a result, in 1988, DNB allowed all financial institutions to merge, and in 1990, the structural policy was officially abandoned, meaning that from then on, all financial institutions could merge without exception (Vanthoor, 2004). This had significant consequences for the financial sector and DNB's supervision, leading to further adoption of the Wtk in 1992 due to the European integration and the changing circumstances in the financial sector (Westerhuis & van Zanden, 2018). This is discussed further in the final chapter. Overall, DNB's behaviour has changed significantly due to European integration, as it has largely abandoned its own perspective during this period. But did this mean that DNB could no longer make its own decisions? Had it become entirely dependent on international trends? Did it lose its sovereignty?

DNB: The end of its sovereignty?

The deregulation of the financial markets has affected DNB's original perspective of ensuring sector stability by preventing banks from becoming too big and too powerful. As a result, DNB had to deregulate its structural policies to compete in the European single market. "To maintain our position in the world", to use, again, the words of the former Finance Minister of the Netherlands, DNB had no other choice than to follow international tendencies (Van den Hout, 2009).

To maintain some grip on the situation, DNB initiated the first international cooperation between central banks, which led to the creation of the Contact Group of Banking Authorities of the European Community in 1972. This informal consultative body aimed to promote close links between the various European central banks and facilitate information exchange. The fact that DNB was the first institution to initiate international cooperation is somewhat surprising, given that only two years earlier, it had minimal contact with its neighbour, the Belgian central bank, regarding its responsibilities (Vanthoor, 2004). However, one of DNB's main tasks was to ensure stability within the sector, and given the internationalisation of the sector, it makes more sense that DNB initiated cooperation with other supervisors, as this was the only way to

maintain control over the sector. The problem with the internationalisation of the financial sector was that financial institutions acted cross-border, while the supervision was only at a national level, which will be further highlighted in the last chapter.

The DNB was not the only central bank that had to deal with internationalisation in the financial markets, and therefore the European Monetary System (EMS) was founded in 1979. This was the first step towards a common European monetary policy, as the Exchange Rate Mechanism was at the core of the EMS (Fendel & Frenkel, 2019). In addition, the EMS was intended to lead to monetary stability within Europe. Nevertheless, it must be acknowledged that, as has often been the case in the history of the European Economic Community, it has been used to promote stagnating European economic integration by encouraging monetary integration. The Dutch Minister of Finance and the DNB stated that sovereignty should be transferred in monetary and budgetary matters, arguing that political unification must precede monetary unification (Vanthoor, 2004).

While the EMS may not have achieved significant outcomes, it can still be regarded as a precursor to the Economic and Monetary Union (EMU). The EMS laid the foundations for “deep and comprehensive agreements among sovereign European governments that remained unmatched elsewhere in the world.” (Fendel & Frenkel, 2019, p. 774). In 1992, the Maastricht Treaty was signed, leading to the creation of EMU, which was divided into three distinct stages to achieve full monetary integration in Europe.³

In 2002, the EMU finally completed monetary unification in Europe by introducing a single currency, the Euro, and adopting a common monetary policy by the European Central Bank (ECB) (Vanthoor, 2004). Initially, DNB saw an essential role in the creation of a European Central Bank, mentioning in its 1989 annual report that an ECB was desirable for banking supervision so that the principle of subsidiarity could be implemented in conjunction with the other tasks of central banks (De Nederlandsche Bank, 1989). In reality, however, this meant the end of the national monetary policies by central banks, as the ECB was in charge of the single monetary policy (Westerhuis & van Zanden, 2018). This raises questions about the sovereignty of national central banks. Have central banks, especially the DNB, lost all their power?

The most straightforward answer to that question is: No, central banks did not lose all their power. For example, in 1998, the European System of Central Banks (ESCB) was established, as a compromise between the ECB and national central banks (NCBs), with the

³ To get to know more about the three different stages of the EMU, this thesis will recommend the following articles: (Artis, 1992; Bean, 1992; Dyson & Featherstone, 1999; Fendel & Frenkel, 2019)

ECB at the helm (Artis, 1992). In addition, the Maastricht Treaty states that the ECB is not a command centre and that all participating central banks, both the ECB and the NCBs, share responsibility for relevant policy areas. Thereby, the accountability of the independent ECB is ensured by a system of checks and balances to which NCBs contribute (Vanthoor, 2004). Moreover, when central banks have to deal with the citizens of a Member State, the NCB has a better chance, as people are more likely to trust their local central bank than the European Central Bank. NCBs, thus, also have an essential communication responsibility (Vanthoor, 2004).

However, central banks did lose some of their sovereignty, as initial national policies, such as maintaining price stability, became the primary objective at the European level (Artis, 1992). Even before the outbreak of the crisis, in 2004, the book *De Nederlandsche Bank 1814-1998* argued that “In the long term, as integration progresses, European interests will increasingly replace national interests” (Vanthoor, 2004, p. 327/328). The work of Hilary Hogan supports this as she argued that the single currency was “catastrophic for the European Union”, as the 2008 financial crisis has shown (Hogan, 2021, p. 440). She argued that the Member States lost control over their monetary policy when they joined the Euro, including the interest rates level. The power of NCBs in this matter was shifted to the ECB, which continued to raise interest rates during the crisis. Additionally, NCBs could no longer devalue their currency during a crisis (Hogan, 2021). These are two measures to combat an economic downturn that has made national central banks dependent on a well-functioning ECB, inevitably losing their former sovereignty.

The amendment of DNB's Banking Act of 1948 into a new Banking Act of 1998 can be seen as part of the development mentioned above of EMU, as the new Banking Act was in line with the Maastricht Treaty and, in particular, the Statute of the ESCB (Westerhuis & van Zanden, 2018). The new tasks in the Banking Act are more broadly defined, aligning with the financial sector's new circumstances. For example, the Bank's task is defined in the Banking Act 1998 as “promoting the smooth operation of payment systems” (Vanthoor, 2004, p. 312).

To reiterate the question, did central banks lose their sovereignty with the creation of European integration? This thesis attempts to answer: Yes, they did. Looking at the development the DNB has undergone, we can argue that it had no choice but to eliminate its Keynesian perspective of protecting the sector's stability by preventing banks from becoming too big and too powerful. Internationalisation in the financial sector was of such influence that a different tactic was needed. The DNB loosened its structural policy due to the dominating economic perspective of

Neoliberalism, which increased competition by opening up markets and reducing barriers in Europe. Additionally, the DNB had to consider working with other supervisors to hold a grip on financial stability, something they did not have to do before. The problem was that, due to European integration and deregulation, financial institutions were operating across borders, while DNB's supervisory role was limited to national borders. To overcome this problem, the ECB was established, taking over some previous tasks of the NCBs.

In the first instance, the ECB's monetary policy seemed relatively stable (Vanthoor, 2004). Until the ECB decided to continue raising the interest rates during the financial crisis in 2008. One important aspect we have not mentioned before is that the ECB did not have a lender of last resort function, as the NCBs did (Hogan, 2021). Meaning that in times of a crisis, the NCB intervened, with, for example, bailouts or capital injections, while the ECB was still in the power of the monetary policy. This led to a significant contradiction. On one side, the ECB was in charge, but the NCB must take action.

In reality, the creation of the ECB meant that member states could no longer use any Keynesian economic policy if their economy got in trouble: they could no longer spend money in their economy to fix it. To use the words of economist Ashoka Mody: "The Maastricht contract essentially said that if a member country had a heart attack, it would receive no emergency care" (Mody, 2018, p. 92/93). Additionally, Mody argued that the "stability of the entire structure rested on this one threat that a country would receive no or only token assistance if it got itself into trouble" (Mody, 2018, p. 93). This was an alarming development as the financial sector became increasingly interconnected. The consequences of this will be discussed in the final chapter.

During the 2008 financial crisis, the ECB's policies forced central banks to raise taxes and cut public spending as the only way to combat the economic collapse over which they had control. This policy was in great contradiction with the Keynesian school, which argued that to create economic growth, spending in the economy was necessary (Filho & Terra, 2012). However, NCBs had no other choice than to change their fiscal policy, as they had no longer control over the monetary policy, thus over the interest rates, and were not able to devalue the national currency as the Euro was established (Hogan, 2021). In line with this perspective, NCB did lose sovereignty and certainly not always in the best way. In the next chapter, this thesis will discuss the rise of too big to fail banks and examine the effect of DNB's loss of sovereignty to prevent the sector from becoming unstable, a development we now know did not work.

5. The Third Chapter: Too Big To Fail Banks

The financial deregulation in the late 1970s and 1980s contributed to changes in the financial sector. As a result, competition in the sector intensified, accelerating the concentration process and increasing the size and scope of financial institutions. Banks became too big and too powerful, generating a public function. They became essential to the well-functioning of the economy: they became Too Big To Fail (TBTF). In the Netherlands, this process accelerated in the 1990s after the DNB abandoned its structural policy. Due to international trends, the DNB had no choice but to allow banks to grow into large financial conglomerates. ABN Amro was one of the banks that benefited greatly from the deregulation process and the abandonment of DNB's structural policy. However, ABN Amro ran into severe problems during the 2008 financial crisis and was even nationalised. The fact that DNB could not prevent this from happening raised questions about the existence of such an institution.

A New Financial Order: The Emergence of Too Big To Fail Banks

The financial sector has undergone a radical transformation in just a few decades. It has moved from a diverse banking landscape with a large number of small specialised institutions to one dominated by a few uniformly large banks. This transformation is due to the financial deregulation and far-reaching European integration, which has fostered the concentration process, and increased the size and scope of financial institutions. As a result, the banking sector became increasingly uniform and concentrated (Stellinga et al., 2019), marking the official end of the traditional boundaries of what has been described as a 'financial zoo'.

The emergence of the new financial order undeniably made the sector less 'boring', as the sector was associated with during the Golden Years (Goodhart, 2011, p. 140). New and unprecedented opportunities emerged, accelerating the growth strategies of banking institutions. Consequently, expanding into a large, internationally-oriented institution became crucial as the industry became more globally interconnected. This necessity was particularly the case for Dutch financial institutions, as the Netherlands was a relatively small market in the internationalised world. As a result, they had to pursue acquisitions and partnerships abroad to remain competitive (Smit, 2016).

Despite these new opportunities, DNB's structural policy limited this development to some extent until it was abandoned in 1990, leading to a fully liberalised Dutch financial sector. Subsequently, financial institutions were able to operate across sectors, blurring traditional financial boundaries and creating the opportunity to grow into a financial conglomerate. This

development manifested rapidly, as evidenced by the fact that only eight years after the full liberalisation of the financial sector, the Netherlands had the highest bank concentration ratio of Europe and the United States, except for Finland. The combined balance sheet of the three largest Dutch banks (ABN Amro, ING and Rabo) represented an impressive 70% of the total balance sheet of all registered banks (Vanthoor, 2004). This is undoubtedly an extraordinary development, especially when one considers that DNB was initially a strong opponent of the banking consolidation process, yet within less than a decade, it found itself at the forefront of this very process. This raises the question of whether DNB's policy differed from the perspective of the financial institutions.

The previous chapters have shown that DNB's policy was mainly based on the Keynesian school, focused on keeping the financial sector safe by allowing limited competition. However, due to the far-reaching internationalisation in the sector, and the pressures from abroad, DNB had to follow the international trend towards the Neoliberal school of thought. This was different for the financial institutions who had, long before financial deregulation, the drive to become international players and tended more to the Neoliberal school. They focused mainly on maximising their profits and becoming bigger and more powerful banking institutions. To achieve this, mergers were necessary, also to withstand international pressures. This was also the main reason for the two Dutch mergers in 1964, creating ANB and Amro, the predecessors of ABN Amro (van Riel, 2016).

In line with the Neoliberal school, the financial institutions generally favoured open competition in the sector. Amro, for example, described in its 1967 annual report the disappearance of the traditional boundaries of the 'financial zoo' as “understandable and economically justifiable” (Amsterdam-Rotterdam Bank, 1967, p. 30). However, the savings and agricultural credit banks received tax concessions that negatively affected the competitive position of other institutions, leading to an “increasing distortion of competition”, which would be detrimental to the financial sector (Amsterdam-Rotterdam Bank, 1967, p. 30). This reflected their early recognition that a level playing field in financial markets created new opportunities and was better for a healthy industry.

With the advent of financial deregulation, banks were given more freedom and competition in the sector increased, providing banks with unprecedented opportunities for growth. Former chairman of ABN Amro, Peter Jan Kalff, explained the need for growth in an interview with *Andere Tijden*. Kalff explained: “If you were a Dutch bank, ..., and you wanted to compete internationally, you had to be able to offer your big clients the same kind of products

as the American and British banks ... If you did not want to do that, you stayed a small local bank. You could choose to do so, ..., but then you would not be part of the big business” (Van den Hout, 2009). This citation illustrates the contradiction between the perspective of the financial institutions, which had the drive to grow into a big and powerful institution, and the DNB, which was wary of this development.

Within a more complex financial sector, some Dutch banks became international global players, making DNB’s task of maintaining stability in the sector harder. The main problem was that the banks saw themselves as private companies, as they originally were, but due to their growing size, they generated a public function. Some banks even became systemic, meaning that they grew to such an extent that they individually affected the stability of the entire financial sector and were indirectly linked to the well-functioning of the economy (Tweede Kamer der Staten-Generaal, 2012). In other words, they became too big to fail, meaning that regulators and central banks had to intervene to prevent such a bank from going bankrupt to reduce its negative impact on society (Michiel Bijlsma et al., 2014).

One Dutch bank that fits this trend is the Dutch TBTF bank ABN Amro, which merged in 1990 when the two banks' previous cultural differences were put aside to meet international pressure to expand (Fogteloo, 2014). The merger increased the growth opportunities, and ABN Amro soon became a global player. In 1998, the bank was already ranked eighth among the world's strongest banks (Vries & Vroom, 1999). Additionally, it has been on the shortlist of many major foreign companies (Nawas, 1995), demonstrating its international importance.

ABN Amro has long been a major national and international player, but that changed when the bank's policy shifted from a “consensus model” to a “free-for-all model”, as the former board member Van den Brink described it (Hensen, 2014, para. 7). In other words, the bank switched to the Anglo-Saxon model, which focused on shareholders' short-term interests and the bank's bonus structure (Fogteloo, 2014). In line with this new direction, the bank's excessive risks increased dramatically, as the potential financial damage was not for the bank's account but for the DNB and the Dutch government, which acted as lender of last resort for ABN Amro as it had become a TBTF institution. During these years, maximising shareholder value became increasingly important, leading to even more risky activities.

Over time, shareholders became dissatisfied with lagging shareholder value, and ABN Amro began to struggle (Smit, 2016). In 2007, ABN Amro was even subject to a hostile takeover by a European consortium of Royal Bank of Scotland, Fortis and Banco Santander (Meinema, 2015). The ensuing financial crisis hit the consortium hard, and the Dutch part of

ABN Amro, owned by Fortis, was eventually nationalised by the Dutch government (Vogels, 2019). DNB and the Dutch Minister of Finance had to declare 'no objection' to the takeover of ABN Amro (De Nederlandsche Bank, 2009), which raises the question of why they allowed it to happen and what they have done to protect the sector from instability.

DNB's Oversight of the New Financial Landscape

Before delving into the ABN Amro case, it is essential to understand DNB's supervisory role in this new financial era. During this period, the main problem was that banks and financial conglomerates operated internationally, while DNB's policy was limited to national borders (Vanthoor, 2004). As mentioned in the previous chapter, DNB initially focused only on its own performance. However, due to the above developments, it had to expand its supervisory role and intensify its cooperation with other regulators to maintain some control over the financial sector.

In the mid-1990s, DNB extended its supervisory remit to macroprudential regulation to keep up with external conditions in the financial sector. This new supervisory task aimed to maintain the stability of the entire industry by reducing the systemic risks posed by TBTF banks (Vanthoor, 2004). As mentioned above, TBTF banks acted globally, increasing financial interconnectedness. This made the sector more unstable, as problems in a single conglomerate could have significant repercussions across the global financial industry and even lead to a systemic crisis, as happened in 2008 (P. White & Yorulmazer, 2014).

Due to these new risks, central banks intensified their cooperation. The Basel Committee, established in 1975, had the leading role in formulating policies for central bank supervision of internationally operating banks. In 1993, this Committee initiated the establishment of the Tripartite Group to supervise the newly established conglomerates. This specific supervision was also extended in 1996 with the Joint Forum on Financial Conglomerates, as it was no longer enough to supervise a conglomerate individually. Therefore, the conglomerates were assessed from a group perspective (Vanthoor, 2004). DNB responded to these international developments by adopting the Wtk in 1992. At the European level, the so-called 'home country control' was introduced, which meant that banks with cross-border branches were supervised by the central bank of their parent company (Vanthoor, 2004).

In the first instance, DNB's national and international policy adjustments seem sufficient to maintain stability in the changing financial sector. However, it was not able to prevent ABN Amro from nationalisation. DNB itself stated in a letter to the Minister of Finance in 2009 that

it believes that “the approach taken at the time ... was the right one” (De Nederlandsche Bank, 2009, p. 4). DNB has both applied its standard risk analysis methodology, FIRM, to identify the relevant risks and has had intensive conversations with the consortium and reviewed the documentation provided by them to determine whether there could be negative consequences for the stability of the sector (De Nederlandsche Bank, 2009).

Nout Wellink, DNB's president at the time, declared that there remained some risks with the takeover of ABN Amro and warned a few times that it could undermine the sector's stability as a possible financial crisis loomed (Tamminga, 2008). But there was too little to not declare ‘no objection’ to the consortium. Wellink said, “If I had just seen a small hole, I would have said no” (ANP, 2010, para. 2). But there was no hole. Moreover, Wellink stood alone, unsupported by the Minister of Finance and other central bank governors. To quote the words of Tamminga (2008, para. 21), “Nobody believed his warnings, but they came true”, and due to the impending financial crisis, the Dutch part of ABN Amro was nationalised for an amount of 27.95 billion euros (Algemene Rekenkamer, 2019, para. 3).

The ABN Amro case demonstrates that DNB's national and international measures were insufficient to maintain a grip on the financial sector's stability. During the Golden Years, an individual bank failure was nothing to worry about, but with the emergence of TBTF banks, it became problematic as a failure of those banks could create significant societal damage and could soon spread over to other institutions globally, leading to a systemic crisis (P. White & Yorulmazer, 2014). Central banks and governments have been given the role of lender of last resort to prevent this from happening by injecting capital to limit the social consequences. This development represents a significant advancement in terms of central banks' primary role in maintaining the safety and stability of the financial sector. However, this role had a flip side, as it created the problem of moral hazard (P. White & Yorulmazer, 2014).

Unintended Consequences: The Downside of the Lender of Last Resort Function

The lender of last resort function of central banks created the problem of moral hazard, as financial institutions did not bear the financial consequences of their actions. As a result, banks took more risks and behaved imprudently. In addition, the safety net provided by the lender of last resort function led banks to take excessive risks, also known as perverse incentives (P. White & Yorulmazer, 2014).

This is precisely what the MFB school feared. They argued that the lender of last resort function of the central bank would encourage banks to engage in riskier behaviour. Moreover, they argued that banks would only overextend themselves, ultimately weakening the entire

financial sector (Gedeon, 1997). In addition, it had become more advantageous to become a TBTF bank. The lender of last resort function has led to lower funding costs as it indirectly protected them and their creditors. As a result, the competitive advantage of TBTF banks over other banking institutions grew with this development, creating an unhealthy and unsustainable financial sector (Bijlsma & Mocking, 2014). The very situation that DNB feared the most and tried to prevent happened: the financial sector became unstable.

The abovementioned development was in line with the perspective of the MFB school. Central banks encouraged unwise lending and riskier behaviour, which weakened the entire sector. The book, written for DNB's 190th anniversary, argues that banks' riskier behaviour was primarily driven by the pursuit of profits (Vanthoor, 2004). This is true, but it does not mean one excludes the other. On the contrary, the drive to maximise profits is accelerated because they do not bear the financial costs of their actions, so they can take more risks and increase their profits. The Dutch anthropologist, and news correspondent, Joris Luyendijk has studied the financial sector and the outbreak of the 2008 financial crisis and explained this development in an interview by saying that the banking institutions had nothing to lose: in good times, they earn the profit generated by the riskier behaviour, but during a crisis, it was the taxpayer who pays the bill (Luyendijk, 2015). In other words, these institutions had everything to gain as they had nothing to lose. This was evident in the aftermath of the crisis, and Luyendijk said that banking institutions had actually learned something: we can get away with anything (Luyendijk, 2015). But if central banks cannot prevent a systemic crisis with all the measures they have taken, and they do create the moral hazard problem, do we still need them?

Central Banks: Essential Guardians or Outdated Institutions?

The abovementioned question is precisely the point the MFB school wants to make, or at least they want people to think of a regime without a central bank (Gedeon, 1997). The British economist and supporter of the MFB school, Kevin Dowd, stated that most people take for granted the unstable banking sector, including the fact that central banks have a lender of last resort function. However, Dowd argued that “The argument for free banking is also very simple”, as “free trade and *laissez-faire* are best” (Dowd, 1993, p. 1). He believed in an automatic stabilising mechanism, also in the banking industry, and, therefore, no state intervention is needed (Dowd, 1993). On the contrary, state intervention or central banks' lender of last resort function only contributed to the instability of the banking system, as it led to the abovementioned problems of moral hazard and perverse incentives. Free banking avoids these problems, leading the MFB school to argue that banking crises are more common under central

banking systems than in free banking regimes (Gedeon, 1997). The American economist Lawrence H. White agreed with this by arguing that moral hazard will be avoided in a free banking system as it “restrains excessive credit creation by fear of failure” (L. H. White, 2017, para. 6). In this perspective, banking institutions are self-responsible for their actions, and due to this responsibility, the sector should be safe.

The MFB school is undoubtedly correct that the lender of last resort function of central banks is being abused by banking institutions. In their perspective, banking institutions and general bankers are competent and pursue long-term interests. However, reality has shown that fraud and short-term interest are the leading causes of bank failures (Vanthoor, 2004). Moreover, the MFB school failed to recognise the significant public function of TBTF banks. For example, Dowd believed that the banking sector, like other industries, was best served by free trade and *laissez-faire* and that there was no need to treat it with different public policies (Dowd, 1993). On the contrary, this thesis tends more towards the words of Dutch Prime Minister Mark Rutte, who argued that banking institutions are a kind of “semi-governmental institutions” incomparable with other large companies “like Heineken” (Jonker, 2018, para. 5).

TBTF banks have a public function, but the main problem mentioned earlier still exists: They still consider themselves as private organisations, meaning they primarily look after their own interests rather than the public interest. This is a logical development, but the bankruptcy of such institutions affects not only the company itself but society as a whole. For this reason, Minsky, a supporter of the Keynesian school, stresses the importance of the existence of a central bank, especially during an extreme market disturbance (Gedeon, 1997). In this respect, the Neoliberal school agrees with the Keynesian school, recognising the importance of a central bank, but within a market-based economy. The Neoliberal school is not for abandoning central banks as the MFB school, but for reregulating the central bank’s function. They argue for an independent central bank without governmental intervention (Major, 2012). Milton Friedman, one of the most famous scholars of the *laissez-faire* economy, also distanced himself from free banking without a central bank, as he argued that “it would not ... solve the problem of ‘inherent instability’” (Rolnick & Weber, 1983, p. 1081).

To return to the question: Do we need a central bank? The answer is: Yes! Central banks are, now more than ever, essential guardians of economic stability. The new financial era has created financial conglomerates that have become too big to fail because of their public function. Therefore, this thesis argues that abandoning a central bank with a lender of last resort function is not advisable. The global economic and, more importantly, social consequences of a systemic bank failure and the subsequent systemic crisis would be unprecedented. The

complete abolition of central banks is, therefore, not the answer. However, this thesis argues that the abuse of TBTF banks should be curbed, as the MFB school argues, but this requires a change in the system itself, which is beyond the scope of this paper.

6. Conclusion

This thesis has provided valuable insights into the perspective of central banks on financial deregulation before the 2008 financial crisis. The case study of De Nederlandsche Bank shows that the dominant school that shaped DNB's approach to financial deregulation was primarily the Keynesian school. However, DNB was forced to adopt policies aligned with the neoliberal school as circumstances evolved. Although the Modern Free Banking school did not significantly influence DNB's perspective on financial deregulation, it provided a crucial critique of central banks' lender of last resort function.

In 1948, DNB became a nationalised modern central bank responsible for the well-functioning Dutch financial sector. Until the 1970s, DNB was mainly influenced by the prevailing economic perspective of the Keynesian school and was convinced that the financial sector's stability was best ensured if banks did not become too big and too powerful. DNB, therefore, established its structural policy. During the Golden Years, the financial sector was relatively safe due to the anti-competitive behaviour and the risk-averse behaviour of banks. In the late 1970s and early 1980s, Neoliberalism became the dominant economic perspective, leading to financial deregulation, which liberalised the financial sector and shifted DNB's Keynesian policies towards more neoliberal measures. DNB was wary of the international trends and believed limiting these developments was the best way to ensure stability. Therefore, this thesis argues that the Keynesian school most influenced DNB's perspective on financial deregulation during the shift from Keynesianism to Neoliberalism.

In the early stages of European integration, DNB largely followed the Keynesian school. However, with the establishment of supranational organisations, DNB had to cede some of its sovereignty to the Higher Authority. With the internationalisation of the financial sector, DNB's loss of sovereignty and the increasing size of financial institutions and the banking process, DNB was forced to abandon some of its Keynesian policies in favour of more neoliberal measures. This process was further accelerated with the establishment of the ECB. Nevertheless, DNB tried to maintain control over the financial sector by taking the lead in initiating cooperation with other central banks. Therefore, this thesis argues that the DNB was still mostly dominated by the Keynesian school but had no choice but to adopt neoliberal measures, even if the DNB feared them. In other words, the Keynesian school dominated the first phase of European integration but was later sidelined, forcing the DNB to adopt the perspective of the Neoliberal school.

During the emergence of TBTF banks, the Neoliberal school dominated DNB's approach to financial deregulation. In 1990, DNB abandoned its structural policy, and the Dutch financial sector was fully liberalised. As a consequence, banks grew into financial conglomerates and generated a public function: they became TBTF. The new financial era made DNB's supervisory task harder because the main problem still existed: TBTF banks saw themselves as a private company. Instead of limiting this development, it became advantageous to become a TBTF bank. DNB's lender of last resort function played an essential role in this development, as it indirectly protected the TBTF bank, leading to the problem of moral hazard. As a result, banks started to behave imprudently and took on perverse incentives. DNB tried to keep the financial sector safe by expanding its supervisory role with macroprudential regulation and intensifying cooperation with other regulators. However, the ABN Amro case illustrates that these measures were insufficient to maintain the sector's stability. It was already too late; what DNB had been trying to prevent since it became a modern central bank happened: the financial industry became unstable.

Overall, it can be concluded that the Keynesian school had the most significant influence on DNB's perspective on financial deregulation in the period 1948 to 2007. Under this perspective, there were almost no problems in the financial sector. However, the shift in economic perspective from Keynesianism to Neoliberalism and the subsequent process of financial deregulation pushed DNB to its limits. DNB initially tried to follow its own perspective, but the changes in the international world forced DNB to adapt to the Neoliberal school, as its policy had to align with the European Central Bank. Therefore, this thesis concludes that DNB was not one of the regulators that "initiated the deregulation process", as Horwitz described. Instead, DNB contributed to financial deregulation only under international pressure, and the abolition of structural policy in 1990 should therefore be seen in this light.

However, the question remains whether it is justified to consider DNB as a culprit for the outbreak of the 2008 financial crisis. Despite DNB's preference for the Keynesian school and robust regulation, it contributed to financial deregulation and the subsequent instability in the financial sector. Moreover, DNB seemed to be aware of the instability created by the deregulation process. Therefore, it seemed justified to consider them as a culprit. Nevertheless, the question remains whether DNB could have done things differently. Since the international developments of the 1980s, DNB has had no choice but to follow global trends. More research is needed to make a complete statement on this. For this thesis, it was only possible to use interviews that had already been conducted and DNB's annual reports. DNB's internal documents and private communications, such as emails between DNB and the Dutch Ministry

of Finance, might give a different insight and lead to a different conclusion. After all, the annual reports only provide an insight into what the bank wanted to say publicly.

Nowadays, instability in the financial sector still exists. Regulation increased after the 2008 financial crisis, but the financial system has not changed. To curb the abuse of the lender of last resort function of central banks and governments by TBTF banks, the financial sector needs to be changed. How the financial sector should be structured requires further research. However, this thesis has shown that the dominance of the Neoliberal school meant that DNB could no longer guarantee financial stability.

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