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The Netherlands: Going Strong After the Financial Crisis

By Sunil Sen

Editor's note: This article is the winning entry in this year's Country Feature Competition. Congratulations to Sunil for his excellent article!

We have all read countless number of articles written about the financial crisis. We have heard more stories from people personally affected than we would like. It is safe to say that the United States economy and, more importantly, its people were greatly impacted by the failures in the banking industry. Over three thousand miles away, the atmosphere in the Netherlands was quite different. Although the financial sector was severely hit by the crisis, it did not have the same impact on personal lives witnessed in the states. Job losses were relatively low, pensions were secure, housing prices did not drastically decrease, and the personal savings levels actually increased. The Netherlands experienced similar financial distresses to the United States; however, it did not experience the systemic problems which led to U.S. citizens being directly affected. These facts raise several questions. Most importantly, what structures successfully helped mitigate the impact of the financial crisis for Dutch residents and what can the United States learn or incorporate to ensure its own security?

THE DUTCH STORY OF FINANCIAL TURMOIL

The crisis in the Netherlands stemmed primarily from solvency and liquidity issues originating from losses in asset backed securities, in particular, those backed by sub-prime loans. The Dutch government reacted similarly to U.S. legislators and began issuing emergency lending to large multinational institutions and guaranteeing troubled debt. Bailouts included €3 billion in aid to Aegon, €10 billion in aid to ING, and €1 billion in aid to SNS Reaal. The government also guaranteed more than €200 billion in corporate debt. These values may appear quite small when compared to the U.S. lending figures; however, one must remember that the Netherlands has only 1/20 the population of the United States!

Banks began to go insolvent in 2008 as witnessed across the world. The Netherlands insured deposits for customers with IceSave (Icelandic Bank) for over €1 billion, which was never repaid by Iceland. Fortis, once one of the world's largest 20 companies, went insolvent and was taken over by three governments overnight. The reaction to Fortis was so severe that it made the Belgium government fall, causing a political crisis. The Dutch portion was bought for a little over €16 billion and the vast majority is still under Dutch control. In many ways, the Dutch experience with Fortis paralleled the United States experience with AIG.

The most recent tragedy was DSB Bank. In late 2009, DSB witnessed a run on the bank scenario and quickly became insolvent. It is interesting to note that improperly priced insurance products were a main driver in its insolvency. DSB had sold term policies which were linked to mortgages using high upfront commissions and high cash surrender values. Legislation rules in the Netherlands forced commission rates to become more transparent. This had a negative consequence as many customers were offered products which they could not afford and felt misled. Further, the business model was under pressure as no high commissions could be charged anymore on their new business. Consequently, there was a huge spike in surren-

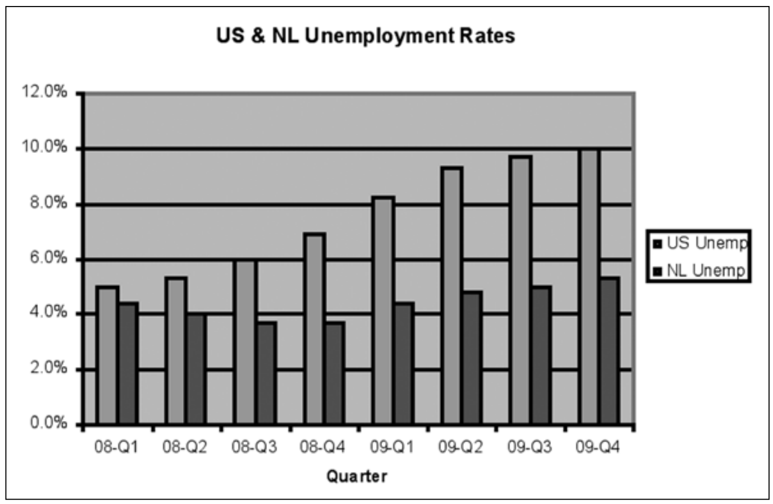
ders and a run on the bank, leading to DSB's insolvency.

In summary, the financial turmoil witnessed in the Netherlands was as severe as witnessed in the United States. So, why did it not devastate the economy as it did in the States?

WHAT STOPPED THE CRISIS FROM SPREADING TO OTHER SECTORS?

While the financial crisis in the United States quickly spread to the general economy, it remained relatively contained in the Netherlands. We must ask ourselves, what backstops were in place that led to such different reactions in the respective economies? We will focus on the main differences which led to Dutch stability, primarily: job security and employment, pension security, housing stability, and more evenly distributed wealth levels. We will analyze these individual impacts and investigate small alterations in the United States which could lead to significantly more stability.

Shortly after the financial crisis began, companies began cost cutting. In the United States, it is easy for a company to cut their expenses at the cost of their own employees through layoffs and redundancies. As a result, unemployment went through the roof. Soon began the downward turn into the recession where sales were low and jobs were scarce. Meanwhile, across the pond unemployment remained relatively unchanged, increasing by only one percent. Workers rights are quite strong in the Netherlands. Among these rights, employers must give required payouts in the case of layoffs and employees whom have a permanent contract have substantial legal rights which protect their job security in stressful times. Consequently, companies cannot transfer losses to employees by letting them go, only to hire them or a



replacement back in six months. Although the companies cannot react as fast and shareholders may suffer more, the employees within the organization do not have to also share in the economic loss.

The pension system in the Netherlands is structured and regulated differently than in the United States. First, most plans are defined benefit plans. This limits the impact for pensioners as the pension entity bears the funding risk. Second, companies may invest a maximum of 5 to 10 percent in a company's own stock, depending on organization classification. This means that a large drop in a company's stock price will have a much lower impact on the …funding in the Netherlands than in the United States. Third, pension funds are required to be a separate entity by law and companies must transfer the appropriate funds to the pension entity on an annual basis to ensure that the pension is fully funded. In the United States, pensions

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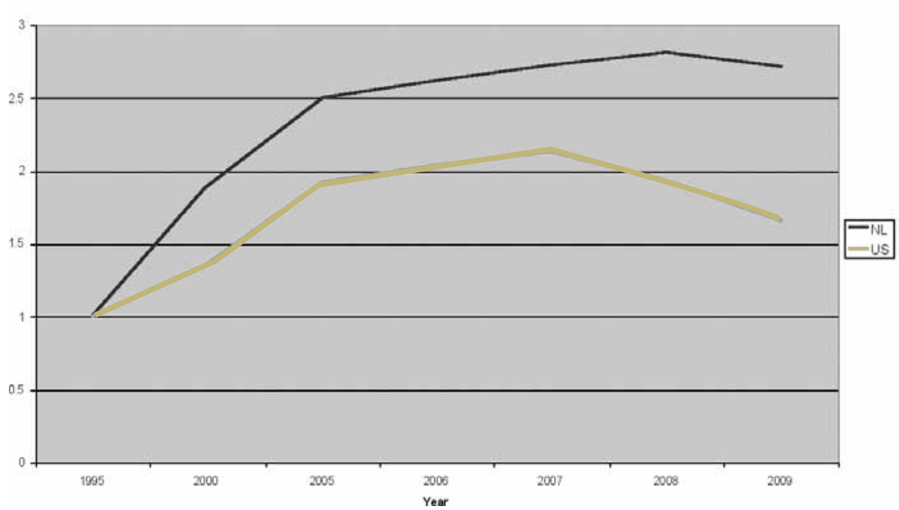
can be underfunded for years in a row and funding requirements are much lower. The Dutch regulations limit the systemic and long-term funding risk. These three impacts greatly reduced the loss due to the financial crisis for the aging population and helped stabilize the economy as a whole.

Wealth levels also played a large role during the financial crisis. Individuals without a substantial financial cushion were subject to extra hardships, sometimes significant extra hardships. The wealth distribution in the Untied States is skewed with the top one percent of the population owning over 20 percent of the wealth. Comparing this to the Netherlands, the top 10 percent of the Dutch population own 20 percent of the wealth. The trend is the same across the board as a percentage of population. The United States has substantially higher levels of lower income individuals who are prone to financial hardship. This means that the average American has much less of a financial cushion than his or her Dutch counterpart. When a crisis hits, there is less money to cover the gap and American pocketbooks will be harder hit.

The Dutch housing market remained much more stable than in the United States. The striking commonality is that both markets experienced explosive increases in housing prices leading up to the crisis. The U.S. market increased primarily due to increased lending and low capital costs. The Dutch housing market increased as a result of the Euro zone. From 1995 to present, the average housing price more than doubled. Although both countries witnessed huge increases in housing prices before the crisis; their economies reacted quite differently. In the Netherlands, bankruptcy is much more painful than in the United States. In the United States your credit may be ruined for 10 years, but in the Netherlands, you could see your wages garnished for 10 years. Consequently, the option to walk away from a mortgage and leave the bank with the loss is much more costly in the Netherlands. As a result, less people exercised this option and prices remained relatively stable.

Housing index 1995-present



LESSONS LEARNED

So, what can we take away from this comparison? The legal differences in workers rights, pension security, and loan underwriting lead to different economic reactions within the two lands. I would not advocate that the United States should incorporate the same legislation as the Netherlands due to cultural differences; however, the United States could induce economic stabilization measures through regulatory reform. First, the United States should further its pension legislation reform. There is little opposition from the general population to greater pension security and independence and would be a win-win for both pensioners and macro-economic stability. As a result of the financial crisis, new funding requirements have been relaxed. The result is companies will weather the financial crisis better; however, at the expense of its employee's future pensions.

Personally, I would rather see the company take the loss rather than transfer the risk to its employees. The second point would be to introduce more workers rights to inhibit companies from transferring their short term losses to their employees. If a company was required to pay six months unemployment before any public unemployment benefits are given, it would be a natural preventive measure to reduce unemployment increases during moments of severe downturn. Furthermore, it would also provide greater long term stability for employees and consequently lessen the impact of consumer spending decreases during a recession.

The United States has primarily dealt with the crisis through costly capital injections and debt guarantees. The national debt has increased tremendously during this period and we will be paying for the financial crisis for many decades to come. If we had had more backstopping measures to reduce the impact of a recession, how much money would the U.S. government have saved during the crisis? How much personnel and financial distress would have been avoided? This financial crisis provided the best hands on training concerning macro-economics and systemic risk in most reader's lifetimes. The question is: will we reform our system in order to withstand the next big one? □