

DISCUSSION OF SEPPON HONKAPOHJA'S "MANAGING FINANCIAL DEREGULATION: LESSONS FROM THE 1980s IN THE NORDIC COUNTRIES"

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Institutional Reforms for Transformation, Inclusion and Sustainability

UNU-WIDER International Development Conference

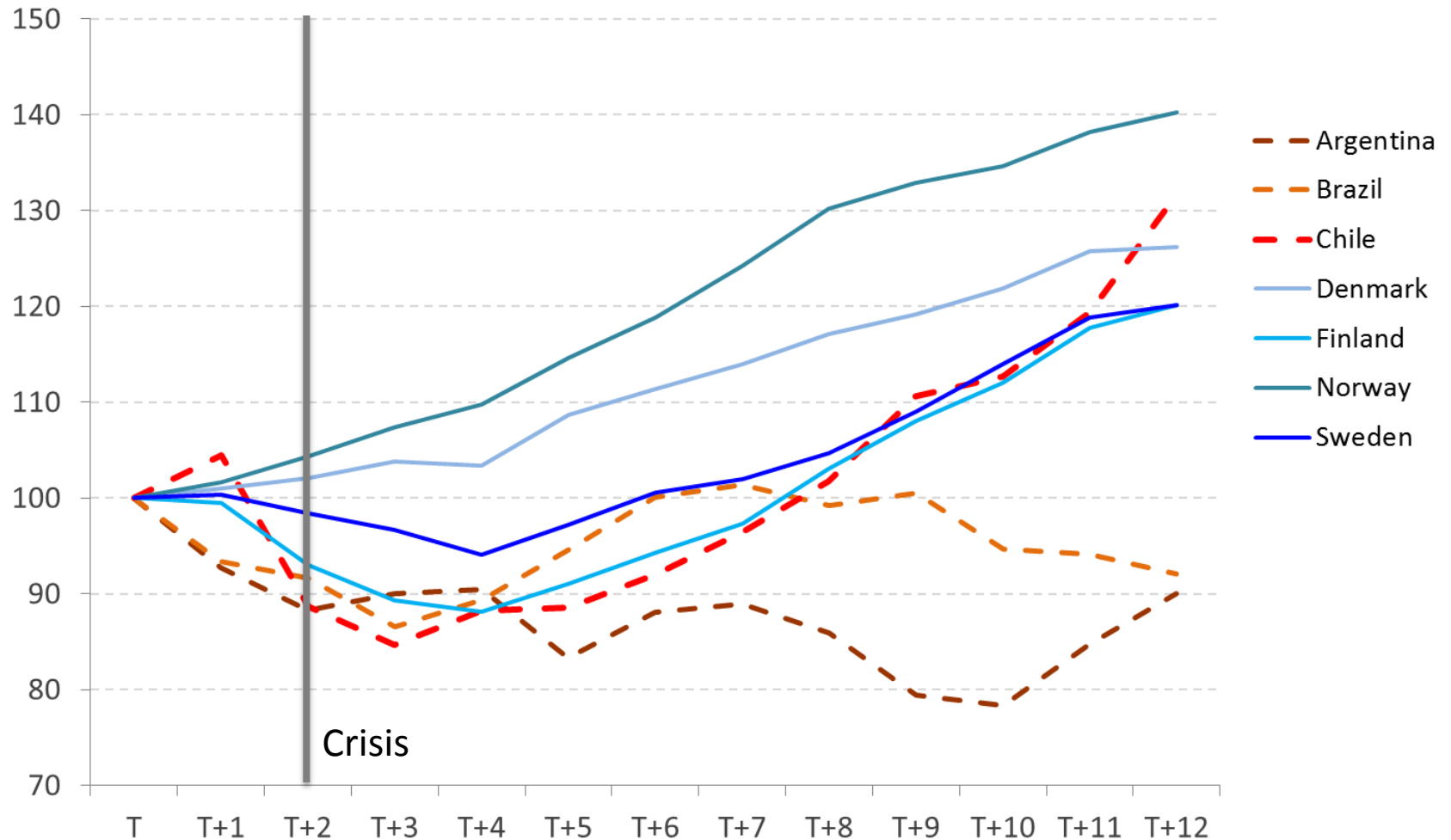
Hanoi, June 30, 2014

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GDP (MM US\$)					
		1982	1989	2008	2013
Argentina		84,302	81,711	324,407	488,213
Brazil		182,972	448,768	1653,539	2242,854
Chile		25,337	29,547	179,577	276,975
Denmark		58,937	110,059	343,881	330,958
Finland		52,461	116,829	273,253	256,922
Norway		61,850	100,771	453,885	511,252
Sweden		105,531	202,987	486,159	557,938
GDP pc PPP (US\$)					
		1982	1989	2008	2013
Argentina		5,055	5,656	14,502	18,749
Brazil		4,041	5,514	10,457	12,220
Chile		3,039	4,740	15,277	19,067
Denmark		12,087	17,721	37,247	37,900
Finland		10,406	16,307	35,762	35,616
Norway		14,842	22,342	52,446	54,946
Sweden		11,608	17,240	37,393	41,188
Source: IMF.					

GDP per capita in Latin America and the Nordic countries during crises

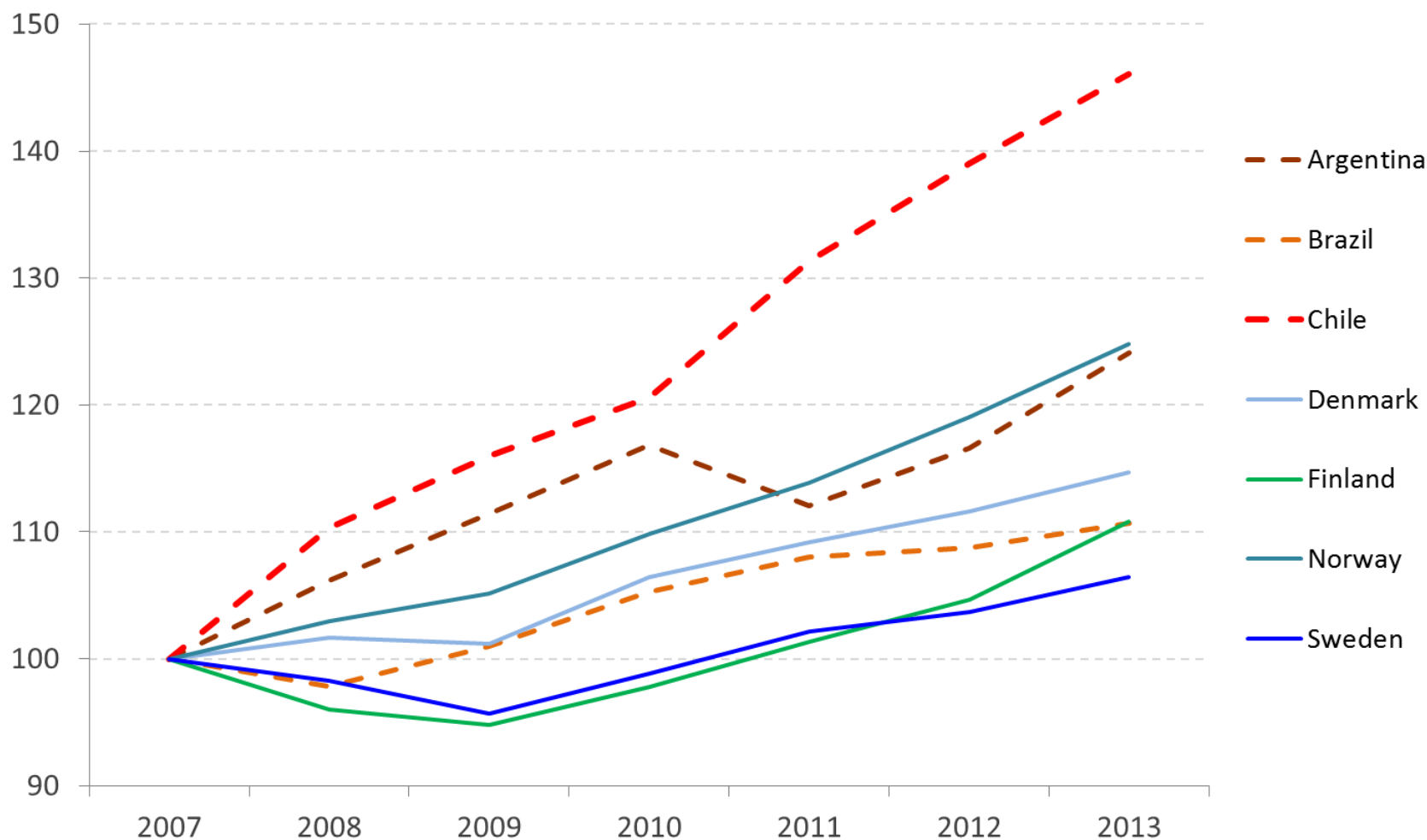
(Crisis + 10, 1980 = 100 in LA and 1989 = 100 in NORD, 2013 US\$)



Source: Data from The Conference Board Total Economy Database.

GDP per capita during the subprime crisis

(2007 - 2013, indexes 2007 = 100, 2013 US\$)



Source: Data from The Conference Board Total Economy Database.

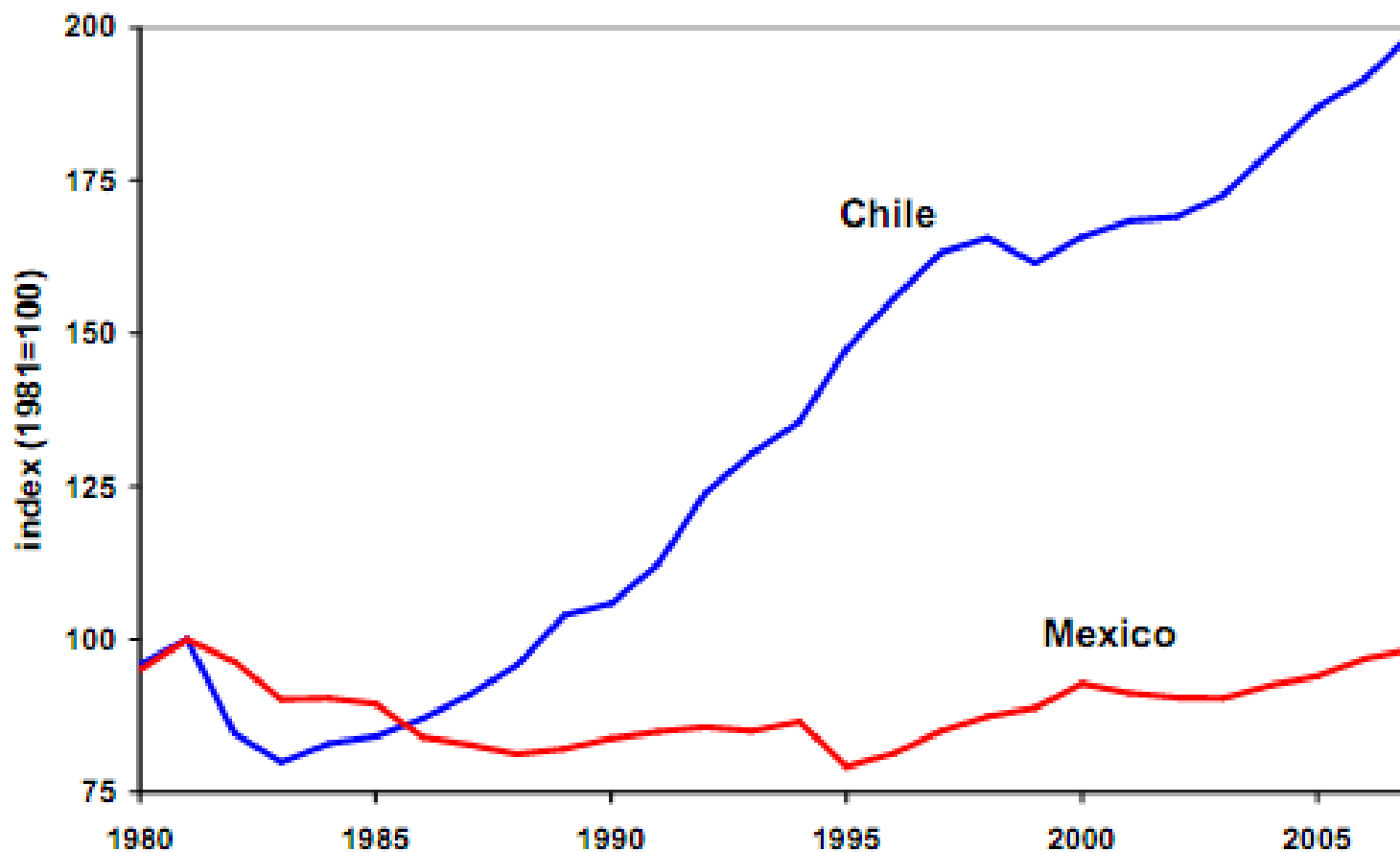
Agenda

- What we do know
- Points with which I agree
- Some doubts

What we do know

- The foundations, the trigger, and the recovery: three different things!
- “Bad banking, bad luck, and bad policy.”
- “All financial crisis are brought about by the same circumstances: easy money, slack regulation, and blue skies thinking.” (Christine Lagarde, 2011)
- The pattern that follows a crisis is similar in all economies, in spite of differences in per capita income levels, in political institutions and traditions, in legal structures, in the size of the economy, and in historical circumstances.

Real GDP per working age person in Chile and Mexico



What we do know

- Standard economics explains well how the crisis unfolded: Bad shocks and too much risk. And we know policies are key to understand recoveries, mostly through productivity (and labor). But, why do we accept so much risk?
 - “We do need psychology to understand how we got there”. Neglected risks? (Shleifer, 2009 and 2012)
 - Agency problems (short run optimization) and vested interest groups (large banks) and bias towards *status quo* (regulators)

Points with which I agree

Lessons from the Nordic countries (and from Chile):

- Flexible exchange rates (and inflation targeting)
- A quick and efficient banking crisis resolution, with banks quickly re-capitalized
- Strong and strict financial supervisory authorities

What about Iceland?

1. The interconnectedness of global markets: trouble can come from anywhere. Bad shocks happen.
2. Too small to be rescued. Size does matter.
3. Nobody is free of doing (ex post) crazy things. Doing the homework.

Some doubts

- A key precondition: strict prudential supervision
- The role of the market
- Recoveries: productivity (and labor)
- Policy implications: Behavioral economics

Some doubts

- Policy implications:
 - Simpler banks
 - Challenges: Large and solvent banks, and competition, innovation, consumer protection, financial inclusion,

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