Why did “It” happen again? The American Subprime Crisis Compared with the Norwegian Banking Crisis 1987-82

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- The purpose of my paper is the describe and analyse the causes of banking crises
- And more specifically: **Which causal factors can be identified as crucial for building up of financial imbalances to such an extent that they trigger a systemic banking crisis?**
- To answer the question I study two cases that are different in many ways, but have experienced systemic banking crises

- I hope the analysis of the cases reveal common patterns
- However, it is important to realize that each banking crisis in history also has unique features
- Moreover, it has to be emphasized that financial crises are complex processes, and that the search for mono-causal explanations will not work

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- In his “Essays on Instability and Finance”, from 1982, Hyman P. Minsky asked: *Can “It” Happen Again?*
- “It” – that is a systemic financial crisis subsequently causing a deep economic depression
- Up until the late 1980s the conventional wisdom among Norwegian economists and policymakers that “It” “couldn't happen here”.

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- Robert E. Lucas in his "presidential address to the American Economic Association", 10th of January 2003:

  "My thesis in this lecture is that macroeconomics in this original sense has succeeded: Its central problem of depression-prevention has been solved, for all practical purposes, and has in fact been solved for many decades."
- **Hence, Lucas obviously excluded the possibility that "It" could happen again in the USA**
- **Obviously, they were all wrong.**

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- In my paper I have chosen a theoretical and analytical framework from Hyman Minsky – in particular his “Financial Instability Hypothesis”
- Minsky’s theory is an attempt to a fully endogenous explanation of the causes of financial crises.
- Minsky mainly generalises upon experiences from post-war USA

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- "Within the neoclassical synthesis a serious depression cannot occur as a result of internal operations of the economy. In this theory a serious depression can only be result of policy errors or non-essential institutional flaws" (Minsky)
- A capitalist economy is inherently unstable and crisis prone
  - Financial system is vital to dynamism in a capitalist economy
  - Driven by innovations and search for profit
  - M makes a distinction between three types of financial positions: *hedge, speculative* and *Ponzi*

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- *The basic Minsky cycle*
- Over the business cycle and especially during a period of boom and prosperity, the financial structure of a capitalist economy become more and more fragile
- It is the mix of the different financial positions that eventually trigger a financial crisis

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- *The Minsky super cycle*
- The institutions of capitalism are vital to stabilize the economy. However, the actors continuously press to alter the rules of the game and change the institutional and regulatory framework
- Thus, there is a long-term deterioration of the major stabilizing institutions, finally bringing about a new regulatory regime

Comparison
Hyman Minsky: "...there are as many varieties of capitalism as Heinz has pickles."

	NO	US
Economy	Small,open High GDP per head Income spread: egalitarian	World's largest High GDP per head Income spread: non-egalitarian
Political system	Parliamentary	Presidential
Supervisory system	In transition from fragmented to integrated (from 1986)	Fragmented
Banking structure	Universal banks, Nationswide branch-banking from late 1960s	Specialized Fragmented, Radical change after 1980

Comparison

	NO	US
Financial system characteristics	Bank based	Market based

Comparison

	NO	US
Financialization	Y	Y
Safety-net	Y	Y
Regulations (legislation)	Tight Liberalization after 1975, Extensive de-reg. 1983-87	More lax Liberalization after 1980 Extensive de-reg. From late 1990s
Financial innovations	Y	Y
Funding characteristics during run-up to crisis	Increased share of short-term debt	Increased share of short-term debt
Steep increase in corporate and household debt	Y	Y

Comparison

	NO	US
Asset price inflation	Y (stock market and housing/real estate bubbles)	Y (housing bubble)
Substantial capital inflow	Y	Y
Wages/salaries to GDP	Preceded by decreasing w/GDP ratios Consumption maintained by increased debt	Preceded by decreasing w/GDP ratios Consumption maintained by increased debt