Lessons for China from Financial Liberalization in Scandinavia

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Summary

In recent years, China has actively engaged in a process of financial liberalization as part of the opening of the Chinese economy towards the rest of the world. However, the experience of financial deregulation in many countries suggests that the road towards financial globalization can be a risky, even dangerous one.

The aim of this paper is to identify a set of policy lessons or policy recommendations, relevant for today's China, from the experience of financial deregulation and the ensuing financial crisis and recovery in Scandinavia during the period 1985-2000. The Nordic experience is worth citing because China today and the Nordic countries before liberalization share a critical mass of common features: a bank-dominated financial system, strong credit controls, exchange (capital account) controls, lack of risk management experience and lack of financial knowledge, but open on the current account side.

This paper draws the following six policy lessons from the Nordic experience.

1. Financial liberalization can be achieved without creating a deep financial crisis.
2. A thorough understanding by policy-makers and financial market participants of the behavioural and institutional linkages within the financial system and to the rest of the economy and the workings of open financial markets is central to making financial liberalization successful.
3. Policy-makers should pay careful attention to initial conditions concerning regulation, taxes and exchange rate arrangements when moving towards financial openness.
4. The financial supervisory system should be reformed prior to or simultaneously with financial liberalization.
5. A "big bang" approach to financial liberalization as applied by the Nordics should be avoided; instead a cautious approach, liberalizing in small but substantive steps, should be preferred.
6. The long-run effects of financial liberalization are most likely to be highly beneficial for China.

This paper concludes by stating that although financial liberalization is a risky venture, its short-run costs or risks can be minimized if China is ready to learn the lessons from other countries.