NORDICS IN GLOBAL CRISIS

Vulnerability and resilience

Thorvaldur Gylfason, Bengt Holmström, Sixten Korkman,
Hans Tson Söderström, Vesa Viiriälä

The Research Institute of the Finnish Economy (ETLA)
Publisher: Taloustieto Oy
# CONTENTS

## PREFACE

## THE AUTHORS

### 1 INTRODUCTION AND SUMMARY:

**PUTTING THE CRISIS INTO PERSPECTIVE** 11

1.1 Panic strikes: Was the Great Moderation a Great Illusion? 13

1.2 Bashing bankers is not enough: The macroeconomics of lopsided globalization 14

1.3 The Great Stabilization prevented a repetition of the Great Depression 16

1.4 Regulation and stabilization: Do we need more? 18

1.5 Some economies suffered more than others 20

1.6 Lessons from Nordic experiences 20

1.7 The world needs a more robust financial system 22

1.8 Exchange rate flexibility is no panacea 23

1.9 The EMU is increasingly subject to strains 24

1.10 Fiscal policy may not be all that powerful but it is still essential 25

1.11 We need both growth and fiscal consolidation 26

1.12 The Nordic model is both vulnerable and resilient 28

Endnotes 32

### 2 THE CRISIS AND THE GLOBAL POLICY RESPONSE 33

2.1 The downturn was exceptionally sharp and synchronized 33

2.2 Unprecedented policy response 37

2.3 The US and the EU are different, but is there (some) convergence? 40

2.4 Was the global policy response effective? 46

2.5 Time for exit? 48

Endnotes 51
6 SAFEGUARDING FINANCIAL INTERMEDIATION:
NORDIC LESSONS 119
6.1 Problems must be recognised before action can be taken 120
6.2 Maintaining confidence is key and requires a solid framework for crisis management 122
6.3 There are many ways to support confidence 125
6.4 Asset disposal strategy and rationalisation deserve substantial attention 131
6.5 Saving the intermediaries is not enough 133
Endnotes 135

7 FROM BOOM TO BUST: THE ICELAND STORY 137
7.1 First to freeze 138
7.2 Lopsided liberalization 142
7.3 Privatization among friends 146
7.4 Increased inequality and other signs 155
7.5 Enter the IMF 156
7.6 Checks and balances, and trust 158
7.7 Prospects 160
7.8 Eleven lessons 162
Endnotes 165

8 EMU AND THE CRISIS: BETTER TO BE IN OR OUT? 167
8.1 Why Finland joined the euro and why Sweden did not 168
8.2 The euro in its first decade 170
8.3 The euro has made little difference for Finland and Sweden so far 172
8.4 The crisis and exchange rates: Why did the Swedish krona weaken so much? 178
8.5 Does depreciation help? 181
8.6 The weak krona: Will Sweden benefit? 182
8.7 Is Sweden pursuing a "beggar-thy-neighbour" policy? 190
8.8 What about Denmark and the euro? 193
8.9 Conclusions on the monetary regime 194
Endnotes 196