Nordics in global crisis Vulnerability and resilience

By Thorvaldur Gylfason, Bengt Holmström, Sixten Korkman, Hans Tson Söderström, and Vesa Vihriälä. 264 pages. Published by The Research Institute of the Finnish Economy (ETLA). ISBN 978-951-628-495-1

This book about the Nordic countries and the global financial crisis aims to describe the crisis "from the point of view" of small open economies with "particular reference to the Nordic economies" (quoted from the back cover). The dual purpose is possibly the book´s only shortcoming. As a book about the financial crisis, it does very well. As a book about the Nordic countries, it lacks some context.

The first chapter summarizes many of the book's conclusions: The crisis resulted from global macroeconomic imbalances and from the workings of financial market. What the authors call the great stabilization prevented a repetition of the great depression. Sweden and Finland were hit hard because of their high degree of economic openness, but despite being vulnerable, the Nordic model is also very resilient. Chapter two describes macro policies in the US and the EU before and during the crisis, and also briefly discusses how to return policy to normality after the crisis management.

Chapter three lifts the book several steps, as the reader is introduced to the authors' interpretation of the crisis as a modern bank run among investment banks. They connect macro factors, such as the high savings rate in China, with the pooling and tranching of mortages. They describe how bonds can be combined to collateralized debt obligations (CDOs) with top-ratings, and why this rating would be correct only under the assumption of independent default risks for the underlying mortages. The chapter is detailed and advanced, yet short and reasonably simple to read.

Chapter 4 describes the great moderation, referring here to the lower variability of growth rates in the postwar period. Credit for the great moderation is given to Keynesian macro-economic stabilization policy and financial regulation. Chapter 5 describes how Sweden and Finland handled the crisis of the early 1990s, including some background regarding these countries' policies in the 1980s. Lessons from Nordic crisis management are discussed in chapter 6, while chapter 7 focuses on the case of Island.

Chapter eight is a particularly interesting one. It uses the variation between Sweden and Finland (and to some extent Denmark) to examine if the euro has made any substantial difference for real economic outcomes. It turns out it hasn´t, at least it has, according to the authors, made surprisingly little difference for Sweden and Finland during the 1998 – 2008 period.

Sweden and Finland make a good comparison because of their similarities in many respects, with the important exception that Finland is a part of the euro zone and Sweden has a floating exchange rate regime with an inflation target. Since joining the EU in 1995, both countries have had similar developments of productivity (both better than most European countries). Finland has had slightly higher growth, most likely caused by the country being initially poorer. Finland has on average had slightly higher unemployment, but also a steeper decline. Inflation has been similar, though slightly lower and more stable in Sweden.

Even during the crisis, when use of the exchange rate mechanism clearly should benefit Sweden, the countries are remarkably similar. Of course, the Swedish krona depreciated sharply, and net exports fell more in Finland than they did in Sweden. But given that Finland has always been more sensitive to business cycles, it is difficult to identify a clear euro-effect in the data according to the authors. Furthermore, in terms of unemployment, Finland actually seems to be doing slightly better than Sweden. Next, the authors turn to Denmark. Since 1982, Denmark has pegged their currency, first to the D-mark, then to the euro without joining the monetary union. Thereby the country will soon have experienced 30 years with the arguably worst possible exchange rate regime: A fixed but adjustable exchange rate, vulnerable to speculative attacks. With this arrangement Denmark has done relatively well.

The authors could well have discussed the implications of their findings in this chapter much deeper. In my reading, the chapter suggests that economic outcomes depend on economic policies but not very much on the monetary regime. The authors more carefully conclude that path-dependency seems to prevail, in that people in the three countries seem happy with existing currency regimes, and none of the countries seem to suffer any particularly high costs of their specific arrangement. In any case, this chapter should be mandatory reading for everybody interested in the euro debate and the effect of various monetary arrangements.

Chapter 9 discusses the role of fiscal policy in stabilization, and the authors are understandably more optimistic regarding automatic stabilizers compared to discretionary stabilization policy. The final three chapters concludes discusses the future of the Nordic model, not only in relation to the crisis but also related to long term structural changes such as increasing tax competition and demographic changes. It is concluded that the Nordic model is highly resilient and that growth in high taxes economies requires a smart tax system. Therefore, reforms increasing taxes on consumption and real estate while lowering them on labor and companies may be necessary in the future.

Many chapters in the book are interesting and well written. The book provides a good introduction to the financial crisis and contains a thoughtful discussion of the Euro. There are, however, some signs that the book was released too soon. Many things had not yet happened when the book was written. For example, the reader is informed about the referendum in Iceland in March 2010 (on compensation to the UK and the Netherlands to cover parts of the losses incurred by depositors in these countries), but not about the outcome (Iceland voted not to pay any compensation) and the aftermath.

The authors often seem content with making careful mainstream conclusions, in many cases bordering on understatements. If you wonder what the authors say about the very large amounts of money that were created and injected into the financial system during the crisis, you will have to settle for the conclusion that "[w]hile monetary support to asset markets is appropriate in current circumstances, central banks need to be concerned about the ultimate consequence of their policy stance as conditions change" (p. 49).

On the other hand, the careful and nuanced approach is also one of the many strengths of the book. Readers who want a balanced mainstream analysis of the crisis and how it was handled, without too much speculation, will be happy with this book, especially if those readers are particularly interested in the Nordic countries.

Andreas Bergh

Dept. of Economics, Lund University, and
Research Institute for Industrial Economics, Stockholm, Sweden