Lessons from the Nordic Financial Crisis

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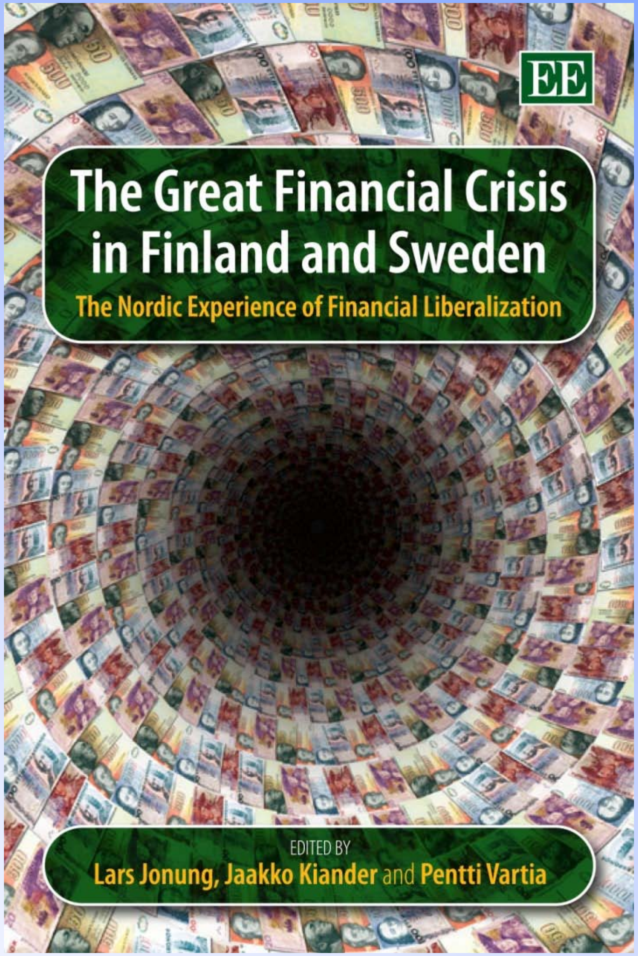
The book cover: A malström of notes



Why a book?

Why look at the Nordic financial crises in the the early 1990s?

- Four laboratory experiments (Denmark, Finland, Norway and Sweden)
- Open and transparent policy process
- Pioneers in engineering financial crisis in Europe/the Western World
- Crises in welfare states

The macroeconomic record the Nordic or Scandinavian countries used to be regarded as a successful one during

the post-World-War-II period.

It can’t happen here!

Then came the great financial crisis

It started with financial liberalization in the mid-1980s with a pegged but adjustable exchange rate:

A sustained lending boom, capital inflows, rising asset prices, and an "overheated" nontradables sector.

The boom turned into a bust in the early 1990s, with falling employment, negative GDP growth, capital outflows, widespread bankruptcies, systemic banking crises, and depression.

The pegged exchange rate was abandoned. This started the recovery.

Lessons from the Nordic experience of financial integration

1. ***Lessons on how to liberalize while avoiding a financial crisis***
2. ***Lessons on how to deal with a crisis***
3. ***Lessons on the long-run effects of financial integration***

Lesson no 1:

The dangers of financial ignorance

(ignorance of financial history)

Lesson no 2:

The dangers of backward-looking policy behaviour

<u>Lesson no 3:</u>

The dangers of large changes in the real rate of interest

Lesson no 4:

The dangers of procyclical monetary policy (of a pegged exchange rate)

Lesson no 5:

The dangers of procyclical fiscal policy

Lesson no 6:

The dangers of procyclical sequencing of reforms

<u>Lesson no 7:</u>

The limits of micro-prudential financial supervision

Lesson no 8:

Financial liberalization can be crisis free

The case of Denmark

Lesson no 9:

The benefits of rapid crisis management

Lesson no 10:

The insufficiency of the lender-of-last-resort function of central banks

Lesson no 11:

The insufficiency of the advice from the IMF

<u>Lesson no 12:</u>

Financial liberalization changes the monetary and fiscal regime

Lesson no 13:

Financial liberalization affects efficiency and growth

Beyond recovery

Remarkable growth, exports being the main engine

Strong fiscal positions

Strong productivity growth

The Nordic tigers?

Lesson no 14:

Financial integration affects the distribution of income and wealth

Lessons from other financial crises:

Very similar

What is specific with Scandinavia?

a) Strong political institutions, no corruption, rapid political response

b) The role of the exchange rate in small open economies

Any novel message?

The long-run effects of financial integration are not as dramatic as the short-run effects, but they may have prove to have greater importance over time.

Any novel message?

Can we learn from the past?

Only from our own past.

Look at Iceland – the Baltics!

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