MACROECONOMIC POLICY AND PERFORMANCE IN THE NORDIC EU COUNTRIES IN THE 1990S

Jaako Kiander

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The main conclusions of the paper are: (i) the fixed (but adjustable) exchange rate regimes may be costly in terms of output and employment if they are not fully credible; and (ii) large economic fluctuations create easily equally large changes in fiscal balances, which may exceed the limits of the Stability and Growth Pact.

Keywords : welfare state, integration, Nordic countries

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VATT, Government Institute for Economic Research

Helsinki

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1 Introduction

The Nordic countries include Denmark, Finland, Iceland, Norway and Sweden. All of them are usually thought to be so called welfare states – i.e., egalitarian societies with extensive public sectors and income redistribution. Although the Nordic countries and their welfare models are not identical there are so many similarities between them and so many differences between them and the other European countries that it is legitimate to speak about 'Nordic model'. This paper reviews the macroeconomic policies and performance of the three Nordic EU countries: namely Denmark, Finland and Sweden. This paper reviews the current state of the so called Nordic welfare state, and the experiences of Denmark, Finland and Sweden in the 1990s in adjusting their public sectors to fiscal consolidation.

The paper also reviews the Nordic experiences of capital market liberalisation and exchange rate regime experiments in the 1980s and 1990s, and their macroeconomic consequences. The large cyclical swings (from boom to a recession and back to another boom) and many macroeconomic imbalances experienced in these countries makes one prone to suggest that financial integration is not necessarily a straightforward or an easy process. The Nordic economic problems of the 1990s were closely – although indirectly – related to international and especially European integration. They may hence provide some lessons for the eastern enlargement of the EU. When new countries entry the union, it has to be decided what kind of currency regime they should adopt; to join the Eurozone immediately, to have a ERM-type quasi-fixed regime or to float. In the light of the Nordic experiences it is not self-evident that financial and macroeconomic adjustment processes linked with these alternatives will be problem-free.

The Nordics have had and still have different integration strategies. In the first phase of European economic integration they relied on being members of EFTA.[1] In the end of the 1960s there was an attempt to establish a Nordic economic union called Nordek, but that attempt failed when Denmark decided to join EEC in 1972 together with the UK, its main trading partner. At the same time Norway's membership in EEC was rejected first time in a referendum. This well-established set up based on Danish EEC membership and the EFTA-memberships of the other Nordics was fundamentally changed in the beginning of the 1990s

[1] In order to promote free trade Denmark, Norway and Sweden established EFTA in 1959 with the UK and few other European countries. Finland joined EFTA as an associate member in 1961 and as a full member in 1986, and Iceland became a member in 1970.

as a result of the accomplishment of internal market program and Maastricht Treaty of the European Union. The EFTA countries started to negotiate new trade arrangements with the EU in order to maintain free access to the internal market. The result of this process was the creation of the European Economic Area (EEA) in 1994 with integrated goods and capital markets. However, at that time Finland, Norway and Sweden were already negotiating over full membership with EU, which they had applied for in 1991. After referendums in autumn 1994 Finland and Sweden decided to join EU in the beginning of 1995. Norway's membership was once again rejected in a referendum. As a result, Norway and Iceland stayed outside of the EU and relied on the EEA agreement in their integration policy.

The deepening of European economic and political integration has continued within the EU. The development towards monetary union was agreed upon in 1991 in the Maastricht Treaty. When Finland and Sweden started negotiations over EU membership, they were obliged to accept the Maastricht Treaty, and EMU as an unavoidable part of the union membership in future. Denmark, instead, as an old member did not accept the Treaty[2] and it finally got a formal right to opt-out of the monetary union. Although Sweden does not have such a formal right to opt-out of EMU Sweden has decided to stay out, at least for a while. As a result, Finland is the only Nordic country which belongs to EMU. Finland joined the monetary union without any hesitation.[3]

2 The macroeconomic performance

The fact that all Nordic countries experienced a turbulent economic cycle of boom and bust between 1987 and 1994 at the same time with advancement of economic integration makes is difficult to separate the impacts of integration from those of the economic crises and the subsequent stabilisation policies. The boom phase was in all countries related to the process of financial deregulation and the introduction of free capital movements. The subsequent recessions were financial crises by their nature, caused by *ex post* overindebtedness and unexpectedly high interest rates.

In a way, the same policies and regime shifts which formed a central part of national integration policies – especially financial deregulation and policy of fixed exchange rates – were also integral factors explaining the Nordic recessions and financial crises.

[2] It was first rejected in a referendum.
[3] In fact, EMU membership and the fulfilment of the Maastricht criteria was the objective of Finnish economic policy even before the Finland officially joined the EU.

Finland and Sweden suffered in the early 1990s from recessions which were among the worst experienced in these countries during the 20th century. Output fell by 10 and 5 percent in each country, respectively, and unemployment rose to a far higher level in the mid 1990s than in the depths of the great depression of the 1930s. While the experience of Finland and Sweden in the early 1990s – declining output in three consecutive years – was unique in the OECD, other Nordic countries and the United Kingdom had similar though milder recession and unemployment patterns. In fact, there was a recession at the same time in almost all European countries.

There was a banking crisis in the aftermath of debt-financed booms in Norway in the latter half of the 1980s, and in Sweden and Finland in the early 1990s. All Nordic countries experienced also a currency crisis in 1992 together with many EMS countries. The Nordic and the UK recessions and debt-crises of the end of 1980s and early 1990s were preceded by debt-financed investment and consumption boom in the late 1980s.

At the same time when capital markets were liberalised the Nordic countries tried also to adopt European exchange rate policies by linking their currencies to the EMS currencies. These attempts finally failed when all Nordic countries experienced severe recessions. As a result of the recessions, all Nordic countries went through a period of disinflation, and adopted macroeconomic policies aimed to low inflation and sound fiscal balance. [4]

TABLE 1. The economic crises of the end of 1980s and early 1990s

	Years of recession	Relative employment change, percent	Largest output gap (OECD estimate), percent of GDP	Change of inflation, percentage points	Increase of unemploy-ment, percentage points
Finland	1990-93	-18.8	-11.3	-6.0	14.9
Sweden	1991-93	-14.7	-5.3	-9.5	6.5
Norway	1988-90	-8.7	-4.3	-7.3	3.9
Denmark	1987-93	-6.5	-5.5	-3.5	4.5
EU	1992-93	-4.0	-2.9	-3.1	3.7
USA	1990-91	-1.0	-2.5	-2.8	2.2

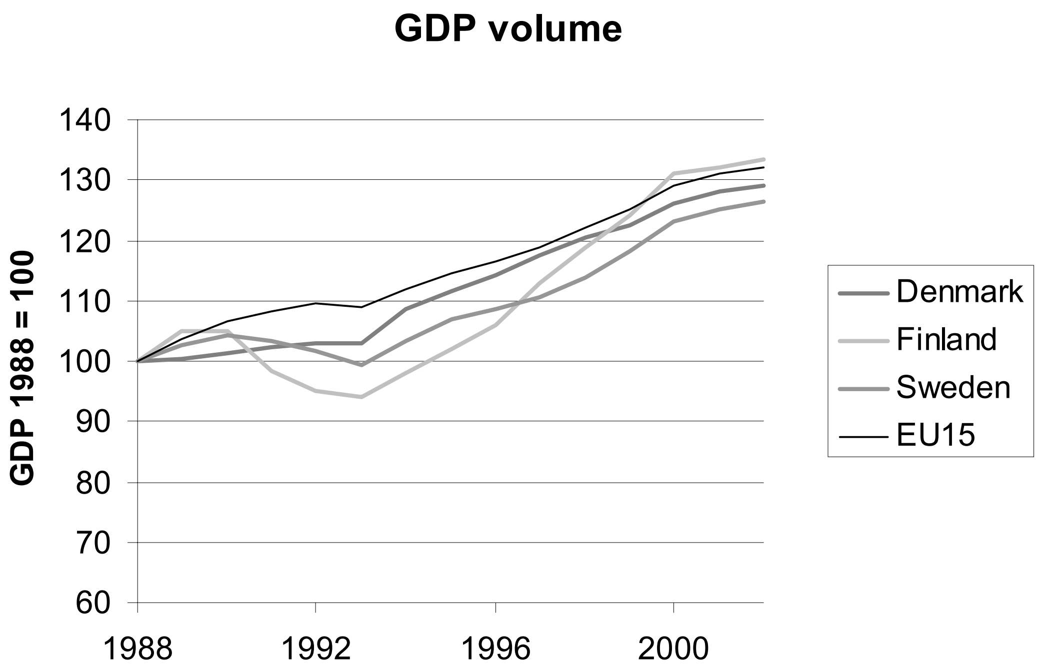
Source: Author's own calculations based on data of OECD Economic Outlook (2000)

[4] For more detailed descriptions of these developments, see e.g. Bordes et al. (1993), Jonung et al. (1996) and Honkapohja and Koskela (1999).

Table 1 shows that the economic downturn was much deeper in the all four Nordic countries than in the other industrial countries at the same time – at least in terms of output losses and rise in unemployment. The downward shock can be viewed as a necessary adjustment to achieve slower and more sustainable rate of inflation. Especially in Finland, Norway and Sweden the disinflation was marked in the recession years.

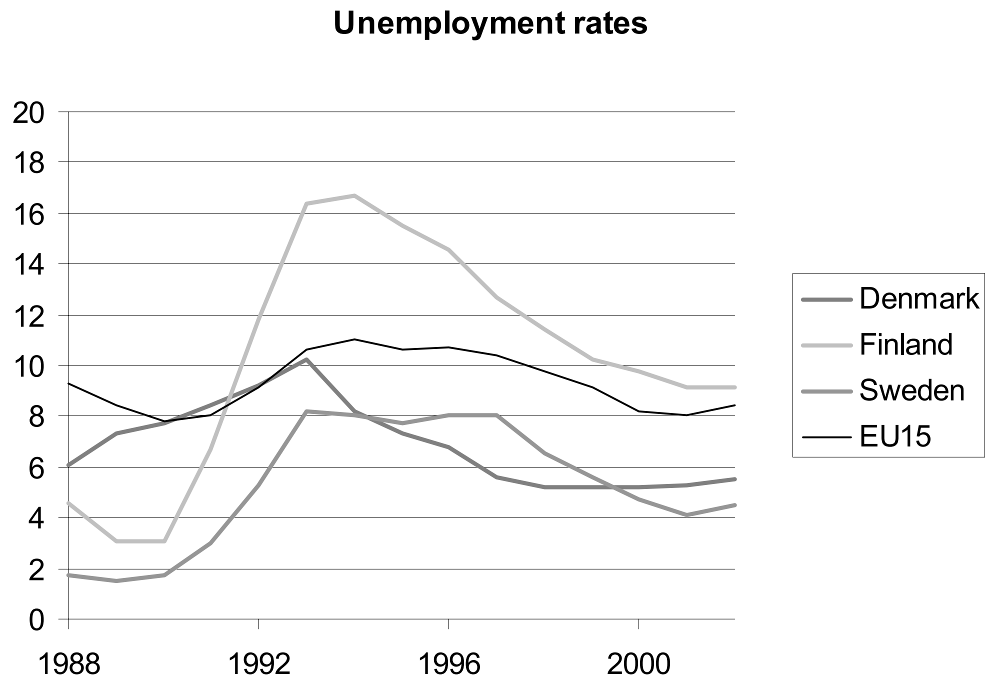
However, when one looks at the indicators of longer term economic development (Figure 1 depicts the path of GDP volume), it is easy to notice that the rate of economic growth has on average been reasonably good in the Nordic countries, notwithstanding the deep recessions of the early 1990s. Only for Sweden the output losses of the early 1990s seem to have been long-lasting. It is somewhat surprising that the country which was first hit in 1991-93, recovered most quickly and finally fared better than the EU15 countries on average. Though it is evident that the macroeconomic malfunctions of the 1990s caused large-scale welfare losses during the 1990s – much larger in the Nordic countries than elsewhere in the European Union.

FIGURE 1



The same holds also for labour market developments. Also in terms of unemployment and employment the Nordic countries recovered rather quickly from their crises. Figure 2 depicts the unemployment rates. For all the time the unemployment rates of Sweden and Denmark stayed below the high European Union average level, and towards the end of the 1990s the both countries achieved almost full employment. For Finland the development of unemployment was less favourable, but still the reduction of unemployment was remarkable.

FIGURE 2

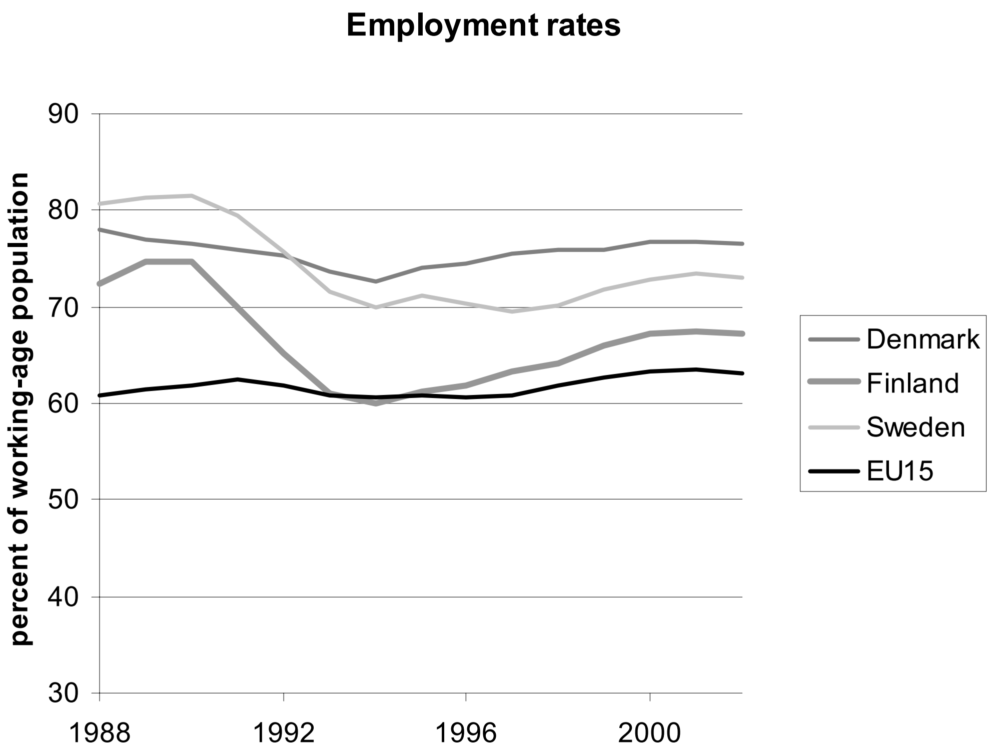


The Nordic welfare states are egalitarian societies with high taxes, organised labour and large public sectors. As such, they have been criticised and viewed sluggish and structurally weak. Redistributive systems have widely be seen as bad for work incentives, and hence also bad for job creation. However, the most extensive welfare states in the world – Denmark and Sweden – have achieved and maintained high living standards, high employment levels and low unemployment. Due to the severity of the economic crisis of the 1990s Finland has been less successful with respect to unemployment. The labour force participation rates of the Nordic populations are as high as in the U.S. and much higher than the EU average. The same applies also to the employment rates, which measure the proportion of working-age people who actually are employed (see Figure 3). This holds even after the turbulent years of the 1990s. It can be viewed as an evidence showing that the crisis and increased unemployment were not so much symptoms of any structural weaknesses of the Nordic economies.

The Danish and Swedish employment rates are much higher than the official EU target for year 2010 (70 percent). Even in Finland, where the unemployment was still in 2002 the second highest in EU, the employment rate exceeded clearly the EU average.

In the light of output and employment figures one can conclude that the macroeconomic performance of the Nordic EU countries has over time been satisfactory and even good although the 1990s was a period plagued by exceptional instability. That instability was a consequence of misjudgements and coordination failures in economic policies.

FIGURE 3



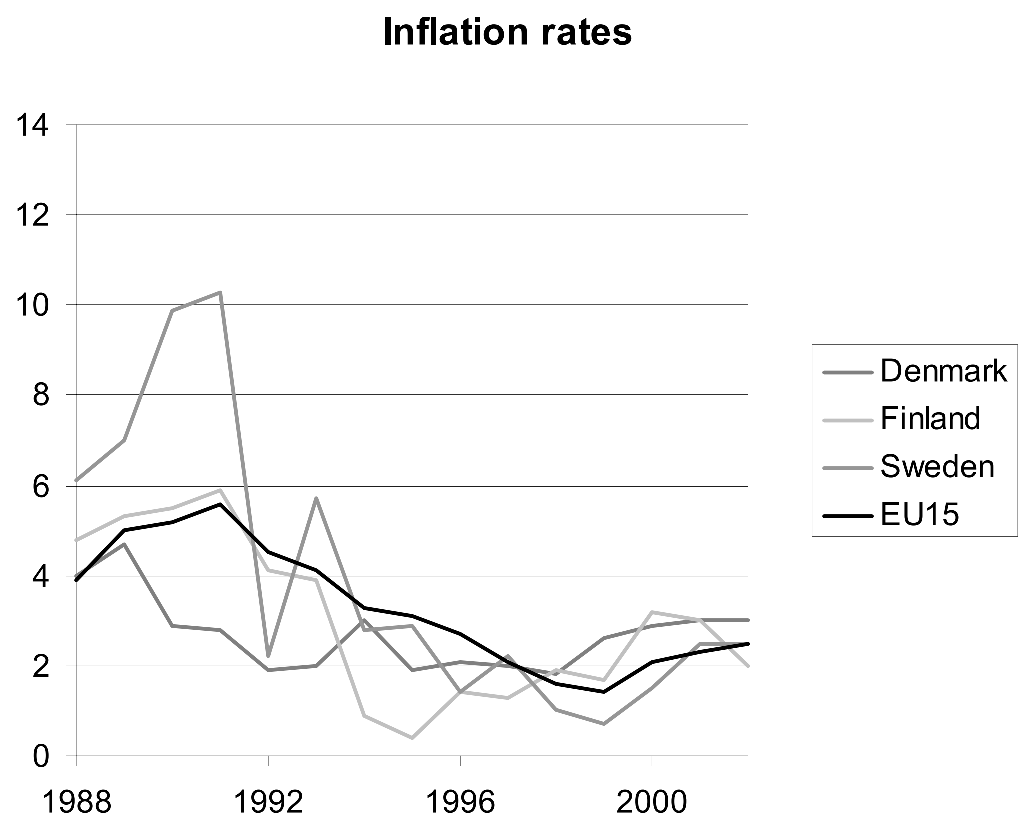
3 Monetary policy and exchange rate regimes

Perhaps the biggest changes affecting monetary policy were caused the 1980s by European integration policies and especially by the deregulation of capital movements. These changes created new challenges and new environments for exchange rate policy. The changes took place in all Nordic countries well before their EU memberships became actual in 1994-95. However, they were necessary steps of integration and preconditions of EU membership (the same deregulatory steps were taken and monetary policy regimes adopted also by Norway although she rejected her EU membership). Liberalisation of international capital movements, deregulation of banking and pursuit of fixed exchange rate and disinflation were parts of economic policy which aimed to integration.

If measured by cumulative output and employment losses, the recessions of the Nordic countries in 1987-1994 were much deeper than those in other European countries or in the USA. There were common factors which help to explain the bad Nordic record, and these factors are closely related to monetary and exchange rate policy regimes.

The Nordic countries had fixed exchange rates and overvalued currencies before the crisis. To make things worse, the inflation rates of Finland and Sweden were higher than those of the core countries of the European currency system (although they did not differ very much from the EU15 average). In addition to this, there were credit expansions, current account deficits, and asset bubbles in the end of the 1980s which made the imbalances (inflation, price level and balance of payments disparities) even worse. These problems were severe in Sweden, Finland and Norway, and much milder in Denmark. To put it shortly, the Nordic countries maintained unsustainable trends but did not have means to change their path due to rules-based monetary policy.

FIGURE 4

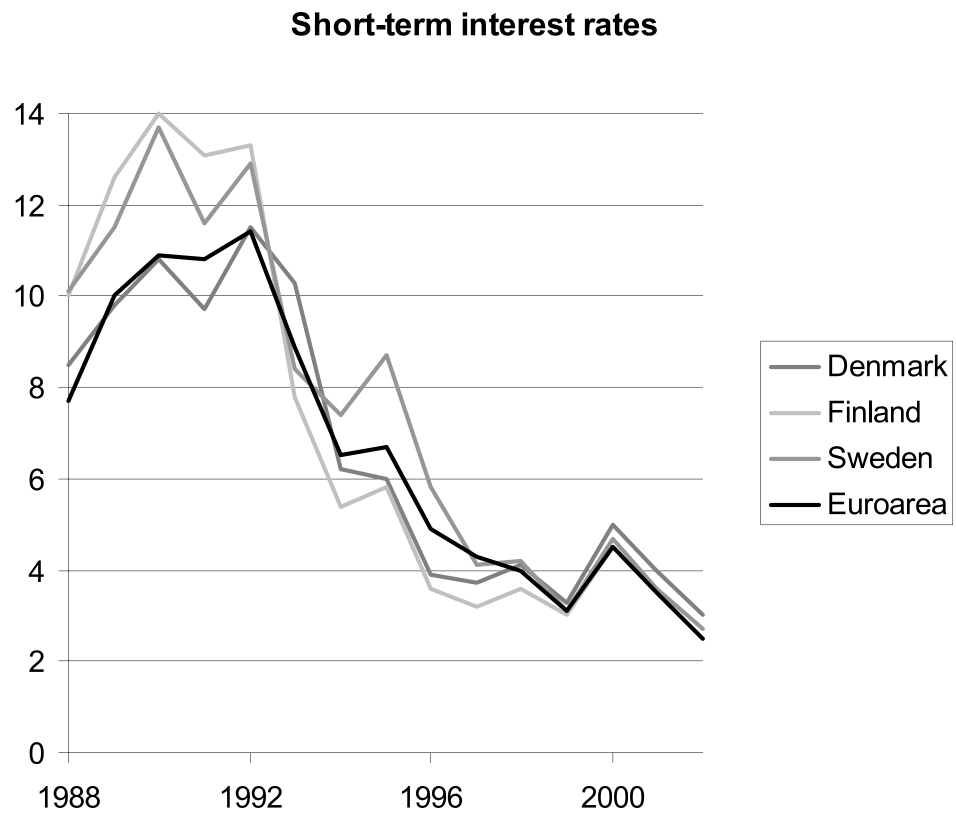


The Nordic recessions were preceded by debt-financed investment and consumption boom in the 1980s. The booms were not only enabled but most likely also caused by fatal interaction of financial deregulation and fixed exchange rate regimes, which in turn were at that time essential parts of financial market integration process. Due to the opening of the capital account, there was in the first phase an abundant supply of credit and lower interest rates. As a result, firms and households were eager to borrow money, and as a consequence, asset prices rose, output and employment increased and inflationary pressures build up.

The boom of the late 1980s turned into a bust consecutively in Norway, Finland and Sweden. The bust was clearly financial by nature; it was a period of high interest rates, falling output and collapsing asset prices, debt-deflation, financial and banking crises and currency crises of varying degrees in all these countries. There was a recession also in Denmark, but it did not lead to financial crisis there. Especially in Sweden and Finland this destructive process began when investors started to lose their confidence as a result of worsening current account deficits and deteriorating profitability of firms. These were caused by increasing competitiveness problems, decreasing demand in the export markets due to international business cycle (and in the Finnish case also by the decline of Soviet trade), and by rising European interest rates. All these factors together started to erode the credibility of the policy of fixed exchange rates which was pursued by the Nordic governments and central banks.

In years 1989-92, there was an almost continuous market pressure against the fixed exchange rate parity, and the central banks of Sweden and Finland tried to defend the exchange rate by raising interest rates, a policy which soon started to harm firms and households. The interest rates fluctuated on very high level while inflation rate decreased, thus rising the real interest rate enormously. Figure 4 shows the rise and fall of Nordic inflation rates, and Figures 5A and 5B the long period of very high nominal (and real) interest rates (the years 1989-1992).

FIGURE 5A



Households and firms responded in these countries to high and volatile interest rates by increasing savings and cutting investment, a change that quickly led to downward spiral of domestic demand and asset prices. High interest rates in debt-ridden economies of Sweden and Finland constrained private demand effectively. Overindebted firms and households were forced to sell their assets, and falling asset prices caused negative equity and balance-sheet problems. A wave of bankruptcies and asset price deflation caused severe problems to banks in both countries. As a result output fell for three years and unemployment soared. A similar chain of events was experienced in Norway a few years earlier, although the macroeconomic consequences of the Norwegian banking crisis were milder. [5] It is important to note that Denmark did not experience similar financial crisis in spite of very high real interest rates. This was very likely due to much smaller credit expansion before the recession.

[5] The perils of fixed exchange rate regimes lacking sufficient credibility is analysed in Svensson (1994). Debt-deflation is discussed e.g. by King (1994) and Wolfson (1996). The Nordic banking crises are described and analysed in Englund (1999), Steigum (1992) and Vihriälä (1997).

TABLE 2: Monetary and exchange rate policy regimes in the 3 Nordic countries

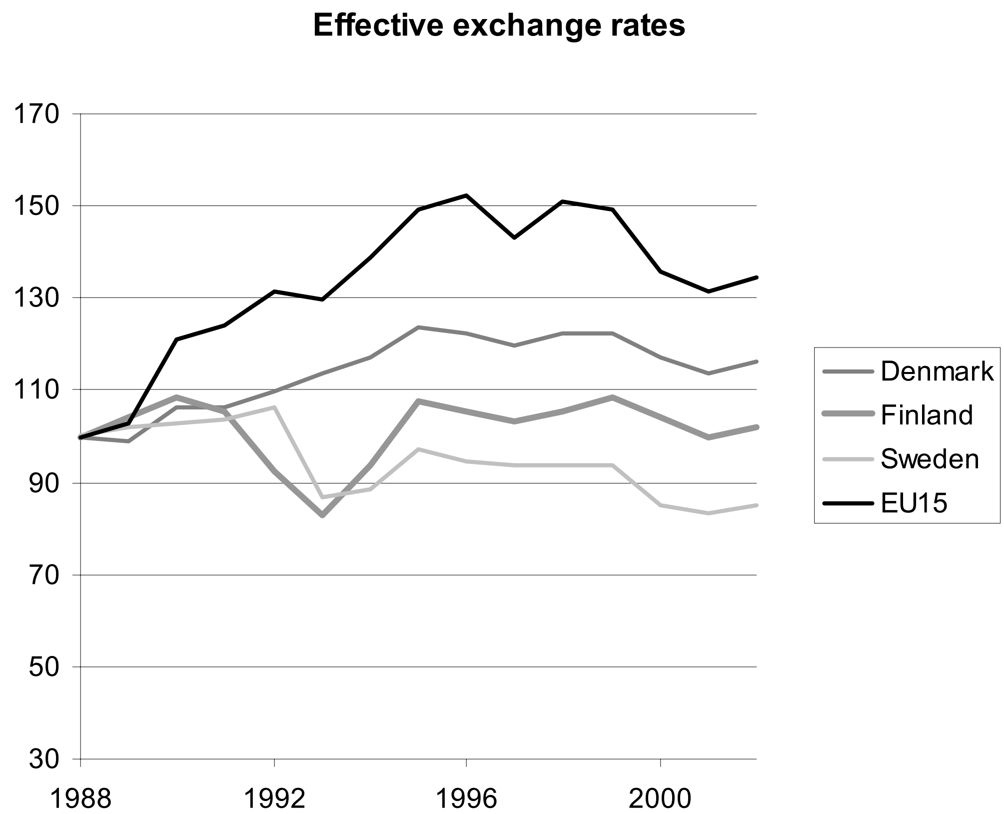
1980-1985	Fixed exchange rate regimes adopted with narrow bands; Denmark joins ERM
1985-1990	Financial market deregulation, credit constraints abolished;
	Inward capital flows and low interest rates help to finance credit expansion; banking crisis in Norway
1989-1992	Period of high interest rates in the face of currency speculation; Finland and Sweden link their currencies unilaterally to ecu in June 1991; Finland forced to devalue in November 1991; asset price deflation
1992	The EMS crisis in September; Finland, UK and Sweden let their currencies to float, Denmark devalues; banking crisis in Finland and Sweden
1992-1996	Finnish and Swedish currencies float, nominal interest rates down; economic recovery and asset price reflation
1995	Finland and Sweden join EU and accept the EMU plan
1996	Finland joins ERM
1999	Finland joins EMU, Sweden stays out, Denmark exercises opt-out but maintains fixed parity

The stubborn continuation of tight monetary and exchange rate policy made the Finnish and Swedish recessions deeper than expected and worse than in other OECD countries at the same time. Afterwards it seems obvious that the recessions of Finland and Sweden were connected with the failure of the European system of fixed exchange rates (especially with the European Monetary System, EMS) and high interest rates imposed before that to all European countries through the EMS by the German central bank, the Bundesbank. The climax of the recession was the European currency crisis in the autumn of 1992. It is likely that both the boom and bust phases could have been stabilised by adopting a floating exchange rate. However, all European countries tried to maintain exchange rate fixed, which made the recessions of the early 1990s worse.

FIGURE 5B

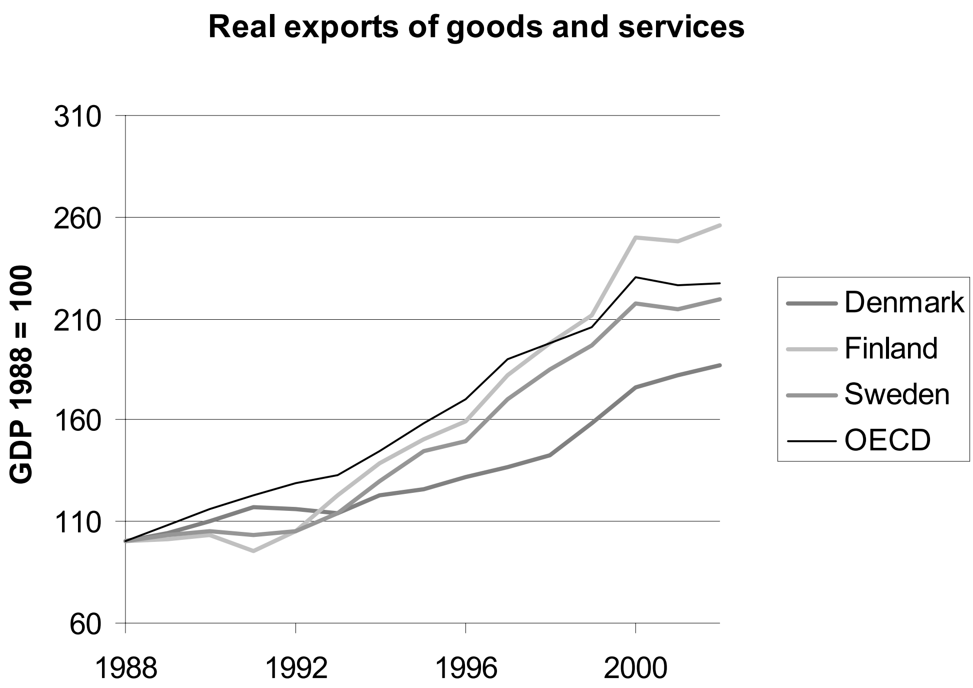
The exchange rate crisis was finally solved by devaluations (Finland devalued in 1991 and Denmark in 1992) and decisions to abandon the fixed parities and letting the currencies to float (Finland, Sweden and the UK in 1992). As a result, the effective exchange rates of these countries depreciated significantly. As can be seen from Figure 6, this depreciation yielded a permanent change in effective and real exchange rates, and a corresponding improvement in competitiveness, which helped these countries to increase their exports. Although the Finnish and Swedish currencies appreciated after 1993, they remained in relative terms weaker than the other EU currencies.

FIGURE 6



The export performance of Finland and Sweden turned out to be outstanding during the 1990s (see Figure 7). That was mainly achieved by the help of exceptionally good competitiveness. It is noteworthy that the export performance of Denmark lagged clearly behind Sweden and Finland (and also behind the OECD average).

FIGURE 7



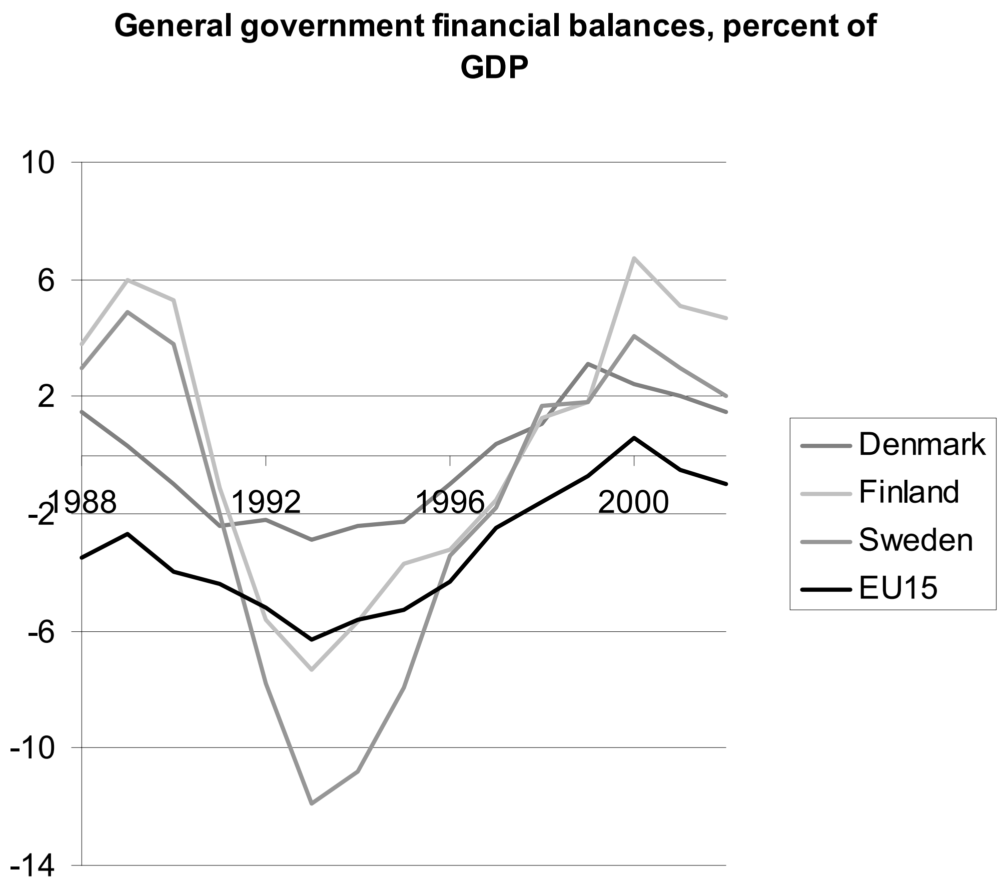
4 Fiscal policy

Although the Nordic countries are far from identical, the Nordic welfare states have some important common features which characterise them. This is why the Nordic model is usually acknowledged in classifications as a separate social model. For instance, Esping-Andersen (1990) distinguishes between three different types of the welfare state. The liberal or marginal welfare state is based on the social protection provided by private market and family. In such a model social benefits are means-tested and low. In the second model social provisions are distributed on the basis of merit and work performance. According to Esping-Andersen, the Scandinavian model is the third one, based on universality principle. That model promotes redistribution and social equity.

There is a certain holistic or universalistic thinking behind the welfare state system in the Nordic model; the society is supposed to take care of citizens from 'cradle to grave' and protect them from the economic and social risks. This is done by providing affordable care, education and housing to everybody – at least in principle. At the same time the welfare system redistributes income between households by using taxes and transfers, and thus decreases inequality. The universality of the welfare system is important in the Nordic countries. Everyone is entitled to the same services and to same benefit systems. The eligibility does not depend on income and wealth as much as on age or needs.

These features make the public sectors of the Nordic countries highly vulnerable in financial terms in the case of economic crisis. Increasing unemployment leads inevitably to lower public sector revenues because of shrinking tax base. This impact is aggravated by the progressivity of the Nordic tax schedules. Rising unemployment also increases public expenditures, the more the higher are the replacement ratios of the social welfare systems.

FIGURE 8



The recession of the 1990s caused a lot of strain to the public finances in all European countries. The biggest changes were seen in Sweden and Finland. Initially – even in year 1990 – the Nordic public sectors were in healthy surplus. However, soon the recessions, unemployment and high interest rates changed the situation quickly and fiscal balances deteriorated significantly (see Figure 8); on average the change was more than 10 percent of

GDP. Although the change was big and sudden, it was proportional to the employment losses as can be seen from Table 3. Hence there is no reason to argue that the large deficits would have been caused by expansionary fiscal policy – or by increases in structural deficits. The rising deficits were of course what one would expect to happen in a deep recession: the automatic stabilisers increase expenditure and decrease tax revenue. In the Finnish case, the fiscal balance was further weakened by the need for public bank support in 1992-94, when the banking crisis became evident.[6]

Table 3. General government fiscal balance

	1990	1993	2000	change 1993-2000
Denmark	-1.0	-2.9	2.7	+5.6
Finland	5.3	-7.3	6.9	+14.2
Sweden	4.0	-11.9	3.4	+15.3
EU15	-4.0	-6.3	0.7	+7.0

As a result of high expenditure level also the taxes need to be high, and the Nordic taxes are on average higher than elsewhere, too. The gross tax rates are in Sweden, Denmark and Finland higher than in any other industrial country. The high tax rates are basically due to relatively high and progressive labour income taxes and consumption taxes – and in Sweden also to property and wealth taxes. Corporate and capital income taxes, in turn, are flat and low in Nordic countries. During the 1990s there were many changes in fiscal policies which affected tax rates, revenues and public expenditures.

These differences can be seen by looking at the elasticities of the change of budget balance with respect to the change of unemployment rate (see Table 4). In Denmark and Finland these elasticities are very close to European Union average, i.e. less than one; the only difference is that the changes were much bigger in Finland. Development in Sweden was totally different: there the elasticity was almost 2,5, implying a very strong counter-cyclical fiscal reaction to the rise of unemployment.

[6] It has been suggested by some researchers that the Nordic recessions would have been partly caused by excessive fiscal deficits and hence by unsustainable and expansionary fiscal policy (see Corsetti and Roubini (1996) and Giavazzi and Pagano (1995)). However, closer analysis of discretionary policies do not support such a view.

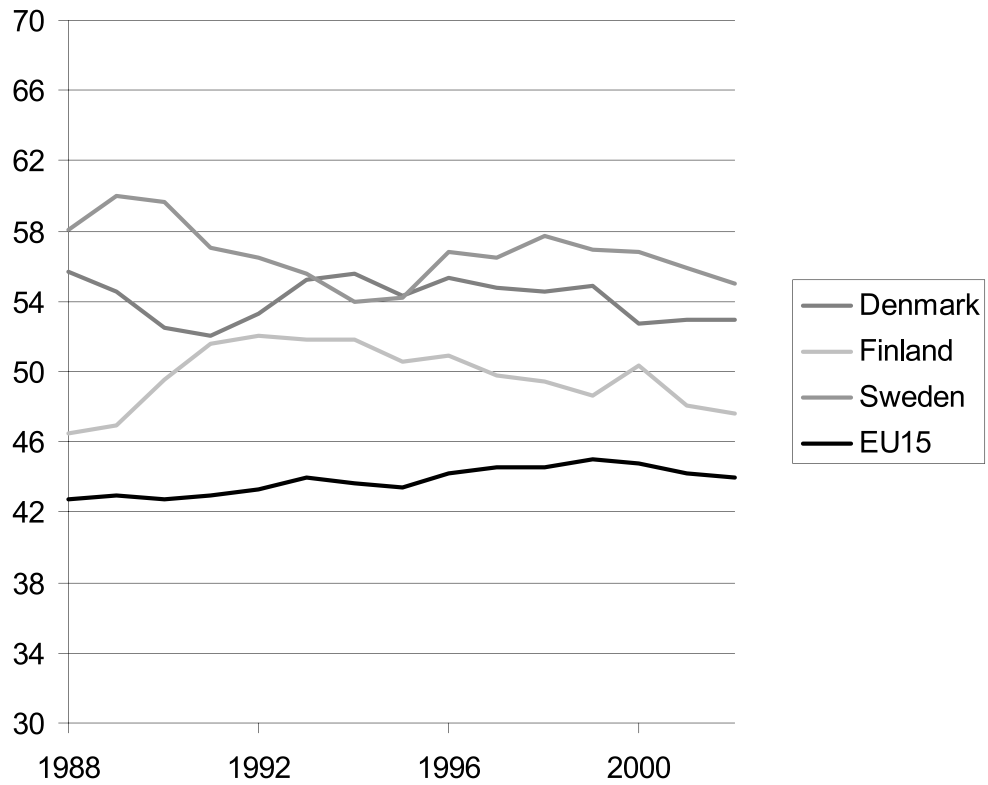
Table 4. Changes in fiscal balance and business cycle 1990-93

	(1) fiscal balance	(2) unemployment	(3) elasticity, (1)/(2)
Denmark	-1.9	+2.4	-0.79
Finland	-12.6	+13.2	-0.95
Sweden	-15.9	+6.5	-2.44
EU15	-2.3	+2.7	-0.85

Fiscal policy was different in the Nordic countries. In Denmark the economic hardships were mildest, and there was not need to any big changes. Still taxes were raised in pro-cyclical manner in the recession years. In Sweden the fiscal policy can be viewed as most accomodative. The Swedish government let the revenues fall (by 5 percent of GDP) during the economic crisis. However, the Swedish tax burden was increased after the crisis (see Figure 9). In Finland the opposite happened. In spite of the deepness of the recession (or because of it!), the government raised most taxes and thus increased the government revenues as a share of GDP (by 2 percentage points). These decisions were reversed after the recession. For this part the Finnish fiscal policy can be seen as pro-cyclical and the Swedish as counter-cyclical.

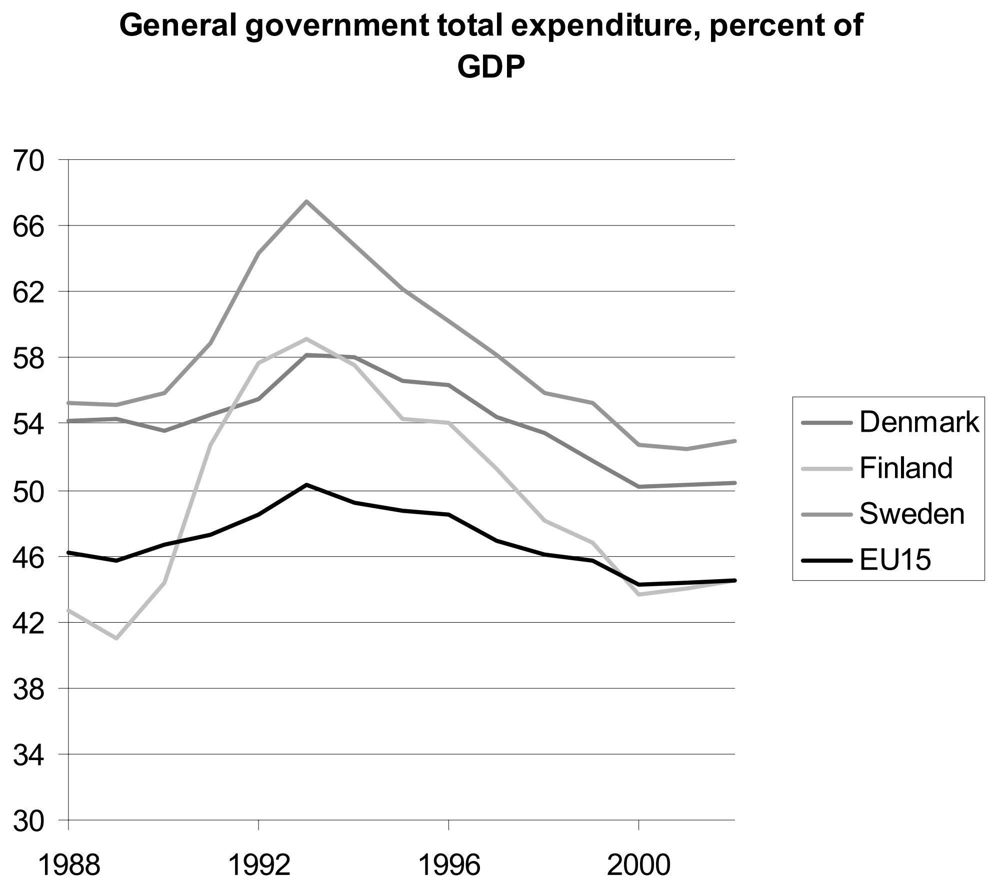
FIGURE 9

General government total revenue, percent of GDP



The large deficits of early 1990s caused much worrying about the sustainability of welfare state model. It was clear that the financing of the public expenditure could not rest for long time on large fiscal deficits. The Nordic governments reacted gradually by restricting the growth of public expenditure. The growth of public demand was restrained in Finland and Sweden in the 1990s and the growth contribution of public demand was almost non-existent. This was a marked difference from the other recoveries of the 20th century. In here Sweden and Finland differed also from the other Nordic and EU countries in which the growth of public demand was allowed to continue also in the 1990s. It seems to be the case that especially in Finland and Sweden the welfare state went through a significant squeeze in the 1990s although there has not been any outright reductions in social expenditures. The timing of expenditure squeeze was different in Sweden and Finland; in Finland it started earlier.

FIGURE 10



The total general government expenditure expressed as a share of GDP (see Figure 10) does not tell very well what is the actual level of discretionary public spending. That is because the total spending includes the interest payments of public debt, and because the expenditure share depends negatively on the level of GDP. When GDP decreases – as in Finland and Sweden in 1991-93 – the public expenditure increases as share of GDP. An alternative way to look on the developments of public expenditure is to construct a time series of real primary expenditures (excluding net interest payments) and calculate its share of long run trend GDP (thus eliminating the effect of short run fluctuations of GDP level). That is presented in Figure 11.

FIGURE 11

General government total primary expenditure, percent of trend-GDP

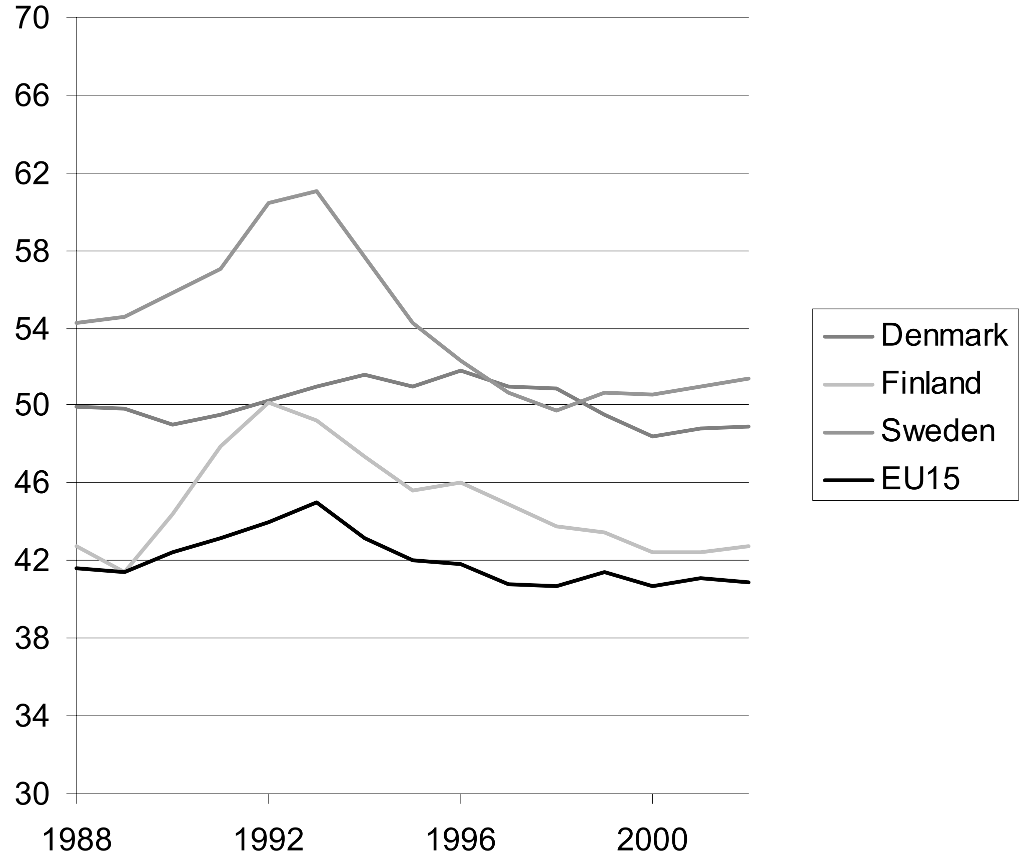
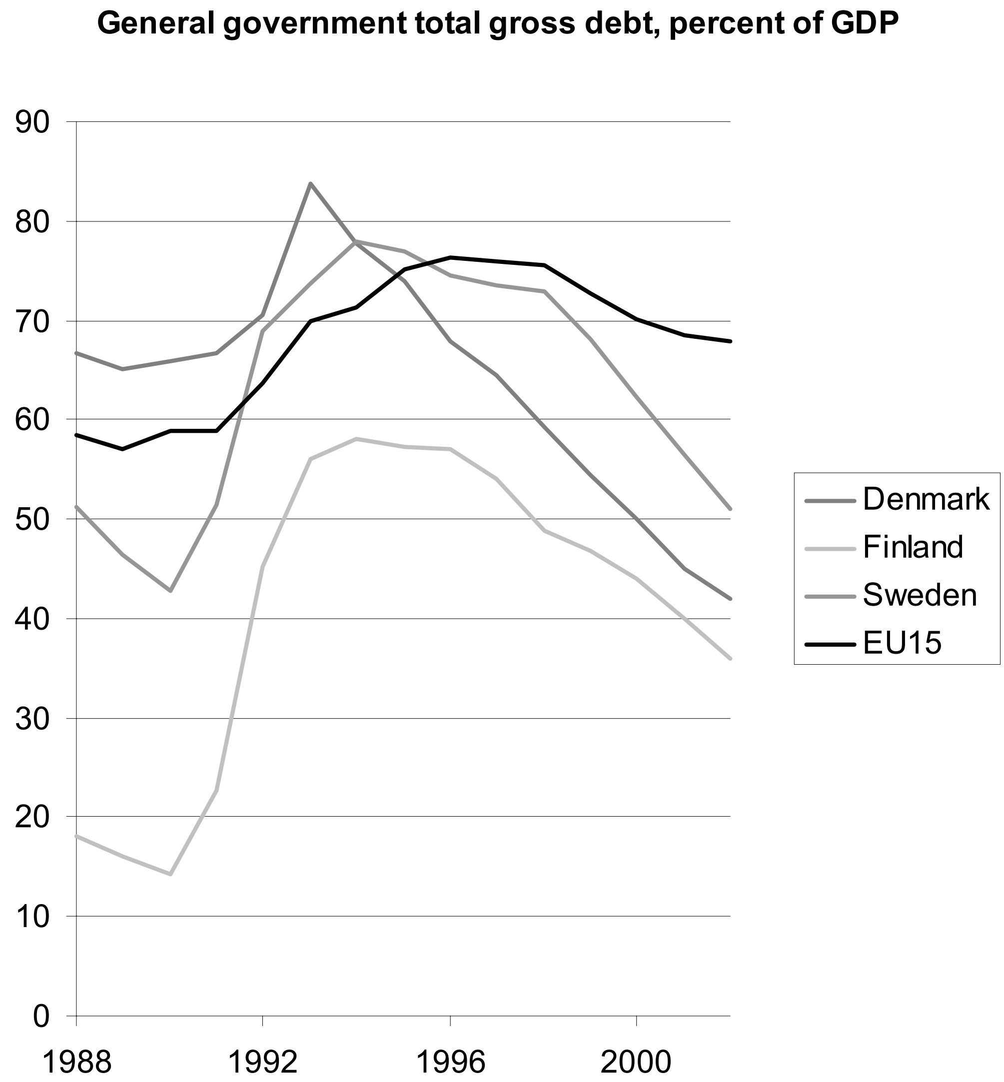


Figure 11 shows that there was in all countries a period of rising primary expenditures during the first years of the 1990s. Most of that can be explained by the fiscal costs of rising unemployment. However, after 1992 the expenditure shares decreased radically in Finland and Sweden, and around year 2000 they were below the pre-crisis levels, which indicates a significant fiscal consolidation. In Denmark as well as in the other EU countries the changes in primary expenditures were much smaller.

The big changes in fiscal balances caused naturally equally large swings in public debt to GDP ratios. These are depicted in Figure 12.

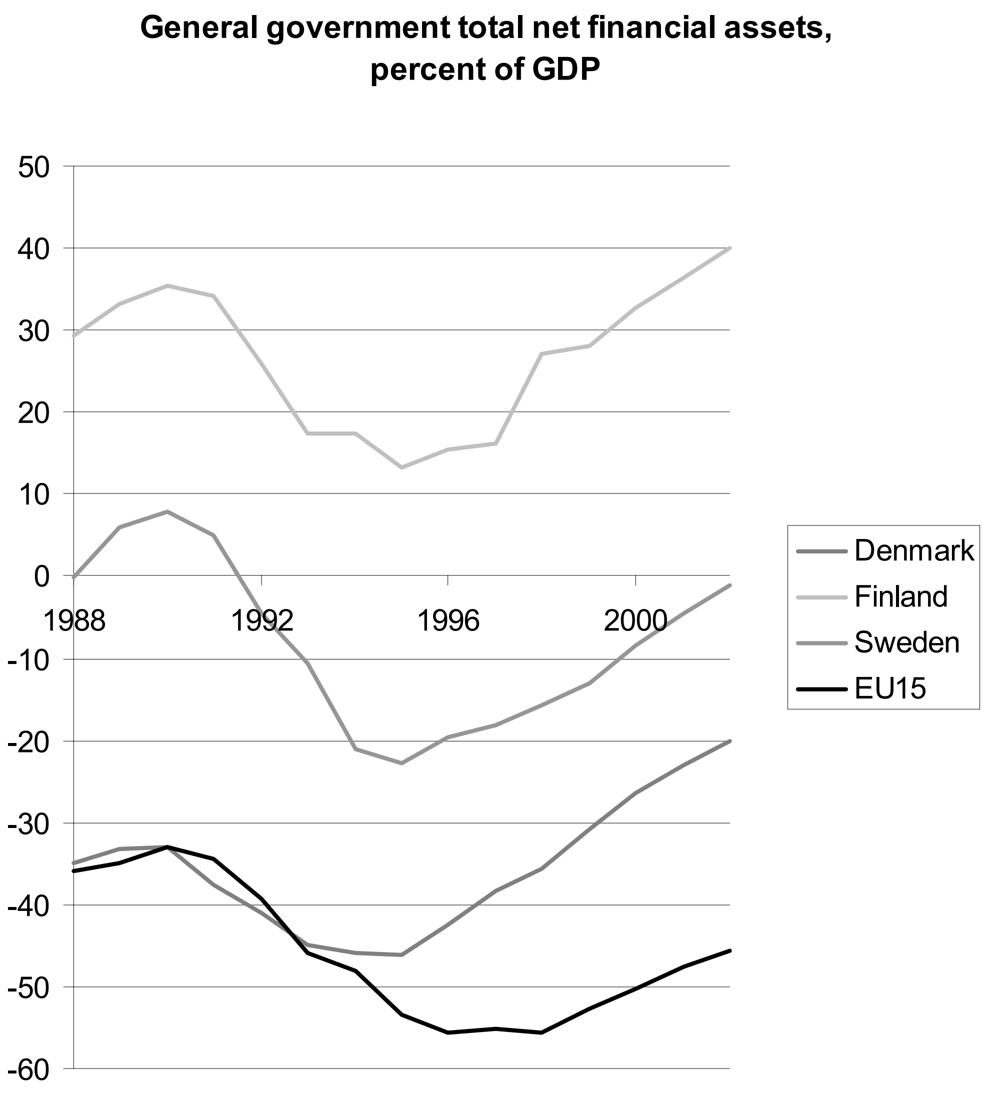
FIGURE 12



The relatively modest recessions in EU15 countries and in Denmark caused an almost 20 percentage point increase in the debt ratios of these countries within a period of couple of years (i.e., in 1991-1995). The more severe financial crises of Finland and Sweden caused huge build-ups of public debt; the debt ratios of these countries rose by 40 percentage points in four years. However, due to the very low initial debt ratio Finland did not exceed the 60 percent limit set by the Maastricht criteria.

The general government gross debt is usually used as a measure of public sector indebtedness, and it is one the criteria of the EMU and the Stability and Growth Pact. However, in addition to large debts, public sectors do in many countries possess also sizeable financial assets. This is the case in the Nordic countries. All Nordic governments have large financial assets which dwarf their net debts, especially if compared to the other EU countries. In Sweden the public sector financial assets are equivalent to the government debt so that the net debt is close to zero. In Finland the situation even more favourable; the general government total net financial assets are positive and about 40 percent of GDP (see Figure 13).

FIGURE 13



5 Conclusions

A central part of the Nordic integration processes in the 1980s and 1990s were the changing monetary and financial regimes. First in the 1980s all the Nordic countries had fixed exchange rate targets; they tried to imitate the exchange rate mechanism of the EMS although they were formally outside of it. After the currency crises of 1992 the paths of Nordic countries started to diverge. Finland joined the EMU. Denmark decided for political and clearly non-economical reasons to stay formally outside the monetary union but still have a fixed exchange rate vis-a-vis the euro. The rest of the Nordics – Sweden, Norway, Iceland – remained in the regime of floating exchange rates with explicit inflation targets. In spite of different choices, all Nordic countries adopted the new policy of low inflation and central bank independency. The adjustment process to this new regime of stable prices was initially painful.

These experiences makes one to ask what to do in similar situations if there is not possibility to use flexible exchange rates any more and when the capital markets have been fully and irreversibly liberalised. The use of currency depreciation helped especially Finland and Sweden to escape from the deflationary trap of the early 1990s which severely threatened the stability of financial system and the competitiveness of exports. If such an possibility is not any more available, how a small open economy is supposed to adjust to negative exogenous shocks? The adjustment problem is not a purely academic question. It is relevant to all Nordic countries (Denmark being a possible exception), as well as to the accession countries since in the past they have experienced different business cycle dynamics than the core countries of the euro area. This question is already central to Finland which is a member of EMU, and also important to Denmark which seeks to maintain fixed exchange rate with euro without formally joining the EMU. The question of substitutes for exchange rate flexibility was also crucial when Sweden decided to postpone her membership in the EMU.

The Nordic experience from the 1990s shows that monetary policy can be a powerful tool in economic policy.

Fiscal policy had to accommodate many economic and financial shocks in all EU countries in the 1990s, and especially in Finland and Sweden, where the economic fluctuations were larger than elsewhere. In most European countries – including Denmark and Finland – the fiscal policy was mostly neutral or pro-cyclical, aiming mainly to fiscal consolidation instead of broader economic stabilization. The main reason for that was partly the severity of fiscal imbalances and partly the joint attempt to fulfil the Maastricht criteria. Sweden was exceptional in this respect with clearly counter-cyclical fiscal policy stance (and with the largest deficits, too). The huge deficits and increases of public debt in Sweden and Finland in the early 1990s showed that the Stability and Growth Pact would very likely have been violated in these countries had it existed in the years of deep recession.

Endnote:

All data is from OECD sources

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