

# SPEECH

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## The new geopolitical map and the international influence of the Nordic region

Ladies and gentlemen, dear friends.

Let me begin by offering my warm thanks to Olli Rehn and Finland's bank for the kind invitation and for this fantastic event – it is a great pleasure and an honour for me to come here today and meet you all. Let me also express my sincere surprise and humble gratitude for having this magnificent award bestowed upon me – I cannot enough emphasise how happy and proud this makes me.

Dear friends,

When I flew here from Stockholm this morning, I was struck, as so many times before, by the fantastic landscape of Sweden and Finland. This landscape is barren in many places - and where it is not barren, there are forests, or lakes. It is a landscape that is completely different from what you see when you fly south, where the grid of fertile agricultural fields never seems to end. I myself never cease to be amazed at how people managed to survive in our region in the past. It must have been a tough life. And you didn't get rich – as recently as in the 19th century, both Finland and Sweden were among the poorest countries in Europe. And when you

look at the conditions, it wasn't so strange. In a world focused on agriculture, Sweden and Finland comprised the economic backwoods of Europe.

But when you look at our two countries today, the situation is quite different – the change is dramatic.

Of course, the transformation is based on a whole series of factors: the industrialisation and refining of our forestry and ore assets; the development of the education system, the creation of limited companies and the whole social model that is known today as the Nordic model. But there is also the factor that I want to focus on here today, namely international trade and cooperation, and how important they are for the prosperity of small economies.

I want to talk about this because I see significant challenges for small countries, not least European ones, to make their voice heard in the international discussions. I also see risks that free trade will develop negatively in the future. And I want to talk about what we can do to, if not reverse this negative trend, then at least slow it down.

**My reflections are strongly coloured by my background and my professional life.**

As many of you know, I was born in Finland, I live in Sweden and I have also spent much of my professional life in other countries, working for various international organisations. I guess I may be described as a true internationalist. But what exactly is an internationalist – can you, for example, have national identity while you are an internationalist? Arja Saijonmaa, who also has bases in both Finland and Sweden, was asked that question in a television programme and answered something like this: To be international, you have to come from somewhere. This unites us. Everyone comes from somewhere. And we should all be proud of this.

In my case, the somewhere was in the southern Österbotten region. It is with a great measure of humility, but also some pride that I can think back and reflect on the road that has taken me from Närpes and my childhood wall-to-wall with the bank office where my father worked as director, and out into the world until I stand here as newly granted Commander First Class of the Order of the White Rose of Finland.

## Sweden's and Finland's international commitments, a brief retrospective

**To give some perspective to today's challenges**, I would like to start with a little look back at the international, or multilateral, commitments in Sweden and Finland. In some areas we have chosen a similar path, but not always. Sweden was fairly quick to understand the value of international trade and the importance of multilateral commitments in this context. Partly as a result of their own lobbying, for example, Sweden was represented at an early stage (1931) on the Board of Directors of the Bank for International Settlements (or BIS as it is called). This event led to Sweden having a relatively large - in some eyes perhaps too large - influence in the global central bank cooperation. For example, it was the same countries that sat on the Board of the BIS that came to be included in the so-called GAB agreement in 1962. The GAB agreement was a credit arrangement to support the international currency and payment system. The countries in question were the G7 countries together with Belgium, the Netherlands, Switzerland and Sweden. The GAB agreement and the G10 cooperation have continued to play a role in later financial collaborations. This has provided an opportunity for closer contacts with the major countries, than could be justified by the ranking of Sweden, in terms of the size of the economy.

However, when the International Monetary Fund (IMF) was established, Sweden was not so quick off the mark. This seems to have been due to fears that one would not be able to pursue a sufficiently far-reaching stabilisation policy. While Finland joined in 1948, it took another 3 years before Sweden also joined. Interestingly, the motive for Sweden seems to have been linked to the desire to join the then world trade organisation (ITO), and to participate in the GATT negotiations, rather than a genuine interest in the IMF. However, IMF membership was in practice a requirement for membership of the ITO, so Sweden therefore decided to apply.

**I think this episode is very symptomatic** of Swedish political priorities during the post-war period – one sees the great value of free trade and competing on equal

terms on the world market, but one has always been very hesitant about reducing one's own freedom to conduct stabilisation policy.

**And this brings us to the different attitudes of Finland and Sweden toward the euro collaboration.** The stabilisation policy aspects were very central to the Swedish decision to remain outside the single currency. But it does not seem to have played the same role in Finland, which, with its less diversified business sector, should be more sensitive to exogenous shocks. Finland focused more on what was structurally desirable and adopted the euro as a currency from the start in 1999.

So there we have two small, fairly similar, foreign trade-dependent countries which make two different choices. **Were these important choices?** Absolutely.

**Have they so far proved crucial to the economic development and prosperity of the countries?** No, I don't think so. Let me explain.

The decisive factor in explaining the economic growth of the countries is that **both countries drew the correct conclusions from the economic policy developments that led to a deep crisis in both countries at the beginning of the 1990s.** And the lesson was that there was no exchange rate regime that would make the economy immune to unsustainable economic policies. This insight led to in-depth reforms of the entire macroeconomic framework in both countries. The government finances were consolidated, a clear regulatory framework for fiscal policy was introduced, the central banks were given greater autonomy and there was a focus on promoting productivity growth in the business sector.

In the thirty years since the crisis, the countries have largely adhered to this and both economies have developed reasonably well – certainly better than in the decades preceding the crisis. So, just as we learned that there is no exchange rate regime that gives immunity to unsustainable economic policy, it is clear that sustainable economic policy can be compatible with different exchange rate regimes. In my work at the IMF dealing with financial crises in different countries, I noticed that this basic insight is often lacking among senior policy-makers in crisis countries. The attitude could remarkably often be described with one word – 'denial'. If you do not come out of denial of the way things stand, there is not much you can do to solve the problems.

**If we look at the differences it entails for a country to have the euro or the krona as its currency,** it is of course the case that the Riksbank has a more direct influence over its own monetary policy than the Bank of Finland does – we can, in theory, decide what policy rate we want to have. In practice, however, it is also clear that this is a freedom with considerable limitations. This is because we have an elephant as a neighbour, and when that elephant makes a move, it affects the Riksbank whether we like it or not. And one might wonder what is best – having a limited, but direct, influence over how the elephant tramples around, or no influence at all, but hopefully a chance to jump out of the way if needed.

This problem is essentially the same in terms of participation in the Banking Union, which is compulsory for all euro countries, but optional for non-euro countries. Swedish politicians have so far refrained from joining, and my feeling is that it is largely about not wanting to give up national self-determination. **But national self-determination, at least in the financial market area, is in many ways a chimera.** When the Swedish Parliament, or the Finnish Parliament for that matter, decides on legislation in the financial market area, one must almost always take into consideration legislation at EU level that is more or less restrictive.

EU legislation in turn must be based on global agreements, because the EU, too, is not acting in complete isolation from the outside world. Deals within, for example, the G20, the Financial Stability Board (FSB) and the Basel Committee on Banking supervision bind the EU, maybe not legally, but politically, as the EU and individual EU countries are represented in these groups. I am not entirely sure that our politicians fully understand that this is the case, but since I have had the privilege of leading the Basel Committee, I can confirm that this is true.

All of this boils down to a truth that can be hard to digest for many people – **standing alone is definitely not a strength in a world with freedom of establishment and free capital movement.** To claim anything else is to engage in wishful thinking. The problem is that this kind of wishful thinking is almost irresistible for some, which leads to an illusion of self-determination that may sometimes have the characteristics of the denial I have just mentioned.

As I touched on before, I believe that one factor that helps explain the difference in Swedish and Finnish emphasis of the value of self-determination is the different geopolitical situation of the countries. Finland has historically been subjected to Russian influence in a completely different way than Sweden. Perhaps this situation has contributed to the illusion of self-determination being easier for the Finnish public to see through than the Swedish public. Maybe it is also true that the currency is linked to the national identity beyond the economic arguments. People quite simply like having the king on their coins.

## International challenges for small European countries

With this background on the Finnish and Swedish multilateral commitment, I would now like to say something about the challenges I envisage for the future – not least for small European countries such as the Nordic ones. **What challenges do I see?**

**The clearest challenge** reflects the known fact that the economic power relations in the world have changed. This is a process that has been going on for a long time and the result is, above all, that so-called emerging economies in Asia and Latin America have grown in strength compared to Europe and the United States. Of course, the Chinese development has been particularly remarkable.

However, I want to be very clear here - the fact that these countries are growing faster than we are is in itself nothing to complain about, even if it would have been good for everyone in Europe if certain European countries, in particular, could have performed better. The reverse side of the coin here is instead on a political level. The emerging economies have legitimate expectations of obtaining political representation that reflects their growing economic strength. And, to a large extent, it is Europe that is expected to make room.

This is evident, for example, in the IMF, where the small Nordic-Baltic countries have to fight constantly to keep their constituency in its current form. Of course, this is not something I need to inform the Bank of Finland about, because you are now managing the constituency with flying colours. But for others it may not be common knowledge.

**Another illustration of the loss of influence by small European countries is the emergence of the G20 and the FSB.** These groups were formed because the large countries saw a need to create forums that better reflected the changing global economic power relations than the existing organisations did. In the context of the economic and financial crisis in 2008-2009, these organisations played a very prominent role and determined to a large extent how the international regulatory agenda should be designed to respond to the crisis. It can be noted that the Nordic region is in principle not represented at all here – Sweden did succeed in joining some working groups in the FSB, but when Nordea moved, some of that representation was quickly taken over by our eastern neighbour. This may seem a good thing for Finland, and I do not in any way question that it happened, but unfortunately it is less than a zero-sum game for the region as a whole. We both become too small to have any genuine influence in the work. All in all, it is clear that the relatively prominent role that even small European countries, such as Sweden, have been able to play in global multilateral cooperation is in the process of being reduced. However, for my own part I have been a Member of the FSB for almost 15 years, but then in the form of personal roles I have had.

**A further challenge with geopolitical overtones is the trend toward increasing protectionism** that we are now seeing in the world, and the EU is unfortunately no exception. Yes, the last few years have shown that there may be reason to consider whether we are not a little too dependent on the world around us in certain specific sectors. I am thinking, for example, of Russian oil and gas, or of the manufacturing capacity for vaccines - in view of what we are experiencing today, for example, the Nord-stream II project appears extremely naïve.

But while there may be reason to take a look at our dependence on the surrounding world, it is important that we do not throw the baby out with the bath water, as we say in Swedish. We must not forget Anders Chydenius' wise comment, namely that it is not worth fighting to preserve national production of a product if it is more lucrative to buy it from someone else. Or as we used to say in my home town: "We won't get rich by chopping wood for one another."

National champions, which are so popular in some countries, are something to be very careful about – often you don't really notice how expensive it is in the long

run to keep alive companies or industries that are not really viable. In Sweden, we had dearly-bought experience of this in connection with the so-called shipbuilding crisis of the 1970s-1980s, a crisis that would have been much less costly if politicians had realised in time that the race was, so to speak, run. I realise, or at least hope, that I am preaching to the converted here, but in the financial market area this is an issue that has become very topical since Britain chose to leave the EU. To what extent should we fight to build up our own capacity within the EU instead of taking advantage of the fact that we have a global financial centre as our closest neighbour, with all the opportunities this offers in terms of competitive financial services?

**What can we do to counteract this development?** Or, as I said at the beginning, what can we do to slow it down? Because, frankly, I do not believe that there is anything we can do to completely reverse this trend.

Well, let me start with the latter aspect, about growing protectionism, not least within the EU. In this respect, I believe it is important that countries such as Finland and Sweden continue to stand up for the Nordic model, which is not based on protecting individual sectors and companies, but on facilitating production transitions by, for example, providing social safety nets for individuals. This unsentimental attitude towards replacing individual industries with new ones is, I believe, fundamental to us being able to survive in an increasingly internationalised world. Having a well-managed, strong economy with steadily rising productivity is also something that provides the necessary weight in a European debate on these matters.

We also need to be perceived as constructive participants in the international work. There is always a need for good workhorses. My presidency of the Basel Committee made one thing clear to me that I believe is of central importance, not least to representatives of smaller countries - namely that it is a complete 'dead end' for a President to pursue one's own national line in the negotiations. It was difficult enough to seek consensus among the Member States on how to improve international banking regulation. If I had tried to deliver a 'Swedish wish list' at the same time, it would never have worked – it would simply have meant that I lost credibility among the Member States.



Another thing that I believe deserves much more attention is to **focus more on the special position of the Nordic, or Nordic-Baltic, region**. The fact that Sweden and Finland belong to a region that in many ways is economically and technologically successful is also something that could be used more as an argument in the discussion about representation in international organisations. The four largest Nordic countries each hold rankings located between 40th and 60th place in the world, in terms of total GDP. If you look to the Nordic countries as a region, however, we have the seventeenth highest GDP in the world. Moreover, the region is economically and financially well-integrated, with a very advanced position in terms of innovation. Therefore, if we could bring more of a 'constituency' way of thinking into different organisations, we might be able to retain more of our international influence. I recognise that the fact that some Nordic countries are not euro countries, and some are not even EU members, can be a complication here. However, I am convinced that coordinated action in this direction could be highly relevant in several organisations, such as the G20, FSB and BIS. Here, I believe that the Nordic-Baltic IMF report on money laundering, which is now being produced, can contribute something to this view. The context is certainly not merely flattering for us, and our banks, but it is important to show that we are prepared to subject ourselves to scrutiny and to take the necessary measures. Another example is the large Nordic-Baltic crisis exercise held in 2019. With over 300 participants from 31 different authorities, this was one of the largest and most ambitious exercises of cross-border crisis cooperation that has ever been carried out. It was a very concrete manifestation of the close cooperation between the Nordic and Baltic countries on financial stability issues - a cooperation that has often been highlighted as an example for other countries to follow.

**Ladies and gentlemen, dear friends**, these were a few reflections from my personal horizon. I have tried to make it clear that we cannot take it for granted that small European countries, such as Sweden and Finland, can retain the relative international influence we have held. The global power balances are changing and we must adapt accordingly. I hope that both Finland and Sweden will realise that we cannot count on everything to remain the same, as long as we just sit still in the boat. In a changing situation, a non-decision is also a decision.

However, I am the first to admit that my perspective is limited. Economics and monetary policy are certainly important, but in these troubled times, of course, the world does not revolve around them alone. However, this is my part of the playing-field, where I can perhaps make a small contribution to the debate. If anyone thinks they can read a wider interpretation than an economic-policy one into what I have said, then I have failed to express myself clearly. Above all, it is in no way my intention to comment on the choice of security policy that is currently being discussed intensively in both Sweden and Finland. It is not for me, in my role as Governor of the Riksbank, to express a preference on this issue. However, I would like to emphasize one thing – it warms the heart of an old Österbotten son with one foot in Finland and one in Sweden to see how highly Finnish-Swedish cooperation is valued on both sides of the Gulf of Bothnia. If our understanding of our mutual dependence and common interests continues to colour our cooperation, I believe that it bodes well not only for Sweden and Finland, but for the Nordic-Baltic region and, ultimately, the whole of Europe.

Thank you for listening!