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My life in crisis? What have I learned about economic policy in the last 50 years?

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LUND UNIVERSITY

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This paper is a translation of a talk given by Lars Jonung at the conference held in his honor at his 70th birthday in Lund on October 3-4, 2014. A few additions and updates have been made to the original talk. He came to Lund to study economics in the autumn of 1965. Both the city and the subject of economics have captivated him ever since. His research covers many areas of economic policy, primarily monetary and fiscal policy. He has a keen interest in the development of economics in Sweden, especially in Knut Wicksell and the members of the Stockholm School. He has participated extensively in Swedish public debate since the 1970s. He has been involved as an advisor both in Stockholm and in Brussels. After ten years at the European Commission as research advisor, he returned to Sweden to serve as chairman of the Fiscal Policy Council 2012-13 and as a senior professor at the Department of Economics at Lund University. He left this position when he turned 70 in the autumn of 2014, becoming professor emeritus.

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My life in crisis

What have I learned about economic policy in the last 50 years?

As the title of my speech today, I have chosen "My life in crisis". Do not worry; there will be no dramatic private revelations from Dr. Freud's psychoanalytic couch. The title should be interpreted as follows: I want to briefly describe how my research and my views of macroeconomic policy have been affected by economic crises. This explains the subtitle "What have I learned about economic policy in the last 50 years?" because I have learned a lot from crises.[1]

Twenty years ago, Ingemar Ståhl, then a dynamic professor here in Lund, gave a speech in my honor when I turned 50. He said that I flourished in crises. You could tell by looking at me that a crisis was coming—I was so excited. The deeper the crisis, the more energized I seemed to be. That is right: crises are something unique that, from a research perspective, macroeconomists have reason to be happy about. The social costs are certainly enormous but let us ignore them for the moment.

My path to crisis research was shaped by firsthand experience at the heart of economic and political decision-making. I had the privilege of experiencing the deep crisis of the 1990s from inside Prime Minister Carl Bildt's office in Rosenbad in Stockholm. Not only that, the position as advisor to the crisis-stricken Bildt premiership gave me the qualifications to end up as an advisor in the European Commission, more specifically at the Directorate-General for Economic and Financial Affairs (DG ECFIN). So, when the euro area's big crisis came in 2008-09, I was on site in Brussels and an insider as well.

1. The road to crises

On an occasion like this, allow me to take a long look back. I came to Lund in 1965 – almost 50 years ago. When deciding between becoming a doctor in medicine or civil engineer in technical physics, I chose to become an economist. I was interested in society, politics, economics, and public debate. Economics promised me answers to many questions. I have found some. Yet the questions have multiplied, and the answers have often shifted over time.

[1] I would like to thank all my colleagues and friends who have contributed to my thinking and my research. This essay has been commented on by so many that I refrain from mentioning them in this acknowledgment note. The essay was originally printed as chapter 15 in my Festschrift *Makropolitik i kris* (*Macropolicies in Crises*), Ekonomihögskolan, Lunds universitet, 2016. I have incorporated several additions to my original Swedish talk from 2014. For clarity, most of these new elements have been placed as footnotes. I owe a deep debt of gratitude to Kurt Schuler for encouraging me to translate my original Swedish text.

A crucial point about universities is that they also function as marriage markets—a vital role often overlooked in analyses of the returns to higher education. I discovered this return firsthand in an economics course, where I met Christina, my wife since 1968 and an accomplished economist in her own right.

Bo Södersten, at that time professor in international economics, had a decisive influence on our life together. At *Athen*, the famous student café in the *AF-borgen,* a landmark building on the Lund University campus housing the student union, we met Bo one afternoon at the end of September 1968. Yes, students could meet, have coffee and talk to a professor at *Athen* at that time. Bo had just returned from a period as a professor at Berkeley in California. He was direct and resolute: "Go to the United States; that is where you can truly learn economics. Here in Lund, there is nothing new to learn. I know what I am talking about." Bo always knew what he was talking about.

The next day Christina and I rushed off with our applications for the exchange program between Lund University and the University of California. It was at the last minute. Later that fall we got married.

We were lucky. We both got scholarships and could choose between the flagship campus in Berkeley or UCLA in Los Angeles. We chose UCLA because it had a young professor, Axel Leijonhufvud, who was scheduled to give a course in Lund in the spring of 1969 on his huge book about Keynes and the Keynesians. It felt reassuring to have that connection, even though the radical, hippie atmosphere of Berkeley was tempting compared to the more conservative environment at UCLA.

We stayed at UCLA for two years, 1969-1971, and completed the required courses for a Ph.D., thanks to new scholarships from Sweden that Axel helped us get. It was a fantastic time. Bo Södersten was absolutely right—this time. The two years at UCLA framed my and Christina's life.

Studies in the monetary history of Sweden

At the time, the Department of Economics at UCLA was viewed by many as the farm club for the University of Chicago's department of economics, where Milton Friedman stood as the pre-eminent figure. A few years earlier, Friedman and Anna Schwartz had published their seminal 1963 volume, *A Monetary History of the United States*, a work that featured prominently on the extensive reading lists for UCLA's graduate courses in money and macroeconomics.[2]

Under Axel's supervision, the plan was for me to prepare a dissertation on Sweden's monetary history in the spirit of Friedman and Schwartz. The project suited me perfectly: it encompassed macroeconomics and monetary theory, politics and society, intellectual debate, the history of

[2] Friedman and Schwartz (1963).

economic thought, data collection, and theoretical analysis, all woven into a framework I could shape according to my own liking.

Back in Sweden, I went to the Riksbank to collect monetary statistics and interview the management of the Riksbank in 1972. Two meetings were most memorable.

First, I met Per Åsbrink, the governor of the Riksbank. When I mentioned Milton Friedman's name, he became visibly upset and almost scolded me. He clearly had strong feelings about Friedman, and our meeting ended sooner than expected.

A few years earlier, Åsbrink had been the driving force behind the creation of the Riksbank's Prize in Economic Sciences in Memory of Alfred Nobel in 1968. I have often wondered how he reacted when the prize was awarded to Milton Friedman in 1976. Had I met him after that decision, I doubt I would have dared to ask for his opinion.

Second, I interviewed Erik Karlsson, a key figure operating behind the scenes in Sweden's financial system. He spoke with notable candor about his role in managing the distribution of long-term capital in the Swedish economy. During our discussion, he presented a matrix illustrating the principal flows of capital: on one side, the major categories of borrowers; on the other, the principal institutional suppliers of funds. He explained the matrix in straightforward terms: "Here are the investors asking for capital, and here are the savers providing it." He then remarked that he was on his way to meet with representatives of some insurance companies to instruct them on the volume of bond purchases they were expected to undertake.

This meeting offered me a clear and telling demonstration of how the Swedish capital market functioned under the prevailing policy regime: one in which the Riksbank not only set the bond rate but also exercised direct influence over the size and allocation of capital across the financial system. This episode provided an illustrative case of the highly regulated and administratively managed financial sector that characterized Sweden during this period.[3]

Eventually, I finished a dissertation in the American style, a few essays tucked between thin covers, completed in 1975, with the modest title *Studies in the Monetary History of Sweden*.[4] It was followed by many essays on Swedish monetary policy over the years. But it did not become a book – not yet. The plan, or rather the illusion, of writing a complete Swedish monetary history still remains with me.

If I am lucky, I will finish it some day. Time goes by quickly, though, and new chapters are needed for every crisis in which the Riksbank is involved. I now find myself waiting for the

[3] It also struck me that both Per Åsbrink and Erik Karlsson had their roots in the Social Democratic Party. This was the reason they were recruited to the Riksbank. My meeting with them fostered my view that the Riksbank should be independent of the government.
[4] See Jonung (1975).

next crash, the one I fear the Riksbank may be steering toward with its ultra-loose monetary policy.[5]

Shortly after our return from UCLA, Christina and I transferred our new knowledge of money and macro into a small textbook on monetary theory and monetary policy published by *Studentlitteratur*, a publisher here in Lund founded by the student union at Lund University. We were pleased with the title: *Pengar. Teori, politik och institutioner (Money. Theory, Politics, and Institutions).* The students shortened it to the more humorous title *Pengar och pengar* (*Money and Money)*.[6]

Working on the book helped me realize that Swedish monetary policy was not like its American counterpart. One of my first essays was *Penningpolitik eller kreditpolitik (Monetary Policy or Credit Policy?*), published in the now-defunct *Ekonomisk Revy* in 1972.[7] Here I noted that the Riksbank pursued credit policy, that is, it placed emphasis on the assets of the commercial banks; on their credit and lending, and controlled the use of credit with the help of a series of bureaucratic techniques and rules. The rationale for this control regime was that interest rates were maintained below the equilibrium level, thereby disabling the normal functioning of the price mechanism.

There were alternatives to this type of regulatory regime, I argued. It would be possible to use the interest rate and open market operations in free and unregulated financial markets, i.e., the price mechanism could be released. At that time and in the Swedish environment of financial repression, this was a politically unrealistic message. This was one of my first pleas for deregulation and market-oriented policies; more were to come.

It proved fruitful to deal with the history and development of Sweden's monetary policy. After World War II, only a handful of Swedish economists had taken this path. Before the war, I soon discovered, nearly all of them had: Eli Heckscher, Karin Kock, Erik Lindahl, Gunnar Myrdal, Bertil Ohlin, Knut Wicksell, and, above all, Sweden's foremost monetarist, Gustav Cassel.

When I told Assar Lindbeck, then Sweden's leading economist, that I intended to author a thesis on the Swedish money supply, he responded with a remark along these lines: "It is in the unplowed fields that you reap the highest returns." Assar was right. A colleague of mine in Lund, however, was far less enthusiastic. With a touch of irony, he wondered whether collecting data on the money supply might not be better left to *länsstyrelsen*, the County Administrative Board, in Malmö. He, too, eventually became a professor, though in a field entirely unrelated to monetary economics.

[5] This was my pessimistic forecast when I gave my Festschrift talk in 2014 based on the extremely expansionary policy of the Riksbank. I was wrong and the Riksbank was lucky. It managed to avert a crisis – this time.
[6] Jonung and Jonung (1972).
[7] Jonung (1972).

The work of Friedman and Schwartz initially had a great influence on me, especially their analysis of the American depression of the 1930s. I began to examine the Swedish crisis of the 1930s from their perspective. I found much that was exciting, in particular the program of price level stabilization announced when Sweden left the gold standard in September 1931. This led me to interviews with Karin Kock, Erik Lundberg, Gunnar Myrdal and Bertil Ohlin, as well as to the classified archives of the Riksbank. My research resulted in an essay on Swedish monetary policy in the 1930s in the 100th anniversary publication of the Swedish Economic Association.[8]

Myrdal made an impression on me when he emphatically said that I could not write about the 1930s. "Why can't I?" was my counter-question. He replied, "You were not there in the 1930s. Only those who were there can write about what it was really like." I have thought about Myrdal's answer ever since. There is a lot in it, but I argued to him then—as I still do—that each generation must approach history in its own way and write its own version, using its own methods and perspectives.

My interest in how economic policies and ideas shaped Sweden during the 1930s led me to examine the intellectual contributions of the Stockholm School of Economics. One outcome of this work was a major conference held in 1987 to mark the School's 50th anniversary. Here I benefited greatly from the support of Erik Lundberg. Thanks to his involvement, we were able to attract an impressive group of participants to the conference. The proceedings from that event were later published under the title *The Stockholm School of Economics Revisited*.[9]

When I was working on Sweden's monetary history, I had to take a stand on Sweden's greatest economist, Knut Wicksell (1851-1926). Christina and I had been fascinated by him and his wife Anna Bugge already before we left for UCLA through a course given in Lund by Carl Uhr that was based on his book on Wicksell's contributions.[10] It showed us the way to Torsten Gårdlund's brilliant biography of Wicksell, claimed to be one of the best ever written of any economist.[11]

Wicksell was a giant. This was evident not least in the attitude of my professors in Lund at the time, Bengt Höglund, Björn Thalberg and Ingemar Ståhl. They spoke of him with profound respect. Since then, Knut Wicksell has remained both a research subject and a source of inspiration for me. I am continually struck by his intellectual acuity, his gift for framing questions, and the striking contrast between his modest scientific attitude as a researcher and his confident, sweeping recommendations as a public debater on virtually every matter under the sun.

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[8] This paper was translated and published in English in the then newly founded *Journal of Monetary Economics*; see Jonung (1979).
[9] Jonung (1991a).
[10] Uhr (1960).
[11] Gårdlund (1958). Much later I had the pleasure of writing an afterword to a new edition of Gårdlund's book that the Stockholm think tank SNS published in 1990.

Wicksell leaves no one who encounters him unaffected. Much later, Christina and I had the opportunity to penetrate his thinking when we edited and published his unpublished manuscripts together with Torun Hedlund-Nyström.[12] Here Wicksell appears as an economist with wide-ranging interests and a strong commitment to advancing society across multiple domains.

Price control policy and inflationary expectations

In the early 1970s, the Swedish government—then Social Democratic under Prime Minister Olof Palme—introduced price controls to curb rising inflation, particularly in food prices. Over the decade, these controls became a permanent feature of economic policy. When the non-socialist government took office in 1976, it established a Price Control Committee, following the Swedish tradition of comprehensive government inquiries, to evaluate the effects of the price regulations. The committee worked for four years before releasing its final report: 130 pages accompanied by 12 appendices totaling more than 1,200 pages.

I was appointed to the committee as a *sakkunnig*, an expert advisor without voting rights on the committee's decisions. It was an exciting assignment that gave me the opportunity to take two initiatives, both giving me new insights into the workings of economic policies in Sweden, one concerned the macroeconomic effects of controls, the other the microeconomic effects.

First, a standard argument used by the proponents of price controls in the 1970s was that controls held down inflationary expectations of the public. Inspired by this view, I suggested that the committee should carry out a questionnaire study of the expectations of the Swedish households to get a grasp of this issue. The chairman of the committee was first skeptical arguing that the public would not be able to give any reasonable estimate of the actual rate of inflation. Still, I got the green light to design and carry out a huge questionnaire with the help of the National Statistical Office.

Here I introduced, for the first time as far as I was aware, questions about the perceived rate of inflation, that is, inflation over the past twelve months, and the expected rate of inflation for the coming twelve months. The responses, covering roughly 8,000 individuals, turned out to be a gold mine for my research. On average, the public provided remarkably accurate quantitative assessments of both current and future inflation. Thanks to the large sample, I was able to explore systematic differences across age, income, region, and gender.[13]

A central finding was that the primary determinant of expected inflation was the respondent's perceived rate of inflation. Subsequent empirical studies for other countries have validated this result.[14]

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[12] Jonung, Hedlund-Nyström and Jonung (2001).
[13] See Jonung (1981) for a summary in English
[14] See Candia et al (2023).

Second, I became interested in how price controls actually operated at the company level. I visited five firms subject to price regulations, each of which had extensive documentation of its interactions with the Price and Cartel Office (SPK), the government authority responsible for implementing the mandated controls. However, the majority of the committee refused to publish my findings, citing the need for SPK to provide its own account. This was, in effect, merely an excuse to suppress my results.

Instead, I eventually published the book *The Political Economy of Price Controls: The Swedish Experience 1970–1987*, which showed how the application of price controls evolved into a process of protracted negotiations with bids, offers, threats, and concessions between SPK and the firms involved.[15] At the time, this represented a new contribution to the literature on the relationship between the regulatory agency responsible for enforcing price controls and the companies subject to them.

As an expert advisor, I was entitled to prepare a reservation for the committee's final report. In my reservation, I proposed that SPK should be closed down in order to reduce the risk that future governments would reintroduce price controls.

Inflation targets and rule-bound policy

Wicksell's proposal of price stabilization as the rule for central bank policy, first presented in 1898, and the Riksbank's price stabilization policy in the early 1930s inspired me to publish an article in 1978 where I proposed an inflation target of 1 percent for the Riksbank within a band of plus/minus 1 percentage point.[16]

This goal required, as I stated, a deregulation of the Swedish financial markets, the abolition of the foreign exchange controls, a floating exchange rate for the krona and an independent Riksbank with the sole aim of holding inflation at the low announced rate. The government would be responsible for fiscal policy, and the rate of unemployment would be determined by collective wage agreements. Inflation in 1978 was around 10 per cent, so I noted a number of transitional problems.

I was early to the party. It was 15 years before the Riksbank introduced an inflation target as a default option, after other alternatives based on a pegged exchange rate had been tried and proved unsustainable. The Riksbank then took the design of the new program of inflation target primarily from Canada, not from Knut Wicksell, although the Bank's management knew of Wicksell's rule.[17]

[15] See Jonung (1990). I was particularly pleased that Mancur Olson agreed to write the foreword.
[16] Jonung (1978).
[17] Jonung (1992).

My connection to UCLA took me back to Los Angeles after I finished my thesis. There I met Michael Bordo, a Ph.D. from Chicago. It was the beginning of a long collaboration that has continued to this day.[18] We share a deep interest in monetary history and monetary policy.

In 1985, I became a member of the SNS Economic Policy Council with Hans Tson Söderström as chairman and Ingemar Hansson, Lars Calmfors, and Johan Myhrman as collaborators. In three reports, we recommended a monetary policy based on rules. In our opinion, this was the path to a more stable, less volatile, Sweden. Our goal was to foster a novel approach to the framing of stabilization policy, breaking away from the Keynesian focus on discretionary policies. Sweden should choose a policy of low inflation, maintain a pegged exchange rate, and avoid devaluations. Growth should come through supply-side policies, that is, deregulation and increased competition.[19]

The Swedish policy of accommodation and devaluations was examined by researchers at a conference I organized on October 8, 1990—exactly eight years after the huge "superdevaluation" of 16 percent of the krona. The conference proceedings were published in a book titled *Devalveringen 1982 – rivstart eller snedtändning (The 1982 Devaluation: A Jumpstart or a Backfire?).* Bengt Assarsson, Klas Fregert, Per Frennberg, Thorvaldur Gylfason, Anne-Marie Pålsson, Lars Werin, and Clas Wihlborg, among others, contributed. I am pleased that all are participating in today's symposium. We collectively noted that the devaluation was both a jumpstart and a backfire.[20]

The SNS group's advocacy of rule-bound policies had a strong influence on the center-right government that came to power after the 1991 election with Carl Bildt as Prime Minister and Anne Wibble as Minister of Finance with the program *Ny start för Sverige* (*A New Start for Sweden)*.

In due course, I was offered the position of advisor to the new Prime Minister after the election of 1991. During the job interview, I wondered whether an advisor to the Prime Minister was even necessary: the Swedish economy appeared strong, and the new government was already committed to a rule-based framework and on supply-side policies. Still, I accepted the post.[21] I made one reservation to Carl Bildt: if he chose to introduce price controls, I would leave my

[18]Michael Bordo and I chose to study the velocity of money (the demand for money) in Bordo and Jonung (1987). This perspective complemented Friedman's and Schwartz's (1963) focus on the money supply. Michael and I later worked on the history of monetary unions and the evolution of monetary and fiscal regimes. See Bordo and Jonung (1997 and 2001).

[19]I later summarized the SNS Council's normative policy message and described its impact and weaknesses in Jonung (2015).

[20] Jonung (1991b).

[21] I also sought advice from Assar Lindbeck, who recommended that I decline the offer to become chief economic advisor to the prime minister. If you want to influence the shaping of policy, he told me, it is more effective to write op-eds in *Dagens Nyheter*, Sweden's leading daily newspaper. Later I served for several years as a columnist for that newspaper, with no noticeable policy effects.

post as advisor. My position reflected what I had learned from studying the price-control experiments of the 1970s. This was in the spring of 1992. How wrong could I have been? Six months later, Sweden found itself in its deepest economic crisis since the 1930s.

The crisis was an overwhelming experience. It felt as if I were in a room where the ceiling began to cave, then the walls collapsed one after another, and finally a black hole opened in the floor, swallowing everything into its depths.

The financial crisis of the 1990s, starting in September 1992, made it clear that the rule-based policy and pegged exchange rate did not serve as an anchor for the Swedish economy, but rather as a weight pulling it down. How does an advisor to the Prime Minister respond in such a situation?

In this case, the task was to explain the lessons of the 1930s crisis: how Sweden was rescued by abandoning the fixed exchange rate to gold, allowing the krona to float and depreciate. Yet the entire mindset of the decision makers, including the Prime Minister, the Finance Minister, and the Governor of the Riksbank, was shaped by a single conviction: never again should Sweden resort to the devaluations of the 1970s and 1980s to escape economic trouble. This created a rigid analytical framework, and consequently, a policy stance based on the interpretation of the most recent crisis.

The Governor of the Riksbank, Bengt Dennis, described me in his memoirs as a ticking time bomb. The management of the Riksbank was worried that my views would spread beyond Rosenbad, the office of the Prime Minister. I was sent to Lund for a while, which was appreciated by my family.

About two months later, in November 1992, the Riksbank abandoned its commitment to the fixed exchange rate, allowing the krona to float. This decision created the conditions for a rule-based monetary policy focused on price stability under a flexible exchange rate regime. In January 1993, the Riksbank formalized this approach, setting an inflation target of 2 percent effective from January 1995. Over time, Governor Bengt Dennis expressed strong approval of both the floating krona and the new policy framework.[22]

Witnessing the 1990s crisis from inside Rosenbad was a jolt, shocking yet strangely inspiring.[23] It was so inspiring that it sparked a determination to understand crises more deeply. After several years of research, that journey culminated in a book exploring how Swedish

[22] See the contributions in Jonung (2003).

[23] The press conference on 19 November 1992 at the Riksbank when Bengt Dennis announced that the krona was being floated was memorable. A feeling of failure dominated. No one saw at the time that this would be the start of a new stabilization policy regime. I told the Prime Minister that his chances of winning the 1994 election had now increased significantly. Unfortunately, the Riksbank did not follow up the floating exchange rate with a substantial reduction in the policy rate. Such a reduction would have brought Sweden out of the crisis more quickly.

stabilization policy has shifted under the pressure of crises. The book was partly based on interviews with policy makers.[24] Conducting the interviews was an experience in itself; many of those being interviewed could not quite remember when, where, how and why.

My research on crises did not end with that volume. It evolved into a project on the great Nordic financial crisis, culminating in a book published in 2009.[25] I tend to study crises ten to twenty years after they occur, admittedly a long lag. But as a researcher, distance in time is essential; it provides the perspective needed to understand the phenomenon fully.

Then I spent ten years as research advisor at DG ECFIN at the European Commission in Brussels, from 2000 to 2010, a job I landed because of my experience as advisor to the Swedish prime minister. It was fascinating to witness the birth of the euro, a new world currency, from inside the European Commission. Such an event does not take place very often.

My previous experience with economic crises proved valuable. Once again, I observed the tension between adhering to established rules and regulations, in this case, the EU's fiscal framework, which demands discipline and rule-based policy, and adapting to political realities. It turned out that short-term political incentives overwhelmed the long-term requirements for fiscal discipline. Those years taught me again that economic policy is not just about numbers and rules. It is about people, power, and priorities.

It was with some *schadenfreude* that I noted the outbreak of the euro crisis in 2010. If you do not follow the manual for a monetary union, you have to expect problems, sooner or later. Those responsible should have learned that *before* the crisis. Now they were groping for new rules *after* the crisis. They are still searching for the rules for fiscal policy that should guarantee a sustainable common currency.

After retiring as a Eurocrat, I returned to Sweden and took on the role of chairman of the Swedish Fiscal Policy Council from 2011 to 2013. It was an intellectually stimulating period. The challenge now was to safeguard a rule-based fiscal policy, an effort that reminded me of the earlier struggle for a rule-based monetary policy. I saw a crucial task: to warn about the financial imbalances that had been building in the Swedish economy since the mid-1990s. Experience had taught me that the greatest threat to sound public finances is a financial crisis.

During my tenure, no crisis erupted, but I often reflected on how fragile stability can be. My hope was, and still is, that the Council continues to raise warnings. When the next crisis comes, it should be able to say, "We told you so," and stand out as a forward-looking, credible authority that deserves to exist to preserve a collective memory of the dangers of fiscal and financial imbalances.

[24] Jonung (1999).
[25] Jonung, Kiander and Vartia (2009).

2. Ten lessons learned

This has been my "crisis journey" so far. Let me now summarize what I believe I have learned about crises and economic policy, with the reservation that I may change my mind in the future.[26] What follows is an impressionistic compilation, with a particular focus on Sweden.

Lesson 1. Crises serve as engines of innovation in economic policy

For society at large, crises serve as powerful catalysts for transformation. They open the door to new ideas, new policies, and often new political leadership. In their aftermath, elections typically remove those who governed during the turmoil. While crises impose severe short-term costs, sharp declines in output and surging unemployment, they can, paradoxically, generate long-term benefits. In the best cases, they lead to stronger institutions, more effective policies, and improved economic outcomes. Crises compel policymakers to search for alternatives, creating a rare *window of opportunity* in which measures once deemed politically impossible suddenly become feasible.

In this way, crises have been the driving force behind major shifts in Swedish economic policy. Politicians rarely embrace change until the pressure becomes irresistible. It is the crisis that compels transformation, acting as a catalyst for policy learning. The deeper the crisis, the more profound the change.

The crisis of the 1990s stands as a watershed moment in Swedish economic policy, arguably more significant than any other, even surpassing the world depression of the 1930s. The reason lies in its origin: the 1990s crisis was largely an internal one, triggered by financial deregulation and overheating during the late 1980s. In contrast, the 1930s crisis was externally driven, a consequence of international turmoil following the collapse of the international gold standard. In the 1990s, Sweden could not blame a hostile global environment. The fault was domestic, and only Swedish solutions could resolve it.

Crises have long been recognized as driving the development of economic theory. Financial crises reveal fundamental relationships and mechanisms that often remain obscured during periods of stability, when numerous confounding factors cloud the empirical picture. In times of crisis, attention converges on the core drivers of macroeconomic dynamics and instabilities, most notably the volume of credit and the behavior of real interest rates, thereby offering unique opportunities for theoretical advancement and empirical insight.

When I was asked in Brussels before the euro crisis what slow-growing EU member states should do to achieve the same high growth as Sweden, my easy answer was: first create a deep

[26] Reading my lessons learned more than ten years after writing them down, I now feel compelled to emphasize the importance of confronting a crisis with a flexible exchange rate for the krona.

crisis. After the crisis, there will be acceptance of policy reforms that are not feasible under "normal" times.

Lesson 2. Indicators of financial crises are often disregarded as time passes

Every major financial crisis has historically been preceded by a period of rapid credit expansion and persistently low interest rates. The financial crisis of the early 1990s demonstrates that prolonged periods of expansive credit policies and low real interest rates, such as those observed in the late 1980s, tend to generate significant financial imbalances.

These insights are often forgotten over time. Since the mid-1990s, Sweden has experienced sustained growth in credit and asset prices, accompanied by a steady decline in interest rates. Despite this longstanding trend, neither the Riksbank nor the government has taken decisive action to counteract these developments. After two decades of accumulation, the financial system is now moving toward increasingly severe imbalances. It appears that policymakers tend to disregard the historical experience.

Lesson 3. In macroeconomic policy, nearly every idea comes back in time.

We often conceive of intellectual development as a linear process: knowledge accumulates gradually through new findings, theories, and experiences, leading to greater wisdom and insight. This is an appealing image of progress through continuous learning. In macroeconomics, such a process does exist, but it is complemented by another dynamic, namely a pendulum-like movement between polar cases.

Old ideas repeatedly resurface. Theories once dismissed as obsolete tend to return after long and variable lags. Indeed, one might argue that remaining steadfast in a particular position, without adapting to contemporary fashions, can eventually render that position relevant again, perhaps after 40 or 50 years. When the pendulum swings back, those who held on may be celebrated for foresight and wisdom, at least until the cycle reverses again.

Let me give you some examples of old views that have been revived recently. I am skeptical of all of them. Once upon a time, I challenged these ideas in my research and writings. In my optimism, I hoped that they were dead and long forgotten. Unfortunately, that hope was misplaced. Now they are coming back, sometimes with surprising force and vigor.

a. Credit policy is back

Since the financial crisis of 2008–09, regulatory attention has increasingly shifted to the asset side of commercial banks, particularly to the composition of their lending. This shift is taking place under the banner of "macroprudential regulation". The regulatory framework has grown ever more complex as different categories of bank lending are assigned varying risk weights, notably through the various Basel agreements.

There is a risk of entering a vicious cycle of increasingly detailed regulations of the assets of commercial banks that could leave the financial system paralyzed as was the case in Sweden in the post-World War II period prior to the financial deregulation. It is not only the Riksbank that is moving in this direction; it is also Sweden's Financial Supervisory Authority.

b. Trust in fine-tuning is back

Stabilization policy was once built on the conviction that fine-tuning could deliver economic stability, primarily through fiscal measures. Policymakers believed that, with carefully calibrated interventions, they could steer the economy with precision.

This view collapsed in the 1980s and 1990s. Experience taught us that fine-tuning was a mirage, and the consensus shifted towards "coarse-tuning"; broad, rule-based frameworks that acknowledged the complexity of the dynamics of the economy.

Still, we see a troubling resurgence of faith in fine-tuning, this time in monetary policy. The Riksbank is castigated for missing the 2 percent inflation target by mere fractions. Deviations of a few tenths of a percentage point, such as those between 1997 and 2011, were treated as monumental failures. This obsession with precision risks turning monetary policy into an exercise in false exactitude, diverting attention from the bigger picture: long-term stability and resilience.

Viewed against the backdrop of the high and volatile inflation of the 1970s and 1980s—often reaching double-digit levels—this criticism appears disproportionate. Neither monetary nor fiscal policy can reasonably be expected to operate with exact precision. It is also important to recognize that economic statistics lack the accuracy and availability required to conduct fine-tuning policies.

c. Full employment is back as a goal for monetary policy

During the 1970s and 1980s, the Riksbank sought to maintain full employment through an accommodative monetary policy, relying extensively on recurrent devaluations. This strategy ultimately produced high and volatile inflation and contributed to weak long-term economic growth.

In response to these outcomes, the Riksbank was granted independence in the 1990s from the executive branch and assigned a mandate centered on maintaining low and stable inflation. Responsibility for employment policy was transferred to institutions other than the central bank.

Today, that is in the early 2010s, some economists, policymakers, and trade unions were once again urging the Riksbank to address unemployment—despite substantial historical evidence indicating that its mandate is best focused on nominal variables such as the rate of inflation and the money supply.

d. *The original Phillips curve is back*

The argument that the Riksbank should adopt employment as an explicit policy objective is reinforced by the revival of another previously discarded idea: the belief in a stable Phillips curve. When this relationship gained prominence in the 1960s, it strongly influenced Swedish economic policymaking, particularly in the area of labor-market policy.

However, once the critique advanced by Milton Friedman and Edmund Phelps, highlighting the decisive role of inflation expectations, was fully recognized, confidence in the simple Phillips curve largely disappeared. Today it re-emerges indirectly through the assumption that the Riksbank has effectively anchored inflation expectations at its 2 percent target. If expectations are presumed to remain fixed, they can be disregarded, and a seemingly stable Phillips curve reappears, one that policymakers might believe can be exploited through more expansionary monetary policy as long as inflation remains on the target.

Such reasoning simultaneously overlooks another well-established insight from the 1970s and 1980s summarized in the Lucas critique and Goodhart's law. Both emphasize that empirical relationships used as a basis for economic policy tend to break down once policymakers attempt to exploit them systematically.

e. Which outdated macroeconomic idea will return next?

From a long-run perspective, seemingly well-established current macroeconomic principles should be viewed as provisional. We should expect them to be outdated in due time. With this in mind, let me propose five candidates for future reconsideration.

- The Riksbank should not be independent because fiscal and monetary policy should be integrated and coordinated.
- Rule-based policies should be abandoned because new circumstances show that they are insufficient.
- Exchange controls should be reintroduced to make it possible to better manage the Swedish economy.
- The floating exchange rate of the krona should be replaced with a pegged but adjustable rate because the floating rate does not provide the monetary policy autonomy that we once imagined.
- The allocation of credit and asset markets should be regulated more strictly, as in the 1950s, to bolster financial stability.

We just have to wait until the pendulum swings again. Then we will know which of the above points will be recycled and become part of tomorrow's dominant macroeconomic view. In the meantime, we can prepare by updating our arguments from past controversies in macroeconomic policy.

Lesson 4. Policy reforms have unexpected consequences

I was early in proposing and arguing for financial deregulation, the abolition of exchange controls and a monetary policy based on inflation targeting. At the time, I saw only the potential gains, greater efficiency, higher growth, and increased economic stability. In many respects, deregulation did indeed yield positive results.

However, I underestimated the severity of the transition problems that could arise, including the risk of a deep financial crisis. Moving from one institutional regime to another is far more difficult than I originally assumed.

I also shared a belief, common among many economists, that a modern financial system is inherently stable. Over time, I have become more pessimistic. The financial system is *not* naturally stable; disturbances can emerge from within. I underestimated the "power of credit" and the destabilizing potential of highly advanced financial markets. I also failed to fully appreciate how certain forms of financial innovations can be profoundly disruptive.

My argument for an inflation target also contains a weakness in hindsight: I did not sufficiently consider the distinction between asset price inflation and consumer price inflation. My defense, if there is one, is that neither did Wicksell nor the Swedish economists who argued for price level stabilization in the 1930s paid attention to asset prices. Wicksell's cumulative process model includes no financial markets beyond the banking system; all changes in the volume of credit have an impact on consumption prices, never on asset prices.[27]

The broader lesson is clear: even when reforms rest on sound arguments, they often unfold in ways we are not able to anticipate. We should bear this in mind whenever we advocate policy reforms.

Lesson 5. Forecasts are at their worst when they are needed most

The idea of fine-tuning the economy rests on the assumption that forecasting can be precise. I lost this belief early in my career, during my time at *Konjunkturinstitutet,* the National Institute of Economic Research, in 1981–82. A veteran chief forecaster once told me that, over his many years at the institute, only one forecast had ever been numerically correct: a prediction in the late 1950s that household savings would rise by 1.9 percent. The actual outcome was 1.9 percent, except savings *fell* rather than rose with that number. The number was right, but the sign was wrong.

Later, during the crisis of the early 1990s, when I found myself in Rosenbad at the center of events, I observed the same pattern again. In a downturn, forecasts were consistently far too optimistic; during recovery, they were consistently too pessimistic.

[27] I elaborate on this argument in Jonung (2025).

In 2000, I joined the Directorate-General for Economic and Financial Affairs at the European Commission in Brussels. At one of my first meetings with the Director-General, I delivered a brief speech on why the directorate should not place its hopes in forecasting. Drawing on theory and experience, I presented forecasting as an essentially hopeless endeavor. The speech gave me a few months of relative peace at work, until I realized that my German Director-General was deeply committed to forecasts, and that forecasting was, and has remained, a central part of the directorate's work.

The lesson is simple: we need forecasts, but they are least reliable just when we depend on them most—during crises.

Lesson 6. Economic history: a guide to better macroeconomics

The farther back you can see, the farther forward you are likely to see. Churchill's remark is one I frequently use to highlight the importance of economic history when evaluating present economic policy choices.

When I first arrived in Lund, I was told at a seminar that bad mathematicians become economists, bad economists become economic historians, bad economic historians become historians, and bad historians become priests. The pecking order was clear.

Now, however, I would argue the opposite: a bad macroeconomist can become a good one by simultaneously becoming a decent economic historian. Economic history provides the only credible empirical foundation for macroeconomics. Sophisticated calibrations of economic models may offer elegance, but they rarely offer conviction. It is far more persuasive to support or criticize a macroeconomic policy measure by showing that a similar measure has been tested before and demonstrating how it worked in practice.

The lesson is straightforward. The evidence from economic history, properly interpreted, outweighs all theoretical refinements.

Lesson 7. History of economic thought: a guide to better macroeconomics

Hans Tson Söderström sometimes asked why I spent so much time studying the work of past economists instead of focusing on contemporary theoretical advances. My response was always the same: these earlier economists developed many of the concepts we now classify as modern, especially in macroeconomic theory. Appreciating the intellectual context in which their ideas were formed greatly enhances our ability to evaluate their present significance.

Moreover, when a macroeconomic theory appears to be primarily a theoretical construction in search of an empirical application, we should approach it with caution. The history of economic thought reminds us that theories grounded in real economic experience tend to endure, while purely abstract formulations often do not. Studying the evolution of macroeconomic ideas is therefore not an antiquarian exercise; it is a rational tool for becoming a better macroeconomist.

Lesson 8. All rules should have an escape clause

Having worked extensively with monetary and fiscal policy rules, I have learned that every rule should include an escape clause: an emergency exit for situations when events unfold in exceptional ways. Such a clause should function as a safety valve when the unexpected happens: shocks, disruptions, or crises that no designer of rules can reliably predict.

If Sweden were to face a crisis as severe as those of the 1930s or 1990s, the monetary and fiscal frameworks must allow for temporary suspension. In a deep crisis, the public sector must be able to act as a shock absorber. Budget deficits must be allowed to rise when necessary, and the Riksbank must retain the ability to stabilize the financial system through generous support.

Of course, the challenge is to determine *when* an exception is justified and *who* should decide. The emergency exit should not become the main entrance. Sound judgment is essential for deciding when the moment has truly come to deviate from established rules.

Lesson 9. The anecdote explains economic policy

Economists are trained to think in terms of coherent systems, formal models, and general patterns. We tend to dismiss anecdotal evidence as irrelevant. Over time, however, I have come to see anecdotes as invaluable for understanding how economic policy is actually made.

I learned this lesson during the long lunches and coffee breaks at the Department of Economics in Lund in the 1970s and 1980s, where Ingemar Ståhl—ever present in the coffee room—presided over lively discussions. Grand ideas about how to solve the world's problems were often punctured by a single well-chosen anecdote. These informal seminars shaped both my view of economic policy and my broader Lund perspective on society.

Let me use three examples to illustrate how anecdotes reveal the mindset of policymakers.
First, I once asked Gunnar Sträng why, as Finance Minister, he was such a firm supporter of credit regulations, despite their negative impact on many citizens. His answer was telling: "We couldn't just let the ordinary worker borrow as much as he wanted; then he might go out and buy alpine skis for his children." The comment revealed the deep paternalism embedded in social democratic thinking. In the same interview, Sträng expressed satisfaction that he personally decided whether *Handelsbanken*—or any commercial bank—was allowed to open a new branch in a small town.

Second, when I wrote my essay on Swedish price stabilization policy in the 1930s, Erik Dahmén told me an anecdote about Erik Lindahl, who helped design the consumer price index used by the Riksbank.[28] Lindahl had such faith in the power of monetary policy that he was prepared to turn to the head of the Riksbank to propose a policy change if the second decimal of the consumer index had moved. Nothing better captures the optimism in the early 1930s held by a leading proponent of the price level stabilization of the Riksbank.

A third anecdote comes from September 1992, shortly after the Riksbank raised interest rates to 500 percent. On my way to the Swedish embassy in Washington to explain the fixed exchange rate policy of the Riksbank, an embassy official asked if I had heard that the mafia had sent a delegation to Stockholm. "Why?" I asked. His reply: "They want to learn how to charge 500 percent interest legally." The story perfectly illustrated how difficult it was to contain currency speculation through extreme monetary tightening.

These examples from my experience show why anecdotes matter: they reveal the assumptions, attitudes, and blind spots shaping economic policy, insights no model can capture.

Lesson 10. Preparing students for economic crises

Economists should introduce students to economic crises as early as possible at the undergraduate level. Our goal is to prepare them for the crises they will inevitably encounter during their lifetimes—something we cannot achieve with the fair-weather, equilibrium-focused models that dominate standard macroeconomics textbooks.

Traditional textbooks devote little attention to crises.[29] This stems from a longstanding tendency among economists to treat crises as abnormal events, exceptions that fall outside the core theory and therefore need not be emphasized in teaching. Nothing could be more misleading. As long as we operate within a modern credit-based financial system, crises should not be viewed as anomalies but as recurring features of economic life.

We owe it to our students to prepare them for a future of crises. Understanding crises should not be viewed as an optional addition to macroeconomics; it should be central to the understanding of how the economy actually evolves.

3. The future

Now that I have looked back, let me conclude by looking forward. I remain an optimist. Another crisis will come, we just do not know when, how, where, or why. But it will come. And when it does, we macroeconomists will again face our familiar challenges: explaining why we did not warn in time, why our models and theories failed to provide the guidance we hoped for, and why we must continue to deepen our research on crises.

[28] See Jonung (1979).
[29] Klas Fregert's and my macro book, Fregert and Jonung (2014), gives considerable space to financial crises in the book's longest chapter.

I am grateful that I chose to become a macroeconomist, and that you chose to attend this conference on *Macroeconomic Policies in Crisis*.[30] I look forward to meeting you again at the conference in Lund that will surely follow the next major economic crisis, when it arrives.

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[30] Perhaps I should emphasize how fortunate I have been in choosing to work as an economist engaged in public debate in Sweden. Few countries can match Sweden’s strong and longstanding tradition of economists participating actively in public discourse, contributing not only to academic discussions but also to the broader shaping of policy and public opinion. See here Jonung (1992).

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