

The effects of the financial crisis of 2007-2008 on the economy of Finland

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<p>This thesis aims to answer how the global financial crisis of 2007-2008 affected the economy of Finland. This is done by considering the crises that followed it. The study is demarcated to include major developments until 2013. Beyond 2013, the financial crisis cannot be considered a relevant cause of developments yet due to the complexity of the economy.</p> <p>The thesis attempts to give information on how Finland as part of the European Union and the euro area related to the state of its economy in crisis, and how much Finland's economy suffered compared to similar economies. The origin of the crisis, as well as the effect of the crisis on Finnish companies and on the tightening of financial regulations, are dealt with as well.</p> <p>The basics of Finnish economy and terminology are given so that people interested in the content but less acquainted with economics can understand most of the content. At best, the thesis attempts to be similar to a guidebook.</p> <p>As Finland suffered two recessions, in 2007-2008 and 2012-2013, Finland's GDP statistics from mainly 2008-2012 were compared to the European Union in general and its western neighboring country, Sweden. The results from this process were that Sweden was successful in avoiding most of the crisis due to not belonging in the euro area.</p> <p>Large Finnish multinational companies were not affected as greatly as their large staff reductions would suggest. Instead, the companies were only implementing their internationalization plans and expanding abroad, which could be easily misattributed as a fault of the crisis.</p> <p>Financial supervision was tightened in the years following the crisis. New, more powerful European financial supervision authorities were founded.</p> <p>Finland's first recession was worse than that of European Union countries in general, but its second recession was not especially damaging and it managed to maintain a high profile by keeping its AAA credit rating in the demarcated timeframe as one of the only three countries in Europe.</p> <p>Finland's comparatively steep recession seems to have been largely caused by its export structure being based on investment goods, and due to being part of the euro area.</p>	
Keywords economy of Finland, financial crisis, recession, Great Recession, economic interdependence, euro area, Eurozone	

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1 Introduction

The aim of this thesis is to analyse how the financial crisis of 2007-2009 affected the economy in the state of Finland, in Northern Europe. Finland, as part of the European Union, is provided certain stability and its membership lessens economic restrictions especially for a country that is somewhat remote. This connection is deeper than usual economic unions due to the fact that it shares the currency euro with many of those countries, making up the euro area.

1.1 Research topic

Economic decline is the general topic of this thesis. This thesis views a recession by definition as recession of GDP rather than that of employment or purchasing power parity. That is similar to the most prevalent view of economics.

The research question of this thesis is similar to the thesis title. It is just a matter of expressing it as a question: *How did the financial crisis of 2007-2008 affect the economy of Finland?*

The thesis focuses on trying to explain how much Finland was affected by the crisis by looking solely at its GDP as an indicator. It is about identifying recessions as defined by the term itself and comparing Finland's GDP to the GDP of similar countries.

As the financial crisis occurred in 2007-2008, this thesis does not attempt to cover events from 2013 onward. The reason for this is that developments occurring after that time could be also due to the European sovereign debt crisis which is only in part caused by 2007-2008 financial crisis, as well as any other events in economy like, for instance, the Russian bans of imports in August 2014. Up to 2013, the cause and effect are reasonably clear and the thesis attempts to cover the developments of those years.

This topic was chosen as it has undoubtedly attracted great media attention and influenced making of policy. The underlying mechanics of the economy are difficult to understand, and despite the severity and global nature of the crisis, any seemingly comprehensive or concise material are few in number. Due to the lack of suitable books and the quite objective nature of economics, I considered articles in financial newspapers reliable. In a way, the thesis attempts to provide reasonable insight into the topic of Finland's economy. It is demarcated to Finland rather than larger workings of European economy, due to the topic being of reasonable size and suiting my education.

The theses for GLOBBA program which I attend at the time of writing must be international in nature. This thesis measures the economy of a single country in GDP, by considering how international or even global phenomena are affecting it. It considers how the economic interdependence of countries, especially in an economic union like the euro area, has affected Finland as one of its member countries. Due to these reasons, this thesis is definitely international in nature.

1.2 Investigative questions

The investigative questions, which the thesis tries to answer and used to analyse the crisis are as follows:

- How much Finland did Finland suffer from the financial crisis of 2007-2008 compared to other countries of Europe?
- How was the economy of Finland in the aftermath of the financial crisis as in to what extent could it be considered stable and/or healthy?
- How highly regulated has the financial sector become following the crisis from the perspective of Finland?

1.3 Background

Financial crisis of the year 2007 was a global banking and financial crisis. The crisis began in United States, caused by numerous factors and their complex interplay. These were the long period of low interest rates as set by the central bank of United States reckless mortgage lending pressured by the United States federal government for people unable to pay back, great willingness to take risk from financial institutions and investing at tens of times of accounting leverage, serious flaws in financial supervision, lack of transparency in the hugely expanded derivatives market, tax benefits for mortgage loans and loopholes in legislation. (Roberts 2008; Sokala 2009.)

For the prevalent views of economics and economic policy the progress from 2008 to 2012 was a complete surprise. According to these views, the financial crisis should not have come to pass. In fact, the wrong belief that modern economy, efficient financial markets and sophisticated risk management had made big crises a thing of the past had

strengthened in the decades leading up to the crisis. (Niiniluoto, Vilkkio & Kuorikoski 2013, 20.)

1.4 Explanation of Finnish economy

This chapter focuses on what kind of an economy Finland is considered to have. This is to allow people who are less familiar with it to have some context into what this thesis is about.

Finland is a modern state. As stated by CIA World Factbook,

“Finland has a highly industrialised, mixed economy with a per capita output equal to that of other western economies. Trade is important, with exports accounting for over one-third of GDP in recent years.”

Fellman, Iversen, Sjögren & Thue (2008, 31) consider there to be a model named Nordic capitalism. It is characterised by

- large public sector
- generous welfare systems
- high level of taxation
- successful state owned companies
- high degree of consensus
- gender equality
- equal opportunities to free education
- high levels of human capital
- low corruption
- policies supporting labour supply by means of income-based transfers and publicly subsidised welfare services
- compromise thinking
- corporatism with centralised but yet open state
- bureaucracy that is professional but not authoritarian.

The standard of living in Finland ranks among the top 15-20 countries in the world (Kokkinen, Jalava, Hjerpe & Hannikainen 2007, 52). It was one of the best performing economies within the EU in recent years. Things changed for the worse in 2009, when it experienced a hard contraction due to financial crisis. (CIA World Factbook)

Further globalization and freedom of trade has had an impact. The portion of foreign trade in production has grown significantly in all developed countries. Such is also the case with Finland. A lot of the production in general is intended for foreign trade. (Bank of Finland 2011, 18)

Finnish export structure is focused towards investment goods exports, essentially machinery. After around 2005, the demand for numerous IT industry related products was

driven up by the global economic boom. Among them were technology for mobile phones as well as promotion of startups in the ICT, gaming, cleantech, and biotechnology sectors. Even while the share of service exports is comparatively large, its share in most industries is still quite small. (Bank of Finland 2011, 18; CIA World Factbook.) In exports Finland ranks 30th among the countries in the world at about 0.7% of total world exports. For many products its position is much better than that. Those products include, for example, electronics, machinery, paper, cardboard and fur exports. (Hautala 2003, 215-216.)

Finland depends on the importing of raw materials, energy, and some components for manufacturing, with the exception of timber and several minerals. Agricultural development is limited due to its climate, and aims to maintain self-sufficiency in basic products. Forestry doubles as a secondary occupation for the rural population and an important export earner. (CIA World Factbook)

Longer-term, Finland must address a few issues. These are its rapidly aging population and decreasing productivity in traditional industries that threaten competitiveness, fiscal sustainability, and economic growth. (CIA World Factbook)

2 Theoretical framework

This framework of the thesis is based mainly on economics with some aspects concerning finance. Note that the title of this thesis refers to the 2007 financial crisis which is the origin of the crises. However, the crises that followed it were economic rather than financial in nature.

2.1 Themes

One topic of great relevance to this thesis is economic interdependence. Economic interdependence means two things in the context of international relations. First, countries are considered interdependent if their economic conditions are contingent on those found in others. Second, countries are considered interdependent if it would be costly for them to break off or relinquish their relationship. (Mansfield and Pollins 2003, 11.)

There are also terms commonly associated with economic decline, or that are relevant in the context of this thesis. Those terms are clarified in the next chapter for the sake of easier understanding.

2.2 Terminology

GDP stands for gross domestic product. It is the monetary value of end products produced in an economy in one year period. (Koskela & Rousu, 2007)

A recession is defined as a significant decline in activity across the economy, lasting longer than a few months. It is visible in industrial production, employment, real income and wholesale-retail trade. A common definition for this is contraction in the GDP for six months (two consecutive quarters). (Businessdictionary a.; Investopedia a.)

A depression is a severe and prolonged downturn in economic activity. In economics, a depression is commonly defined as an extreme recession that lasts for a number of years. A depression is characterized by economic factors such as substantial increases in unemployment, a drop in available credit, diminishing output, and general lack of confidence. (Businessdictionary b.; Investopedia b.)

It is worth mentioning in the context of this thesis that Finland's depression of 1991-1993 had a deep effect on the economy of Finland throughout the 1990s, especially in terms of employment but also in culture, politics, and the general socio-political atmosphere. (Sapinen 1996) Because of that, economic crises are of particular interest to people of Fin-

land. Also, in the observed time period of 2007-2013 in this thesis, it is not commonly agreed that there was any kind of depression.

Euro area means countries which have adopted euro as single currency. (Publications Office of the European Union, 7.3.1.) The term euro area is much less used than the unofficial term Eurozone, which is synonymous with it, and refers to the same group of countries.

3 Methods

The methods used in this thesis were desktop research methods. What it means is that I did not conduct surveys or interviews of any kind, and the information was researched from news and literary sources.

The thesis used GDP data from Eurostat, for which a Web address can be found in the references of this thesis. This data was used to produce the graphic figures which allow this thesis to better visualize the recession periods.

The figures of this thesis have the Eurostat specifications mentioned in order to recreate them if needed for further study. For example, for Figure 1, the description of Figure 1 is followed by the data range and settings were chosen in Eurostat:

Figure 1. GDP changes in Finland and EU27 during timeframe in which Finland's economy was affected by financial crisis.

Seasonally adjusted and adjusted data by working days. Million euro, chain-linked volumes, reference year 2005 (at 2005 exchange rates). Gross domestic product at market prices.

The research in the rest of this thesis is based on mostly financial newspaper articles published online, as they tend to have rather generally accepted economic views. Some information and sources for terminology, background etc. which helps create a context to the reader is also from books and official reports.

4 Results

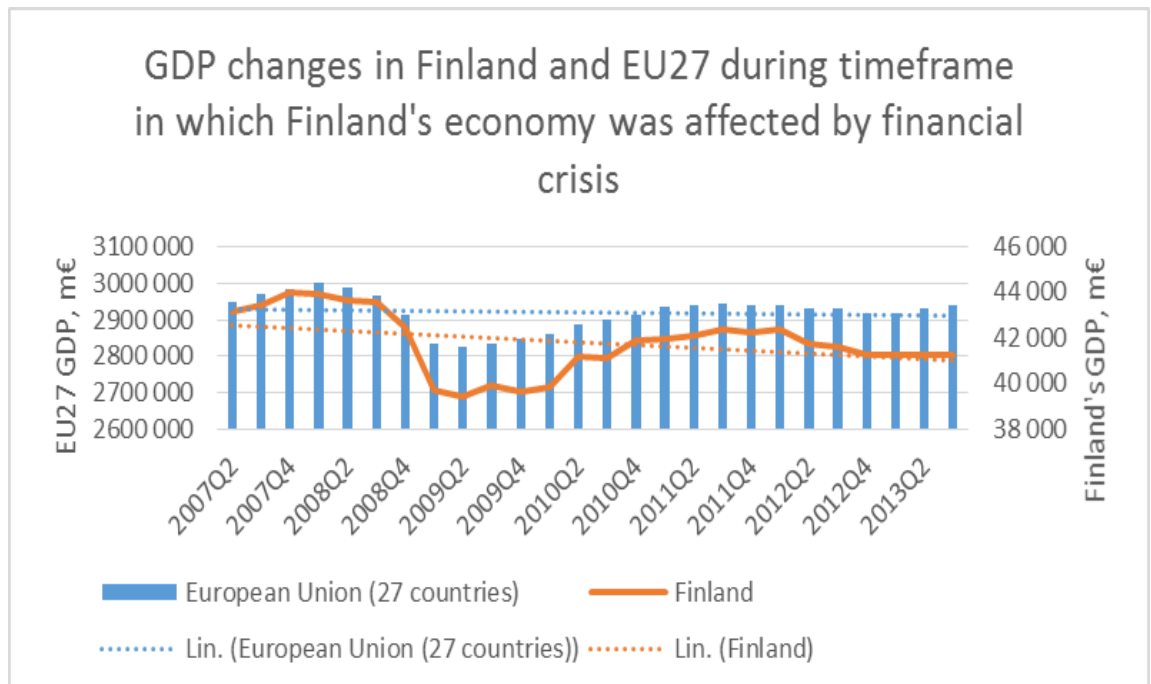
This chapter shows the results provided by the analysis of GDP data. The method used was outlined in the previous chapter. This chapter provides results to the investigative questions which are then discussed in the next chapter.

4.1 Effects of the crisis on the economy of Finland

This subchapter focuses on how Finland suffered from the financial crisis in terms of its overall economy. I decided to compare Finland here with EU in general as it existed in 2007, as the EU is comprised of an economically interdependent geographical region with similar economies, most of them using the same currency.

4.1.1 The overview of changes in Finland's GDP 2007-2013

Finland experienced two recessions after the financial crisis. The first one was the more severe one. It took place from Q1 (first quarter) of 2008 until Q2 of 2009, meaning it lasted for 18 months. The second recession was years later, from Q2 of 2012 to Q1 of 2013, lasting for 12 months. Out of the European countries with quarterly GDP data, only Poland, Slovakia and Moldova did not have a recession during this period. (OECD Stat Extracts)



Source: Eurostat

Figure 1. GDP changes in Finland and EU27 during timeframe in which Finland's economy was affected by financial crisis.

Seasonally adjusted and adjusted data by working days. Million euro, chain-linked volumes, reference year 2005 (at 2005 exchange rates).

Gross domestic product at market prices.

Figure 1 uses data from two quarters prior to the beginning of Finland's recession in order to show comparison to EU's 27 countries as it existed in 2007, and likewise two quarters after the second recession. The guideline / dashed line allows seeing the general trend of Finland's GDP when compared to EU as a whole. As a result, given this period of time that is slightly prolonged from both ends, Finland's economy clearly took more of a negative impact than EU as a whole.

Figure 1 suggests that Finland was also having trouble recovering from the crisis. Its GDP did not really grow while the EU as a whole had its GDP increase.

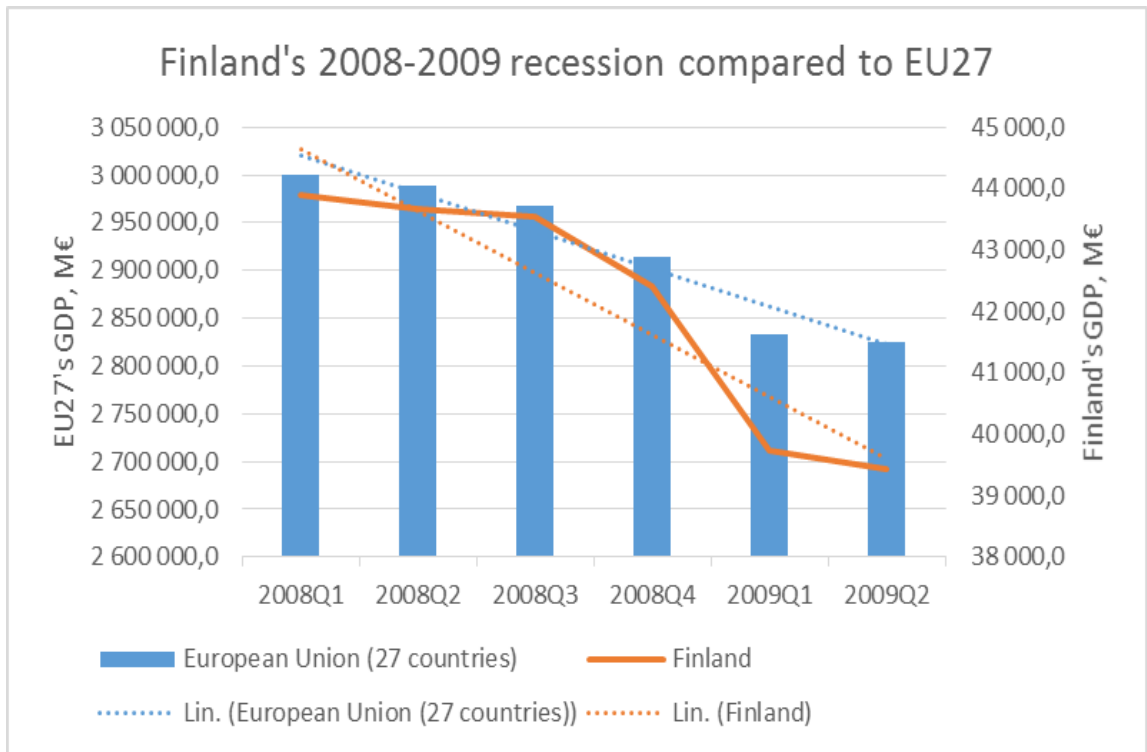
After looking at the larger timeframe, the recession periods are clear. It is only logical to follow it with a closer look to how Finland suffered in comparison to EU in the specific recessions.

4.1.2 Finland's first recession as part of Great Recession

As stated in World Economic Outlook April 2009 (International Monetary Fund 2009, 32),

“The difficult and highly uncertain short-term outlook underlines the need for policymakers to act decisively to deal with a severe global recession that has taken on dangerous dimensions despite wide-ranging efforts.”

The recession data for the overall G20-zone, representing 85% of all GWP (gross world product), depict that there existed as a global recession throughout Q3-2008 until Q1-2009 (OECD Stat Extracts). Europe had the first victim of global recession, with Ireland being the first country to fall in a recession that took place Q2-Q3 2007 (OECD Stat Extracts). The global recession of 2007-2009 became to be called Great Recession (Rampell 2009).

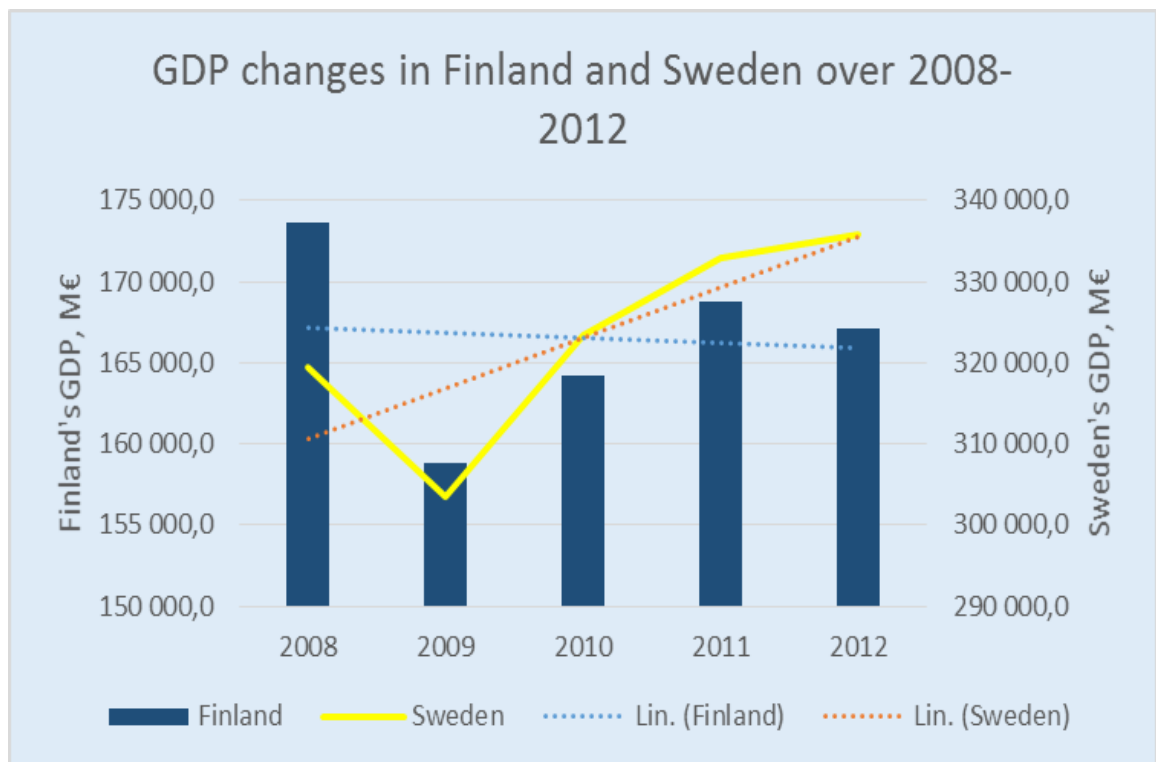


Source: Eurostat

Figure 2. GDP changes in Finland and EU27 during Finland's 2008-2009 recession. Seasonally adjusted and adjusted data by working days. Million euro, chain-linked volumes, reference year 2005 (at 2005 exchange rates). Gross domestic product at market prices.

As seen here, Finland's recession that took place from Q1-2008 to Q2-2009 was more severe than that of EU in general. Coming into 2009, Finland's GDP fell 6% in a single quarter. Such a fall would be a major hit to any economy.

It could be said that by being economically interdependent with EU, Finland was bound to experience Great Recession. However, only being part of EU does not explain it, since the fall is too steep. In order to analyse the extent to which belonging to the euro area is the cause of Finland's recessions, it should be compared to another country. Finland's western neighbouring country Sweden belongs to the European Union but does not belong to the euro area. That puts it in a curious position to compare against. Sweden is still economically interdependent of Finland, but not as much as Finland is to middle Europe due to the common currency. However, 75% of foreign trade of Sweden is to Europe (SwedenAbroad). It is also a similar country with Nordic capitalism. That means that the simplest explanation for any differences in these countries' GDP growth is the fact that Finland belongs to the euro area.



Source: Eurostat

Figure 3. Differences in Finland and Sweden's GDP between 2008 and 2012. Million euro, chain-linked volumes, reference year 2005 (at 2005 exchange rates). Gross domestic product at market prices.

The hit in Finland's GDP was more severe than Sweden's. While Sweden took a hit going into 2009, Sweden recovered far better from the crisis, even rising to 7% above its 2007 GDP in 2012 while Finland was unable to match its own 2007 GDP when comparing their recovery up to 2012. (The Economist 2012.)

As seen in Figure 1, Sweden's growth overall negatively correlates with Finland. It seems clear that being part of the euro area greatly affects Finland.

In developed countries growth turned out slower than previously, and in many countries unemployment stayed at significantly high levels. Emerging economies recovered faster from the crisis, and their growth rate reached the former levels. (Bank of Finland 2010, 8.)

The global financial crisis emerging in 2008 would eventually lead to other crises. The crisis of confidence in the financial markets made it difficult for the most financially unstable states to get loans, which gradually led to increasing problems for banks and grew the need for governments to take on more debt. Financial markets soon started to doubt the ability to pay of the financially unstable countries, which led to the European sovereign debt crisis that took place in 2010. (Niiniluoto, Vilkkio & Kuorikoski 2013, 20.)

4.1.3 European sovereign debt crisis

Shocking news originated in Greece in 2009. Following the general election in October 2009, the new Greek government released a revised 2009 budget deficit forecast of 12.7 percent of GDP. It was especially troubling due to being double the previous estimate of 6.0 percent. In addition, Greece had masked its deficit and debt levels which were then revised to show significantly larger deficits. Revealing such an absolute violation of the fiscal rules regarding euro for Greece was interpreted strongly in political narrative. Fiscal irresponsibility of the peripheral nations became the focus of the narrative, but it was misdirecting – the more important factors were the underlying financial and macroeconomic imbalances. (Lane 2012, 56.)

On 3 February 2010, the European Commission considered the means for Greece to balance its budget deficit and to improve its competitiveness. In March 2010 Eurogroup Heads of State or Government agreed that, if necessary, they would support Greece with bilateral loans as well as financing from the International Money Fund. Greece submitted an official loan request to those countries and IMF on 23 April 2010. On 2 May 2010, euro area finance ministers agreed that they would activate stability support to Greece. Later Finnish Parliament approved Finland's share of the financial package of EUR 1.6 billion extended to Greece. (Bank of Finland 2010, 129-130.)

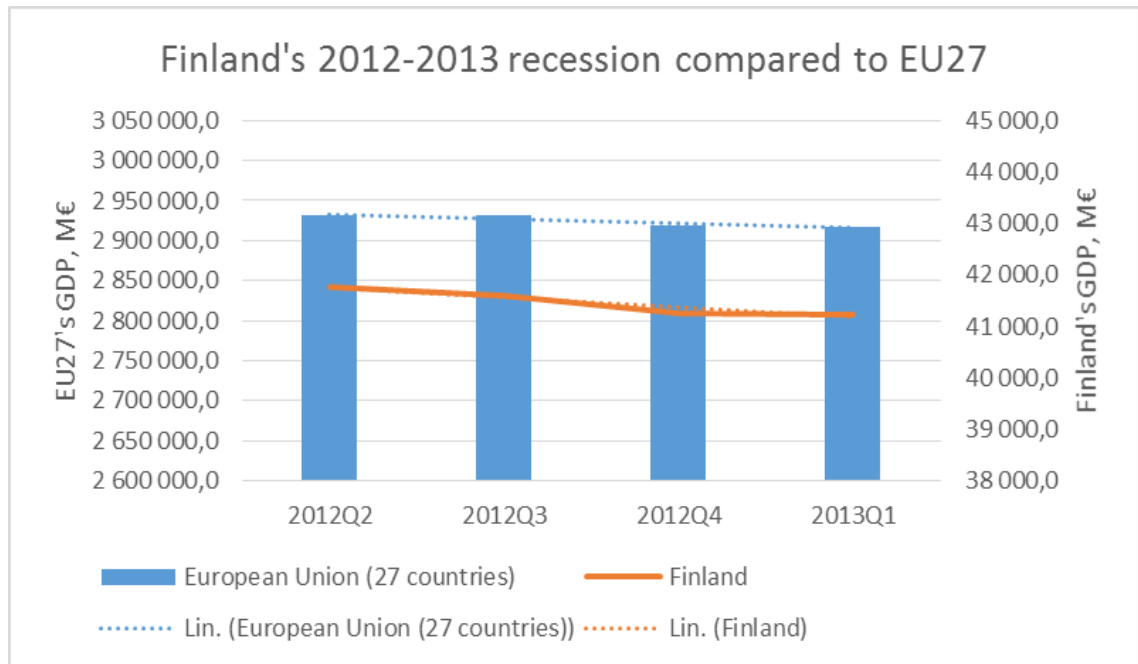
While the first and most in need of financial assistance among EU countries was Greece, assistance also needed to be provided to Ireland, Portugal, Spain and Cyprus in the following years. Out of them, only Cyprus is still being financially assisted. (European Commission)

Finland's economy was affected due to the fact that it had to borrow money to fiscally more unstable or irresponsible countries in order to keep the euro area more stable. However, the impact of the acknowledged troubles of Greece and others affected Finland beyond simply borrowing. The euro area was deeply interdependent, and the troubles in one country reflected to others. Due to this difficulty, Finland faced a second recession beginning in Q2-2012.

It should be noted that while Finland has since lost its AAA credit rating (AAA being the best), in 2013 it maintained high profile. It was one of the only three EU countries with AAA rating along with Germany and Luxembourg. (Business Insider 2013)

4.1.4 Finland's second recession due to European sovereign debt crisis

The repercussions of the European sovereign debt crisis caused Finland to enter recession in Q2-2012, ending in Q1-2013.

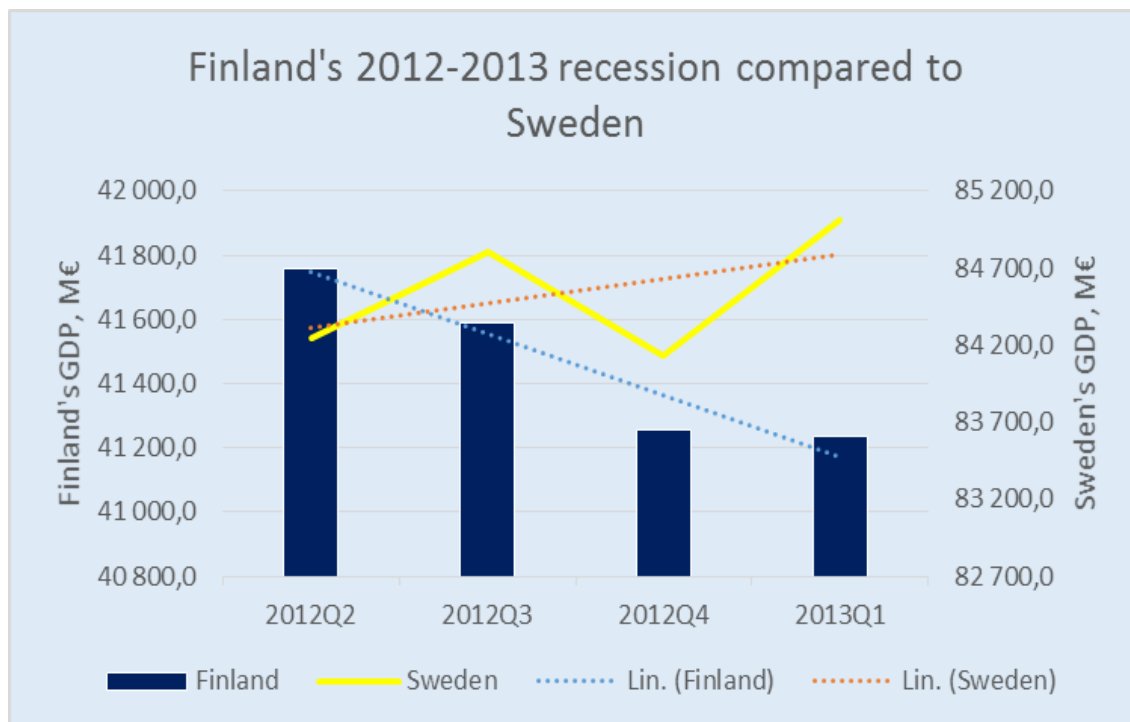


Source: Eurostat

Figure 4. GDP changes in Finland and EU27 during Finland's 2012-2013 recession. Seasonally adjusted and adjusted data by working days. Million euro, chain-linked volumes, reference year 2005 (at 2005 exchange rates). Gross domestic product at market prices.

The 2012-2013 recession of Finland did not see a huge fall in GDP. Finland suffered about as much as the EU as a whole. As Finland is a peripheral country in the euro area and is unlikely to be close to the exact development of European GDP, the debt crisis would seem to affect most euro area countries in a very similar way.

As in the earlier subchapter, it should be possible to find some causality through comparison with Sweden. I took a look at its GDP development during Finland's recession.



Source: Eurostat

Figure 5. Finland's 2012-2013 recession compared to Sweden.

Seasonally adjusted and adjusted data by working days. Million euro, chain-linked volumes, reference year 2005 (at 2005 exchange rates). Gross domestic product at market prices.

While Finland was in recession, Sweden's GDP developed regardless of the euro area's woes. Interestingly, the data gives a very strong impression that Finland's GDP development negatively correlated with Sweden's GDP development. This is a very strong indication that by not being part of the euro area, Sweden's economy was actually gaining momentum compared to it.

The thesis has made clear the falls in GDP that qualify as recessions and compared them to the similar statistics of European Union. However, it is worthwhile to consider the general view of the economy as well, even though this thesis is focused on the GDP-centric view.

4.1.5 Considering effect of recessions in general

Finland had been one of the best performing economies within the EU in recent years and its banks and financial markets avoided the worst of global financial crisis. However, the global recession caused by the financial crisis and the problems in finance sector weakened the will and ability for foreign companies to invest, which affected Finnish invest-

ments goods exports unfavourably. The global slowdown hit exports and domestic demand hard in 2009, with Finland experiencing one of the deepest contractions in the euro zone. A lot of Finland's production in general is intended for foreign trade, and the shock amplified originating from exports markets in Finland. It was due to the focus of Finnish export structure towards investment goods exports, essentially machinery.

A recovery of exports, domestic trade, and household consumption stimulated economic growth in 2010-11. However, the economy was dampened by continued recession in 2012-13. The recession had a negative effect on general government finances and the debt ratio, turning previously strong budget surpluses into deficits, but Finland took action to ensure it that it met the EU deficit targets in 2013 and retained its triple-A credit rating. Following that, Finland's has to stimulate growth while challenged by the weak export demand in the EU, not to mention its own government austerity measures. (Bank of Finland 2011, 8; CIA World Factbook)

4.2 Effect of the crisis on Finnish companies

This part focuses on Finnish multinational groups of companies. Multinational companies employ a lot of the Finnish workforce and effects on them are relevant to this thesis.

Finnish multinational groups of companies reduced their staff during 2007-2010 all over the world by 82000 people, which is notable. Most of the staff reduction, 66000 people, happened in Finland. Thus adaptation did not happen evenly but instead was concentrated on Finland.

The concentration of staff reduction on Finland did not ultimately result from the exports and total production collapse by the global crisis, but instead from the fact that despite the ongoing crisis Finnish multinational companies continued their internationalization strategies in their key regions all over the world. In some aspects, the developments in internationalization were made clearer in the crisis years compared to normal years of growth. (Sauramo and Oesch 2013, 6.)

For Finnish multinational groups of companies, business expansion abroad has substituted domestic business. This has been visible in, for example, diluted investment activity in Finland for industrial companies. It is natural to assume that business expansion abroad substitutes for industry exports in the home country, which reduces domestic investments. (Sauramo and Oesch 2013, 63.)

From this we can draw the conclusion that while large companies did greatly reduce staff during crisis years 2007-2010, it was largely not because of the financial crisis.

4.3 Financial regulations

This part focuses on what the financial crisis meant for financial regulations in Finland.

Financial sector regulation has been extensively updated in the years leading to 2010. A large proportion of the changes have been in response to the lessons of the financial crisis.

With regard to the banks, the changes are aimed at enhancing their ability to withstand losses by boosting the quality and level of their capital. The new capital adequacy requirements for banks do not present a significant challenge for most Finnish credit institutions, as their capital structure already meets both the quantitative and qualitative requirements.

The beginning of 2011 brought the establishment of new financial supervision authorities for Europe: the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA) as well as the European Systemic Risk Board (ESRB), a cooperative body of central banks and supervisors established in connection with the European Central Bank.

The new authorities have much broader powers than the previous European supervisory committees. They can issue standards that are directly binding on EU's Member States. They will also work together to harmonise supervisory practices, for example in supervisory colleges relating to banks and insurance companies. In some cases, they will also be responsible for supervising individual market participants or systems, as with ESMA, which has responsibility for credit rating agencies. All three authorities will also have a specifically defined role in customer protection. National supervisory responsibility for banks, insurance companies and other supervised entities will, however, continue unchanged. (FIN-FSA, 2-3.)

5 Discussion

This part attempts to combine the data from results to come up with a reasonable summary and conclusions.

Finland was hit hard by the first recession which it experienced in 2008-2009, in much greater effect than EU generally. It can also be determined from the comparison between Finland and Sweden that Finland's recession was definitely caused by being part of the euro area. This can only mean that other factors contributed to Finland's deeper recession. The likely cause for this is the lack of demand for Finnish exports due to Finnish export structure.

The results for the comparisons to Sweden were surprising. Sweden has successfully grown due to staying out of the euro area and managed to avoid the debt crisis and deep recessions. The world economy is difficult to interpret, and the events that led to the financial crisis of 2007-2008 were unpredictable to the prevalent view of economics, but in light of this data I draw the conclusion that Finland made a bad decision in joining the euro area.

European sovereign debt crisis proved that Finland was able to withstand the ramifications of financial crisis rather well. Despite having a comparatively deeper initial recession it managed to keep its AAA credit rating.

Large Finnish multinational companies were not affected as greatly as their large staff reductions would suggest. Rather, the companies were only implementing their internationalization plans and expanding abroad, which could be easily misattributed as a fault of the crisis.

2011 saw the founding of new financial supervision authorities for Europe. The new authorities have much broader powers than the previous European supervisory committees. They can issue standards that are directly binding on the Member States of the EU. In other words, the financial regulation has been tightened in order to prevent any incident similar to 2007 from reoccurring.

The trustworthiness of the data represented in this thesis appears adequate, as many of the sources are well known. In this process have learned a lot of things that are not limited

to only the topic of Finnish economy as part of much larger crises. The issue of demarcation of the very complex data on the crises, trying to find consistent information and yet deliver it as accessibly as possible to the reader was challenging but seemed like a manageable one.

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