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## English summaries

### Verð- og launamyndun í litlu opnu hagkerfi

*Wage and price formation in a small open economy: Evidence from Iceland*

Þórarinn G. Pétursson

This paper uses an open-economy version of a wage-price model with imperfect competition in goods and labour markets to analyse wage and price inflation in Iceland. The model identifies three main sources of wage and price inflation in Iceland: a conflicting claims channel, a real exchange rate channel and an excess demand channel. There is also some evidence of an upward shift in the equilibrium mark-ups in the late 1980s. The results indicate that this might be due to a substantial rise in the cost of capital that reflected the move towards market-determined interest rates and a shift in policy priorities towards price stability, which cumulated in a path-breaking labour market agreement in early 1990. These changes led to a downward shift in steady-state inflation and an upward shift in the natural rate of unemployment.

*Keywords:* Wage and price formation, mark-up pricing, wage bargaining.

*JEL:* E31, J30, C32, C51.

## Samband verðbólgu við laun og innflutningsverð

*The relationship between consumer prices, wages and import prices*

Guðmundur Guðmundsson

Inflation in Iceland and its variability have changed considerably in past decades. Some established methods in econometric modelling are therefore not directly applicable and common assumptions must be modified. Two kinds of models are estimated to represent the relationship between consumer prices, wages and import prices. One regards wages and import prices as exogenous in a model of inflation while the other is a three-equation model of these series. The models have considerable predictive power for inflation when the future of other variables is known. But they do not explain important features of past Icelandic inflation.

*Keywords:* Inflation, time series analysis, heteroscedasticity.

*JEL:* E31, C20, C32, C53.

## Peningamálastefna og gengisstefna í litlum opnum hagkerfum: Ísland

*Monetary and exchange rate policy in small open economies: The case of Iceland*

Joseph Stiglitz

This paper discusses monetary and exchange rate policy and the financial risks that are involved for small open economies in the current environment of less restricted and increased volume of global capital movements. It then goes on to analyse the policy interventions that are available to reduce and manage these risks. The specific case of Iceland is discussed within this framework. While it might be preferable if the problems posed by global financial instability are addressed by reforms in the global financial architecture, significant reforms are not likely to emerge in the near future. In the meanwhile, countries such as Iceland must take responsibility for their own welfare by managing these risks. That entails actions that reduce the likelihood of a crisis occurring and that reduce the costs incurred when the crisis occurs. Tax and regulatory policies (including financial sector regulation and disclosure regulation) can and should be used both to reduce the likelihood of a crisis and to help manage the economy through a crisis. Such regulations can affect short-term capital flows, which have been at the centre of recent crises. There are arguments for the use of price-based interventions and controls imposed through prudential banking regulations. But reducing the risks faced by a country requires even more extensive action: it entails focusing on appropriate bankruptcy codes, exchange rate regimes and designs of financial systems.

*Keywords:* Financial stability, monetary and exchange rate policy, tax and regulatory policies, Iceland.

*JEL:* F33, F36, E42.