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## The Transition from the Classical Regime to the Statist Regime: 1900–1950

**Abstract** The political and economic background of the postwar regulatory regime in Sweden is discussed in this chapter. The great depression of the 1930s had profound effects on the political and economic establishments as well as on the theoretical framework of economics. In Sweden, these effects coincided with the beginning in 1932 of the long hegemonic position of the Social Democratic party as the dominant—though far from unrivaled—political force in Swedish society. The outbreak of World War II and the introduction of war finance further served to accentuate these tendencies. After the war, the Social Democratic government prepared to reshape Sweden into the “People’s Home” (*Folkhemmet*).

**Keywords** Gold standard · Social democracy · Sweden · Banking regulation

The story begins during the Classical Regime. Sweden adopted the gold standard in 1873 in a monetary union with Denmark and Norway. Its central bank, the Riksbank, was created as a private for-profit bank in 1657

but, after going bankrupt, was taken over by the government in 1668. Government ownership made the Riksbank different from central banks elsewhere; in some countries, central banks were not nationalized until after World War II.<sup>1</sup> With the growth of the banking sector, the government and the Riksbank gradually began to find their respective roles in the financial system.

## Historical Background of the Swedish Banking Sector

Economic growth in Sweden accelerated after the 1860s, especially during the decades around 1900, when it was very high compared with other European countries. At the same time, urbanization increased along with the need for new dwellings and developed public services. Between 1893 and 1900, industrial production approximately doubled, primarily through expansion of the engineering and pulp industries. This growth increased the demand for capital as well as the need for a smoothly working financial system. As early as the 1880s, structural problems in the functioning of the financial system were identified, one of which was lack of capital. At the end of the nineteenth century and beginning of the twentieth century, Swedish foreign debt increased rapidly and was among the highest in the world on a per capita level. This capital was used primarily to establish the national infrastructure. However, from a national perspective, it was necessary for Sweden to meet the general need for capital using available resources. This was accomplished through a combination of governmental involvement and regulations and with the help of financial intermediaries on the open market.<sup>2</sup>

To develop the financial market and make it easier to acquire capital for investments, several fundamental legislative changes were made during the last decade of the nineteenth century and in the early twentieth century. Of fundamental importance was the Riksbank's concentration on central banking activities, which left lending on the open market to banks, savings banks, and insurance companies. The Riksbank focused instead on interest rate policy and note issuing, which was centralized at the Riksbank in 1903.<sup>3</sup>

By 1892, savings bank legislation had been revised. The revised law included several limitations on savings banks' activities. Specifically, their lending was to focus on private persons and small-scale businesses, such as family farms and handicrafts. It was important that the savings banks' capital be invested safely, including in bonds. The majority of the savings banks' deposits came from the working and middle classes. Savings banks were seen as important players in the fostering of discipline and education among the working class in particular.<sup>4</sup>

## Introduction of Early Regulations

The regulation of banks and insurance companies also underwent extensive changes in 1903. For insurance companies, the 1903 legislation was the first law to address both mutual and joint stock companies. The new law was initially planned to be implemented in the 1880s, but a desire to coordinate Swedish regulation with new legislation in Denmark and Norway delayed its introduction. The new insurance law eliminated the differences between mutual and joint stock companies and thus stabilized the entire insurance industry. Of special importance was stricter regulation of life insurance companies' investments to help secure policyholders' capital.<sup>5</sup> The 1903 insurance law was replaced by new legislation 1948.

New legislation for banks was also introduced in 1903. Compared to insurance companies, banks were given a larger degree of freedom in their investment activity as well as in their ordinary business. Through the regulation of liquidity and solidity, banks were more economically stable than they were before the legislation. Thus, the capital requirements for establishing banks were increased, which led to a merger wave among the smaller banks. The stricter capital requirements were intended to make banks more resistant to economic turbulence and hence lower risk in the financial system. This goal was consistent with the wishes of both the government and the newly established Bank Inspection Board (*Bankinspektionen*), which was responsible for bank supervision.

The bank legislation of 1903 was in place for only eight years; in 1911, a new bank law was introduced that imposed stricter liquidity requirements. The new legislation also opened the door to a new business activity because it gave large banks permission to own and trade shares, albeit with certain restrictions. Behind this new regulation lay the German model of universal banking, which had supporters in Swedish industry and among the large banks. From a general perspective, the Swedish legislation was ahead of regulations in several other European countries, especially in the promotion of economic stability and liquidity among banks. The bank legislation of 1911 remained in place until 1955, when a new regulation was enacted that in large part was identical to or based on the 1911 law.<sup>6</sup>

As discussed above, the Swedish financial system underwent extensive changes around 1900. Increased demand for capital in local communities and industry and for infrastructure investments had increased pressure on the financial system.

New legislative measures were introduced as a means to address these issues, resulting in a more controlled but better secured financial system. These regulations resulted in a financial system in which banks were the main providers of capital for industry and trade while savings banks extended credit to individuals and small-scale businesses. Together with the insurance companies, the savings banks also purchased bonds issued by the state, mortgage companies, and private enterprises. The state, primarily through legislation and bank and insurance inspection boards, propelled a gradual change from self-regulation to a larger degree of state control. In addition, the different actors in the financial market were locked into specific customer groups for several decades.

## Problems and Crises of the Early Twentieth Century

For decades before World War I, the gold standard had been associated with financial stability. National currencies and the domestic purchasing power of money were convertible into gold at a fixed value. This regime, which was intended to automatically adjust imbalances in financial

flows between countries, was the embodiment of the established orthodoxy at the time. In today's terminology, it was a disinflationary system that favored stable currencies over high employment. Central banks, most of which at that time were privately owned, were viewed as technical institutions that upheld a mostly automatic operating system. However, research has shown that the gold standard, in contrast to its official image, was not an automatic system but instead relied on constant interventions by and cooperation among national central banks.<sup>7</sup> Nevertheless, the official image provided considerable legitimacy for central banks and freedom from political interference in the realm of finance.<sup>8</sup>

With the outbreak of World War I in 1914, a number of countries, including Sweden, took their currencies off the gold standard. As World War II would do later, the First World War profoundly changed the setting of both the international and Swedish political and economic landscapes. War regulations forced the government to take a more active role in the economy, leading to government intervention on a scale previously unseen. Politically, food riots and the revolution in Russia sent shockwaves across the world. An extension of the franchise removed the acute threat of revolutionary efforts by the Social Democratic Party, which had been created in 1889, and set it on the path of political reformatory hegemony. Its more orthodox Socialist wing broke out and formed a more revolution-oriented party. A similar split of the Socialist movement occurred internationally.<sup>9</sup>

In the years after the war, Sweden was hit by a deflation crisis. Large credit extensions to the business sector led to massive losses for banks. Two of the largest banks, *Svenska Handelsbanken* and *Skandinaviska Kreditaktiebolaget*, barely managed to avoid government injections of capital in exchange for ownership. Debentures were issued and pragmatic exceptions from regulations were granted, allowing the banks to treat the debentures as equity to fulfill their capital requirements. The government did, however, nationalize the failing agricultural bank *AB Svenska Lantmännens bank* and injected capital in *AB Nordiska Handelsbanken* in exchange for half ownership. It is likely that the government's demonstrated willingness to inject capital into banks when needed lent confidence to the banking sector and helped to stem the crisis.

The deflation crisis led to discussion about the need to increase regulation. In 1922, the head of the Ministry of Finance stated that it was “obvious” that the banking system was flawed, especially because of “the risks and other inconveniences...connected to the banks’ liberal financing of speculations in securities.”<sup>10</sup> However, he added that “it is not equally obvious which actions can and should be taken in order to establish a more sound economic order...”<sup>11</sup> A government committee, delivering its results in 1927, voiced concern that liberal credit extension resulted in both massive losses for banks and inflationary tendencies. However, as the deflation crisis faded toward the mid-1920s, the regulatory momentum was lost and only marginal regulatory changes were made.<sup>12</sup> Nevertheless, the direct interventions and the discussions about a tightening of the bank regulatory framework can be seen as the first signs that the comparatively liberal approach consistent with the Classical Regime was starting to unravel.

## The Origin of a New Economic Policy

The economic troubles of the early 1920s led to increased criticism of the economic system. Some viewed the experiences of the war economy as a blueprint for a functional non-capitalist planned economy. There was also criticism of the principles of the gold standard. In 1923, John Maynard Keynes called the gold standard a “barbarous relic” that was not up to “the requirements of the age.”<sup>13</sup> Nevertheless, countries reverted to the gold standard, including Sweden, officially, in 1924. In many countries, the reversion was followed by deflation and severe contractions, but in Sweden, the price of reversion was relatively small. The reason for the difference was probably that the deflation crisis of 1920–1922 had already done much of the disinflationary work of the regime.<sup>14</sup> Regardless, the gold standard could no longer guarantee financial stability. The reasons that the gold standard in the interwar years did not function as well as it had before the war have been widely debated.<sup>15</sup>

The postwar crisis of the 1920s was not enough to break the gold standard regime. However, the crisis that started on the New York Stock

Exchange in 1929 and developed into the Great Depression proved to be sufficient. Great Britain went off the gold standard in September 1931. The Swedish government, assisted by a large loan from Marcus Wallenberg, the head of the *Stockholms Enskilda Bank (SEB)*, made a desperate effort to cling to gold but relented within a month. The subsequent rapid devaluation of Swedish currency likely gave exports a boost and helped Sweden to make a comparatively quick economic recovery.

On the political scene, the dominant event was the beginning of the Social Democratic hegemony, which remained the main government-controlling party until 1976. Through a deal with the Agrarian Party, Social Democrats were able to form a government in 1932 and began to initiate public work projects to increase employment.

The economic policy implemented by the Social Democrats in the 1930s, its inspiration and its effects have been topics of lengthy debate.<sup>16</sup> Did the policy emerge from the old theoretical framework of socialism and its insistence on the recurring crises of capitalism? Or was it spawned by the new economic ideas associated with British Liberals such as Keynes or the home-spun Swedish Stockholm School? The Marxist doctrine, out of which Social Democracy emerged, did cite the periodically recurring lack of demand as a key flaw of capitalism that would eventually lead to its demise. However, the notion that the goal was not to overthrow the existing order during a crisis but rather to actively manage the system was a profound break with Marxist doctrine. This notion had been discussed sporadically by Social Democrats at least since 1908.<sup>17</sup>

Another major ideological influence was developments among liberals in Britain who started to question the tenets of classical liberalism in favor of what they considered a more socially responsible liberalism. Bertil Ohlin, a key member of the “Stockholm School,” was deeply influenced in his youth by Keynes’ 1926 book, *The End of Laissez-faire*.<sup>18</sup> Another book produced by British Liberals (with the involvement of Keynes) was the 1928 British Liberal Party manifesto, the so-called *Yellow Book*. This book was well received by Swedish Social Democrats, who viewed it as confirmation that their gut-felt suspicions about unfettered capitalism could be intellectually supported. Tage Erlander, the Social Democratic Party leader and prime minister

from 1945 to 1969, expressed the relationship among Swedish Social Democracy, *The Yellow Book* and theory in the 1930s as follows:

A bridge had been built over the gap between Socialism's will to act and its demand that its policies should rest on a solid theoretical ground. ...The battle between Liberalism and Socialism belonged to the past... *The Yellow Book* did not contain anything new to us Social Democrats. It reconnected to thoughts that had been present earlier in the workers' movement, but it filled us with self-esteem. It was we who had the real theory, not our opponents. Our satisfaction became even greater when, during the 1930s, the young Swedish economists Gunnar Myrdal and Bertil Ohlin supported the theory of active employment. The era of ideological bewilderment was over.<sup>19</sup>

## The Social Democrats and Financial Regulation in the 1930s

In finance, the main event was the so-called Krueger crash in 1932. Ivar Kreuger built a financial empire based on financial innovation and fraudulent accounting. In 2007, the *Economist* anointed Kreuger "the patron saint of sinners" and "arguably the most brilliant and ambitious swindler who ever lived."<sup>20</sup> In exchange for a grant of a national monopoly on the production of matches, Kreuger offered loans to governments around the world. The money came from investors and banks who bought into the scheme because they expected the match monopoly to generate huge profits. This scheme sounds far-fetched today, but one must bear in mind that this was an era in which a large part of the population were habitual smokers and cooking was done with gas ovens. When the profits failed to materialize, Kreuger attempted to keep his empire afloat by borrowing increasing amounts of money, paying out dividends to investors using borrowed money. In 1932, when the situation became unsustainable, Kreuger shot himself, unleashing a fall in the value of stocks and securities that were to a large extent owned by banks in Sweden. The losses threatened the survival of the banks. For the fledgling Social Democratic government, the situation was



problematic: Should they assist in a bailout of profligate financial capitalism in the middle of a depression? The answer was yes. The Minister of Finance, Ernst Wigforss, defended the bailout by saying that the demise of the ailing banks would cause too much damage to the economy.<sup>21</sup> In other words, the fledgling Social Democratic government followed the doctrine of “too big to fail.”

A month after Kreuger’s suicide, a government commission was created. The continuity from earlier decades was clear. The commission returned to the question that had been left unresolved after the deflation crisis in the 1920s and acknowledged the ideological problem of regulation:

Legislation is here faced with the delicate task of making a trade-off between, on the one hand, the interest of the public in exercising control over the banks...and, on the other hand, the interest of the banks to be allowed, like any other private enterprise, to freely operate their business without restrictions that might hinder their sound development.<sup>22</sup>

The result, however, was a tightening of the regulatory framework, including the abolishment of banks’ right to own and speculate in stocks.<sup>23</sup> It is unlikely that the 1932 regulatory reform was linked to the ideological vision of Social Democracy; rather, it was a continuation of concerns that went back at least to the beginning of the century. The events of the 1930s provided enough momentum to push through the changes. Compared to the regulations that had been introduced in the USA—some of them also following the Kreuger debacle—the Swedish financial markets can still be described as liberal in the traditional sense.<sup>24</sup>

On the macrolevel, the gold standard had a pseudo-existence, with its resumption deferred year after year. Relying on advice from academic economists, a price-level targeting system that has been described as a precursor of the inflation targeting of later decades was attempted. Instead, however, the currency was soon fixed to the British pound, because at that time Great Britain was the largest trading partner. The task of monetary policy, however, still lay very much in the hands of a relatively independent central bank. The governor of the central bank

at the time, Ivar Rooth, wrote in his memoirs that he experienced no major conflicts with the Social Democrats during the 1930s.<sup>25</sup>

The indefinite deferment of the gold standard led to a vacuum in the framework of monetary policy. Dag Hammarskjöld, the future leader of the United Nations, was already working at the Department of Finance when he was recruited to the Riksbank as Rooth's advisor. In 1935, Hammarskjöld presented a lecture at a meeting of the Swedish Bankers' Association in which he expounded on monetary policy without the gold standard. The advantage of the gold standard, he argued, was that it functioned like an automatic machine that legitimized non-interference by politicians in the realm of monetary policy. Without the gold standard, there was nothing to prevent interference from politicians. A new source of legitimacy and guidance for monetary policy was therefore to be found in the emerging profession of economists like him, who were lending central banks their expertise.<sup>26</sup> As mentioned above, subsequent research has shown that the gold standard did not actually work in this way, but Hammarskjöld was probably right to recognize the rhetorical power of the supposed machine-like character of the system. In a telling anecdote, a British cabinet member, when told that Britain went off the gold standard, is said to have exclaimed, "Nobody told us we could do this!"<sup>27</sup> In the 1930s, politicians and economists gradually became accustomed to the notion of a functioning economy without the gold standard.

As they did with financial policy, the Social Democrats in the 1930s mostly continued the housing policy of earlier years. However, housing started to emerge as the main concern and would become a matter of great importance in the financial system after World War II. In their highly influential book, *Crisis in the Population Question* (*Kris i befolkningsfrågan*), Gunnar Myrdal and his wife, Alva (the former already a professor of economics and an important advisor to Wigforss), identified the construction of a large amount of new housing as a foundation for raising the national standard of living. Construction was also associated with maintaining employment levels, and public works carried out by the government included

construction of housing. A government investigation resulted in the introduction of various subsidies for housing for the poor.<sup>28</sup>

In the second half of the 1930s, the depression had given way to boom times in Sweden. Most likely, the devaluation that occurred after the *krona* was taken off the gold standard and the exchange rate was fixed against the pound gave a significant boost to the economy.<sup>29</sup> The deflationary pressure of the early 1930s eventually gave rise to inflationary pressure. Concerns about inflation—also voiced within the labor movement because of fear that real wages were falling—led to renewed interest in how to organize the Swedish financial system and monetary policy.

A 1937 parliamentary bill produced nothing concrete, but within it can be found many of the pieces that would eventually comprise the Post-World War II regime. Wigforss attached a memo to the bill that provides a glimpse into the development of the thinking at the time. Keeping inflation in line was still seen as the number one priority because of concerns that the public's wages were being eroded. Another concern was the bullish stock market. Wigforss noted that both revaluation of the currency against the pound and restrictions on the extension of credit might become necessary to curb inflation. The tools he had in mind to restrict credit extension were a mix of old and new. The central bank could raise the interest rate and conduct open market operations, whereas the government could overbalance the budget, presumably by raising taxes or reducing or eliminating tariffs. A transaction tax on stocks to mitigate speculation on the stock market was also considered.<sup>30</sup>

Notably, Wigforss cautioned that actions taken to reduce inflation had to take into account “risks of diminished employment and diminished output.”<sup>31</sup> Although the overall responsibility of the central bank to guard the purchasing power of money was affirmed, he added that it was on the condition that “all of the government's actions that influence the economy...are coordinated so that they support and do not contradict each other.”<sup>32</sup> Wigforss' words were careful, but their meaning was clear: the independence of the central bank to fulfill its mission as it saw fit was de facto constrained.

## World War II

In September 1939, World War II broke out. Increased imports to Sweden caused by the hoarding of foreign goods in expectation of import restrictions placed a strain on foreign currency reserves. Foreign investors withdrew their investments in Sweden, which further increased the pressure. The Riksbank took action to restrict the outflow of foreign currency, and agreements were made with commercial banks to provide foreign currency only for purposes deemed legitimate.<sup>33</sup> This was in practice a rationing of foreign currency, with commercial banks assisting in administration of the rationing procedure. Similar use of private businesses and organizations to administer war regulations had taken place during World War I.<sup>34</sup> Import restrictions further helped to control the outflow of funds.

In the first phase of the war, there was a squeeze on financial markets. People withdrew deposits from banks, and businesses borrowed more money than usual in order to hoard raw material. This behavior resulted in upward pressure on market interest rates. Soon, however, the financial situation in Sweden was characterized by an excess of funds, since few investments were made and the public was once again depositing their money. This drove down interest rates, especially since it was impossible to place money abroad. Commercial banks were, therefore, more than happy to oblige the wartime expansion of government expenditure because they needed to place their money somewhere. By 1942, half of the government's excess spending over income was financed directly by commercial banks.<sup>35</sup>

When the balance of the war seemed to swing conclusively in favor of the Allies, planning for a Swedish future in a postwar world began. The experiences following the end of World War I and the subsequent deflation crisis were still very fresh in the minds of politicians and the public. There was widespread concern that another economic slump would occur after World War II. High employment levels had been established as an important priority in the 1930s, and active policies were prepared with the goal of avoiding a depression. These policies were bound to create tension with the prewar orthodoxy. A committee established by

the Riksbank in 1943 wrote that a deflationary process that aimed to restore prewar price levels would “come into conflict with the demands of maintaining full employment, which is a crucial part of the monetary program such as it has developed during the last decade.”<sup>36</sup>

## The Social Democratic Postwar Program

As mentioned above, the Social Democratic government had been fairly moderate in its policies during the 1930s. In many ways, it simply continued the policies of earlier decades. There was never an open commitment to abolish the gold standard but rather only a continual suspension of it. The war years saw the formation of more radical ideas. A joint statement by the organizations that composed the Swedish labor movement was published in 1944 under the title *The Labor Movement's Postwar Program* (*Arbetarrörelsens efterkrigsprogram*). The committee that produced the program was chaired by Wigforss and had Gunnar Myrdal as its primary expert. The program description began with the following statement:

The world in which our people will live, once peace has been restored, must largely become an entirely new world. The prewar economic system will not be able to solve the problems that the future will hold. It gave rise to constantly recurring crises with unemployment and diminished production.<sup>37</sup>

The experiences from the war, when social coordination of the market economy had been able to assure a functional economy, were explicitly mentioned as a blueprint for the postwar era.

The main priorities of the future were explicitly identified: full employment, fair distribution, higher standards of living, and higher efficiency and more democracy in the private sector.<sup>38</sup> The postwar program also took a clear position on keeping inflation in check. The very first of the 27 points proposed to achieve the stated goals was to ensure stability of prices, avoiding both postwar inflation and deflation. The program espoused what Charles Kindleberger has called a “Keynesian”

view of inflation, that is, viewing changes in price levels as being due to real economic changes rather than to increases in the quantity of money.<sup>39</sup> A controlled fall in general price levels caused by resumption of trade, removal of wartime monopolies, and increased efficiency was therefore deemed desirable.<sup>40</sup>

An important means of achieving the new society was the low interest rate policy. This policy was part of a business-friendly attitude in which the state would help the private sector to maintain sustainable economic growth by keeping interest rates low.<sup>41</sup> Low interest rates were also important for housing. The interest rate hike at the beginning of the war and increases in the costs of raw materials had resulted in reduced construction, which led to wartime efforts to revitalize it.<sup>42</sup> The postwar program not only described housing construction as an important social concern in line with the Myrdal book of the 1930s but also asserted that it was a “key industry” necessary to maintain employment and noted that its expansion was thought to explain the higher level of employment in Sweden relative to other countries during the 1930s.<sup>43</sup>

The financial sector was not directly targeted by the stated goals, but the expanded section on the motivation for the program included several direct plans regarding it. In light of the recurring crises of the preceding decades, capitalism was considered a fickle and unreliable system that fluctuated between speculative excesses and long periods of underinvestment. A general smoothing of the business cycle would not be enough to ensure full employment. Instead, a “general plan for investments in society” was needed.<sup>44</sup> A new investment body was envisioned in which representatives of different groups in society, including business organizations and labor unions, would work together to develop investment plans. The state was also supposed to develop its own commercial bank. The most radical conclusion concerned insurance agencies; the state was to completely nationalize insurance, “not only in order to extend government influence on the capital market but also because private enterprise in this sector is to some extent economically inefficient.”<sup>45</sup>

The end of the war and the postwar program unleashed what has become known in Sweden as the “planned economy debate” (*planhushållningsdebatten*). Its terminology—pitching planning against free markets—was a direct descendant of the socialist calculation debate that had

occurred after World War I. However, the terminology is misleading. Planning did not mean a Soviet-style command economy but instead referred to the government interventions advocated in the postwar program. The Social Democratic Party had officially abandoned the goal of socialization at the party congress of 1932. Its official goal, and in essence its redefinition of socialism, became to ensure that the inefficiencies of capitalism—its constant fluctuations—were kept in check by the planning efforts of the government and its growing cadre of experts. Opposing this vision was the bulk of Swedish businesses and political opposition in the form of conservatism and the new form of social liberalism. The latter agreed to abolish *laissez-faire*—to the consternation of more classical liberals—but felt that the heightened degree of government intervention in the economy envisioned by the Social Democrats was a step too far. The Social Democratic agenda was thus far from unchallenged.<sup>46</sup>

## International Postwar Development

Swedish monetary and banking policies in the years following the war were heavily influenced by international development. Increased skepticism about the notion of the economy as a self-regulating system was an international phenomenon. The new international world order developed at Bretton Woods was the work of “market pessimists”<sup>47</sup> and aimed to facilitate increased world trade by minimizing exchange rate fluctuations, which were believed to be inevitable in a system based on market-based exchange rates. Although currencies could be converted as part of trade, control over capital flows was allowed and commonly exercised. Finally, the goal of keeping employment and output high was affirmed, and thus individual members of the accord were allowed to depreciate their currency if it was deemed necessary to avoid high unemployment.<sup>48</sup>

As mentioned above, Sweden had experienced large withdrawals of foreign currencies in 1939. Resumption of trade threatened to once again deplete the nation’s currency as a population hungry for import goods regained access to world markets. Furthermore, Sweden, because of its wartime neutrality, was largely kept in the dark concerning the

development of the Bretton Woods accord and its impact on Sweden's postwar future. Considerable uncertainty thus reinforced the ideological motivation to maintain many of the wartime regulations. In 1947, a currency crisis in which the Swedish currency reserves were nearly depleted led to import restrictions.<sup>49</sup>

## Toward a New Macroeconomic Regime

The years following the end of the war were characterized by increasing tension between central bank officials, whose mindset had been shaped by the gold standard era, and the advocates of increased state intervention. As mentioned above, the Social Democratic vision for money and banking had been very vague; it did not officially abrogate the gold standard but instead suspended it year after year. Wigforss' memorandum on the 1937 bill contained a hint that monetary policy should be part of an overarching government policy for full employment but was otherwise very orthodox. Mats Lemne, who later became governor of the central bank, thought that the directives to the central bank during these years became "fuzzier and fuzzier."<sup>50</sup> The reason for this vagueness was probably the government's lack of a detailed plan for what it wanted to do with money and banking.

Nevertheless, events and practical considerations joined ideology to mold the government's policy into the form it would roughly maintain for decades. The large government wartime debt needed to be rolled over; i.e., new bonds had to be issued to replace older bonds that matured. During the war, one of the main tasks of the central bank had been to ensure that the government's bonds could be placed on the domestic market. This continued during the years after the war.<sup>51</sup> Similarly, as mentioned above, there was the fear of a postwar depression. All of these factors contributed to the decision to make maintenance of low interest rates the fundamental postwar monetary policy.

A very similar situation was encountered by most industrial nations after the war. The resulting so-called low interest rate policy was an



important part of the beginning of what became the Statist Regime. Milton Friedman, who devoted his life to dismantling the postwar economic order, stated that during the low interest rate policy era,

the only role assigned to monetary policy was to keep whatever interest rates it affected low so as to avoid interfering with the investment regarded as needed to offset the secular stagnation that was confidently expected to be the major problem for the future.<sup>52</sup>

Friedman wrote that the shift was caused by two factors: the theoretic revolution initiated by Keynes and “the brute force of events.”<sup>53</sup> As we have seen, the direct influence of Keynes should not be overestimated. Myrdal wrote a more or less accurate account of the system that was to emerge by 1944 without mentioning Keynes or any new theoretical developments. Instead, Myrdal derived the new paradigm from the reality of power politics. He argued that the combined interests of governments burdened by unprecedentedly high debts and powerful interest groups in business and agriculture converged in a long-term commitment to low interest rates. To avoid inflationary pressure caused by low interest rates, Myrdal argued, the function of the interest rate to limit investments had to be replaced by investment control and high taxes. Low cost of debt and high tax revenues would also allow the expansion of government activities in the economy.<sup>54</sup>

It seems likely, then, that the main driver of the shift was pragmatic rather than ideological. Indeed, many of the changes that occurred in Sweden also occurred in non-Social Democratic countries, the most notable being the USA. Indeed, the very use of the concept of “macroeconomic regime” implies a large cross-national convergence in policy that transcends the party adherence of national governments. A pragmatic change in the face of events—albeit it can be argued that these events were misinterpreted—thus explains a great deal of the establishment of the new regime. Ideology and theory were nonetheless important to provide a cognitive framework and legitimacy of the policy shift.

It is important to distinguish between two forms of pressure derived from pragmatic considerations. First, there was a gradually evolving regulatory ambition that started in the beginning of the twentieth century.

This amounted to a tentative experimentation with constraints and regulations of the banking sector in an otherwise liberal economic order. The failure of financial markets in 1929, the subsequent depression, and the Kreuger crisis led to more regulation. Economic planning during World War II, the increased ambition of the Social Democrats toward the end of the war, and the increased dominance of Keynesian theories did not initiate this process. The motivation for the low interest rate, however, was very different from that behind the regulatory movement to stabilize the banking sector: one grew out of a series of recurring crises; the other grew out of large government debt and the perceived need to stimulate the economy in order to ensure full employment.

In any case, the ideology of the Social Democrats, the experiences of government wartime planning, and the academic revolution of Keynesianism were very much compatible with the pragmatically derived policies. It is highly probable that the entrenchment of these policies was due to the convergence of pragmatism, theory, and ideology.

For central bank officials, the new developments were seen as a disaster. Whereas the gold standard had legitimized considerable central bank independence, the end of the war saw a sharp reduction of that independence as central banks became subjugated to the roles of ensuring that large government debts could be managed and preventing a postwar recession. The international cooperative organization for central banks, the Bank for International Settlements (BIS), argued constantly against the low interest rate policy and referred to the fear of postwar depression as “something of a psychosis.”<sup>55</sup>

In 1945, there was a widespread fear that inflation would strike the Swedish economy and cause an increase in interest rates. An important part of the Social Democratic policy was therefore to push back against inflation tendencies. The national debt had increased considerably during the war, with the banks being the major buyers of government bonds. With the end of the war, there was an important shift in the banks' capital management from bonds toward lending. One effect of this shift was an increase in the number of treasury securities on the Swedish market, which compelled the state, i.e., the Riksbank, to buy

securities to prevent interest rates from rising. The Riksbank was thus faced with the task of halting inflation without being allowed to raise interest rates. Consequently, the Riksbank contacted actors in the financial market to persuade them—through informal agreements—to limit their lending and issuing of bonds. Even industrial companies that were dependent on the issuance of bonds for their own financing were contacted by the Riksbank in an effort to persuade them to refrain from issuing new bonds.

This policy was introduced by the government, but the Riksbank—which was responsible for its execution—was reluctant. Ivar Rooth, who had found little reason to question the Social Democratic government in the 1930s and during the war, now found his beliefs increasingly challenged by the new government policies. Consistent with the prewar mindset, he thought that the only way to reduce lending in the financial system was for the Riksbank to stop purchasing treasury securities and allow the interest rate to increase. This policy was supported by the banks and other financial actors. On several occasions during the time period 1947–1948, this topic came up for discussion in Parliament, where the Social Democrats protected their policy from attacks leveled by the more right-wing parties. In its economic declaration after the parliamentary election in 1948, the Social Democratic government made it clear that the low interest rate and restrictive lending policies would prevail.<sup>56</sup>

The worst problem, in Rooth's mind, was that in order to keep interest rates low, the central bank had to print money and use it to buy government bonds. This was, in essence, financing government debt and stimulating the economy with the printing press, a severe breach of established central bank wisdom. Rooth was concerned by the inflationary effects of this and tried unsuccessfully to persuade the government to let the central bank raise interest rates. The new policies and the traditional view on proper monetary policy could no longer be reconciled. After a final attempt to persuade the board of the Riksbank to change their policy, Ivar Rooth handed in his resignation.<sup>57</sup> He said, "I cannot participate in the central bank policy that is about to be inaugurated."<sup>58</sup> The stage was set for the next phase of the development of the Swedish financial system.

## Notes

1. Larsson, *Staten och kapitalet*; Jonung, "Swedish Experience Under the Classical Gold Standard".
2. Larsson, "State and the Financial System", 170–172.
3. Larsson, "State and the Financial System", 172–173. Previously, when commercial banks had the right to issue notes, the banks owned the notes and were liable on an "all for one and one for all" basis.
4. Sjölander, *Den naturliga ordningen*.
5. Larsson, *Staten och kapitalet*.
6. Larsson, *Staten och kapitalet*.
7. Bloomfield, *Monetary Policy Under the International Gold Standard* (1959); Capie, *Future of Central Banking*.
8. Capie, *Future of Central Banking*.
9. Newman, *Socialism*, 47.
10. SOU 1927:11, 44.
11. Quoted in SOU 1927:11, 43–44.
12. SOU 1927:11, 108; Larsson, *Staten och kapitalet*.
13. Keynes, *Tract on Monetary Reform*, 172.
14. Jonung, "Swedish Experience Under the Classical Gold Standard", 361; Magnusson, *Sveriges ekonomiska historia*, 194.
15. Eichengreen, *Golden Fetters*.
16. Magnusson, *Sveriges ekonomiska historia*.
17. Lewin, *Planhushållningsdebatten*, 25.
18. Berggren, "Bertil Ohlin", 533.
19. Erlander, *Tage Erlander, 1901–1939*, 177–178.
20. Kreuger, Sten. 2007. "Fraud and financial innovation: The match king." *The Economist*. <http://www.economist.com/node/10278667>. Accessed on April 23 2017.
21. Wigforss, *Kreugerkris*.
22. SOU 1932:30.
23. Larsson, *Staten och kapitalet*, 100.
24. Jonung, "Riksbankens politik 1945–1990", 349.
25. Berg and Jonung, "Pioneering Price Level Targeting"; Magnusson, *Economic History of Sweden*, 195; Rooth, *Ivar Rooth*, 68.
26. Hammarskjöld, "Centralbankerna i nutidens ekonomiska liv"; Söderberg, *Constructing Invisible Hands*.
27. Taylor, *English History*, 297.

28. Boverket, *Bostadspolitiken*, 42–44; Myrdal and Myrdal, *Kris i befolkningsfrågan*.
29. Magnusson, *An Economic History of Sweden*, p. 195.
30. “Kungl. Maj:ts proposition nr 318”, 49.
31. “Kungl. Maj:ts proposition nr 318”, 52.
32. “Kungl. Maj:ts proposition nr 318”, 52.
33. SOU 1941:18, 180.
34. Söderberg, *Constructing Invisible Hands*.
35. SOU 1941:18, 180; SOU 1942:25, 194; SOU 1944:11.
36. Quoted in SOU 1944:11, 210.
37. *Arbetarrörelsens efterkrigsprogram*, 3.
38. *Arbetarrörelsens efterkrigsprogram*, 5.
39. Kindleberger, *Keynesianism vs. Monetarism*.
40. *Arbetarrörelsens efterkrigsprogram*, 6.
41. *Arbetarrörelsens efterkrigsprogram*, 7.
42. SOU 1942:25, 17–418.
43. *Arbetarrörelsens efterkrigsprogram*, 8.
44. *Arbetarrörelsens efterkrigsprogram*, 80.
45. *Arbetarrörelsens efterkrigsprogram*, 83.
46. Sejersted, *Age of Social Democracy*; Heckscher, *Ödeläggelsen av 1800-talets hushållning*; Lewin, *Planhushållningsdebatten*.
47. Skildelsky, *John Maynard Keynes*, 15.
48. Kenen, “Bretton Woods System”.
49. Ahlström and Carlson, “Hammar skjöld, Sverige och Bretton Woods”; Magnusson, *Sveriges ekonomiska historia*, 202.
50. The Riksbank archive, Lemne (1991a), Ansvaret för penningvärdet, Riksbankschefers arkiv.
51. The Riksbank archive, Lemne (1991b), Obligationskän, Riksbankschefers arkiv.
52. Friedman, *Program for Monetary Stability*, 1.
53. Friedman, *Program for Monetary Stability*, 1–2.
54. Myrdal, *Varning för fredsoptimism*.
55. BIS, *Annual Report 1951*, 251.
56. Rooth, *Ivar Rooth*.
57. Rooth, *Ivar Rooth*; Jonung, “Riksbankens politik 1945–1990”, 296.
58. Rooth, *Ivar Rooth*, appendix 1.

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