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FINANCIALISATION, ECONOMY, SOCIETY AND SUSTAINABLE  
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Financialisation and the Financial and Economic

Crises: The Case of Sweden

Alexis Stenfors

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# Financialisation and the Financial and Economic Crises:

## The Case of Sweden

**Alexis Stenfors**

**Affiliations of author:** University of Leeds and University of Portsmouth

**Abstract:** This study on Sweden examines the Swedish financialisation process through the lens of the global financial crisis and the subsequent Eurozone sovereign debt crisis. The emphasis of the study is twofold. First, by acknowledging the rapid and widespread Swedish financialisation process, it traces the transformation of Sweden from a 'debt-led consumption boom' country towards an 'export-led mercantilist' regime. Second, by highlighting the country's unique characteristics within such a classification, the study considers its ability to shield itself from some of the turbulence in the international financial markets following the recent crises. The outline of the report is as follows. Sections 1 and 2 provide a summary of key characteristics of the Swedish financialisation process since the 1980s. Section 3 studies the effects of the Swedish financialisation process in more detail by examining four channels in particular: investment, distribution, household consumption and the current account. Section 4 analyses the transmission mechanism of the global financial crisis and the Eurozone sovereign debt crisis vis-à-vis Sweden. Section 5 concludes.

**Key words:** Sweden, Swedish model, financialisation, financial system, financial crisis, banking crisis, Eurozone crisis

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**Contact details:** Alexis Stenfors, Portsmouth Business School, University of Portsmouth, Richmond Building, Portland Street, Portsmouth PO1 3DE, United Kingdom, e-mail: alexis.stenfors@port.ac.uk

**Website:** [www.fessud.eu](http://www.fessud.eu)

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## ABBREVIATIONS

ATP	Allmänna Tilläggspensionen
bp	basis point [1/100%]
CDS	Credit Default Swap
CIP	covered interest rate parity
CHF	Swiss franc
CPI	Consumer Price Index
CRS	Cross Currency Swap
DKK	Danish krone
ECB	European Central Bank
ERM	Exchange Rate Mechanism
EONIA	Euro Overnight Index Average
EU	European Union
EUR	euro
EURIBOR	Euro Interbank Offered Rate
FX	foreign exchange
GBP	Pound sterling
GDP	Gross Domestic Product
GB	Government bond
JPY	Japanese yen
KIX	Effective exchange rate index for the Swedish krona (by NIER)
LHS	left hand side
LIBOR	London Interbank Offered Rate
LO	Landsorganisationen i Sverige (Swedish Trade Union Confederation)
MB	Mortgage bond
NIER	National Institute of Economic Research (Konjunkturinstitutet)
NOK	Norwegian krone
OECD	Organisation for Economic Co-operation and Development
OIS	Overnight Index Swap
PIIGS	Portugal, Ireland, Italy, Greece and Spain
PPA	Premium Pension Authority
PRS	Premiereservsystemet (Premium Reserve System)
RHS	right hand side
SAF	Svenska Arbetsgivareföreningen (Swedish Employers Association)
SEK	Swedish krona
SME	Small and medium-sized enterprises
SONIA	Sterling Overnight Interbank Average Rate
STIBOR	Stockholm Interbank Offered Rate



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STINA  
USD

Stockholm Tomnext Interbank Average  
United States dollar

## 1. Introduction

This report studies the Swedish financialisation process through the lens of the global financial crisis and the subsequent Eurozone sovereign debt crisis. By drawing on the key results from the FESSUD study on the Swedish financial system (Stenfors, 2014a<sup>1</sup>), it extends the analysis by considering a country classification in accordance with the rising current account imbalances in the global economy (Hein, 2012). The emphasis of the report is twofold. First, by acknowledging the rapid and widespread Swedish financialisation process, it traces the transformation of Sweden from a 'debt-led consumption boom' country towards an 'export-led mercantilist' regime. Second, by highlighting the country's unique characteristics within such a classification, the report considers its ability to shield itself from some of the turbulence in the international financial markets following the recent crises.

The outline of the report is as follows. Section 2 provides a summary of key characteristics of the Swedish financialisation process since the 1980s. Section 3 studies the effects of the Swedish financialisation process in more detail by examining four channels in particular: investment, distribution, household consumption and the current account. Section 4 analyses the transmission mechanism of the global financial crisis and the Eurozone sovereign debt crisis vis-à-vis Sweden. Section 5 concludes.

## 2. The Swedish Financialisation Process since the 1980s

During the decades running up to the 1980s, Sweden traditionally presented itself as an exception within political economy, where crude classifications become, if not invalid, then at least open for questioning. The 'third way', the 'Swedish model' or the 'Scandinavian legal system', highlighting the uniqueness of the small, developed countries in Northern Europe, became convenient labels for economists, political scientists and legal scholars alike to portray some of these characteristics. Even among its critics, the Swedish (or Nordic) model was often regarded as a successful synthesis between capitalism and socialism, between free enterprise and social planning. Although there is no clear definition of the Swedish model, most scholars would agree that the following characteristics could be attributed to it: a 'decommodified' wage relation, public commitment to full employment, welfare state universalism, a large social service sector, egalitarianism (in particular with regards to women) and a kind of class compromise between capital, labour and farmers (and later including white collar workers) (Ryner,

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<sup>1</sup> Note that some sections in this report are identical to that in Stenfors (2014a).

1999; 2007). Broadly speaking, the society could truly be portrayed as egalitarian, with a solid social safety net stretching from free education to universal health care.

The demise of the Swedish model coincides with the deregulation process that was put in motion during the 1980s. This also marks the beginning of a remarkably widespread financialisation process in the country. Once put in motion, the financialisation process gained pace rapidly and has since profoundly changed the Swedish society. In line with the FESSUD project, the processes of financialisation contain the following eight features: large-scale expansion and proliferation of financial markets; de-regulation of the financial system itself and the economy more generally; the birth of a whole range of new financial institutions and markets; at a systemic level, the dominance of finance over industry, with implications for capital investment and so for productive activity; market mechanisms, complemented or even reinforced by policies, that underpin rising inequality of incomes and of inequality more generally; consumption tending to be sustained by the extension of credit; not merely the expansion and proliferation of financial instruments and markets but also the penetration of such financing into a widening range of both economic and social (and environmental) reproduction; and a particular culture (individualistic, rationalistic, and market orientated). Seen through the lens financialisation as defined and outlined above, some of the transformations can be summarised as follows.

First, the Swedish financial system has been transformed from one of the most regulated to one of the least regulated in the developed world. A high degree of protectionism has been replaced by internationalism and openness to foreign financial interests. Sweden today is truly a small, *open*, economy.

Second, the previously under-developed financial market is barely recognisable. For a country with less than 10 million people, Sweden ranks disproportionately high in terms of stock market capitalisation and turnover in the SEK-denominated foreign exchange and derivatives markets.

Third, the country, traditionally regarded as having had a typical bank-based system, has embraced the more market-based model with gusto, and in many respects gone further than Anglo-Saxon countries. The banking sector remains large and has increased in size relative to GDP, and is highly concentrated. At the same time, a vast range of new players has entered the financial arena.

Fourth, neoliberalism (as defined broadly) has penetrated the Swedish society profoundly but also, perhaps surprisingly, with little social and political resistance. Seen from a political perspective, the country has transformed itself from a role model for those wishing to implement reforms often associated with the Swedish Social Democratic Party to a 'poster boy' for European parties on the Right, aiming to pursue an agenda with a limited role of the state. Hence, whereas Sweden was ahead its time in conducting

Keynesian economic policy, it has come to lead by example in implementing reforms associated with a free-market ideology.

Fifth, the change in macroeconomic, as well as monetary, policy has evolved remarkably during the period. The central bank adopted inflation targeting relatively early after a long tradition of various fixed exchange rate regimes, whereas government policy has changed to encompass a range of measures seemingly incompatible with the 'old' Swedish model, such as income tax cuts, large scale privatisation programmes and policies aimed at achieving budget surpluses and government debt reduction. Within the international foreign exchange and money markets, Sweden has evolved from being perceived as a volatile, unpredictable country during the late 1980s and early 1990s to gradually gaining a 'safe-haven' status.

Sixth, the rate of increase in *inequality* is the highest in the world, albeit from very low levels. The consensus-based and solidaristic wage negotiation process has been replaced by mediation in between increasingly fragmented unions.

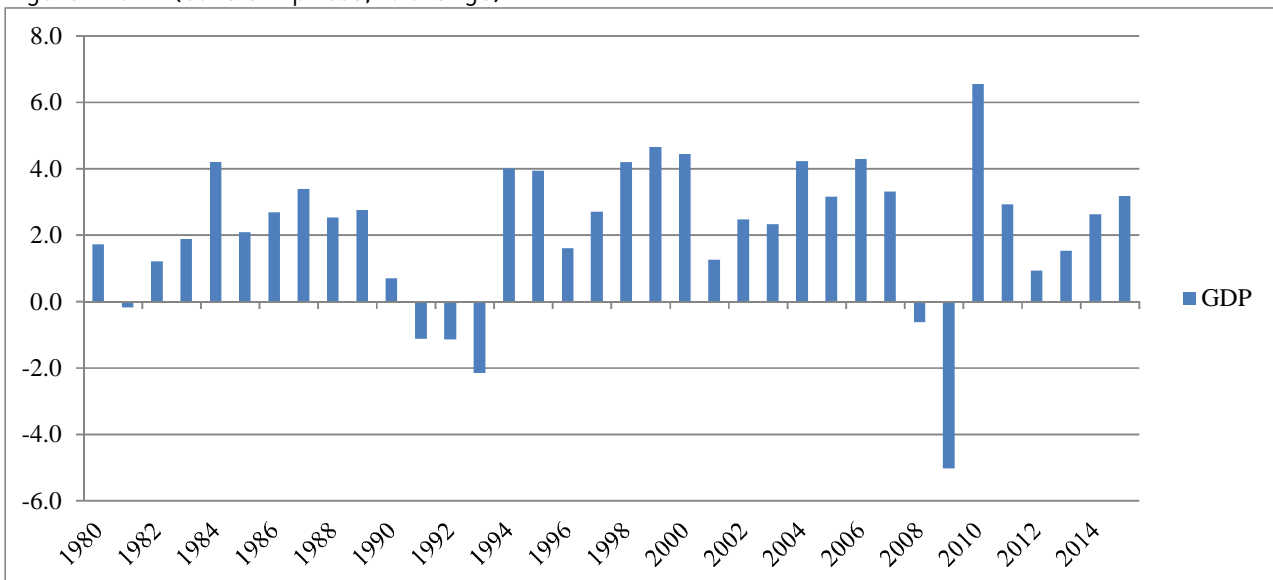
Seventh, the financialisation process has become highly visible in overall 'daily life', not least as market mechanisms have been encouraged to enter previously 'sacred' areas, such as housing, education, health care and pensions. The Swedish population has, directly and indirectly, become a collective of individual investors and risk managers highly exposed to the direction and volatility of the financial markets.

The financialisation process in Sweden might portray itself as a paradox. How could such a radical reform agenda be implemented without much opposition politically (given the political hegemony of the Social Democratic Party for almost a century) or popularly (given a largely homogenous population having grown accustomed to and prided itself of the Swedish model for several generations)? However, as Stenfors (2014a) argues, Sweden should not be regarded so much as a country that suddenly has abandoned the 'state' in favour of the 'markets', but as a culture that historically has been distinctively consensus-based, pragmatic and also rather individualistic. Financialisation has been embraced widely not as a perceived end-goal in itself, but as a pragmatic choice in an on-going ambition to maintain economic growth, full employment and individual freedom in an increasingly globalised world. In fact, the famous Swedish model contained a number of features that, when put to the test at particular junctions in time, proved unusually fertile for grains of financialisation: an overall belief in market mechanisms and efficiency (as long as quality and security is assured); a relatively corporate-friendly tax system; a conflict-free and non-politicised wage negotiation process; a unique long-term corporate governance structure; a pragmatic adoption of inflation targeting outside the Eurozone; a consensus-based agenda against budget deficits and unsustainable government debt; and a widely embraced strategy to increase household financial literacy both directly and indirectly.



However, Sweden has also had a different journey during the very recent era of financialisation, making comparisons with other European countries hard to find yet again. Sweden is neither member of the Eurozone, nor a small, open transitional economy like those in Central and Eastern Europe. Indeed, the global financial crisis – having provided the financialisation literature with an abundance of material and insights – affected Sweden differently. A severe downturn in 2009 was rapidly reversed (see Figure 1). This report aims to highlight some of these differences, and to trace their roots within the concept of financialisation.

Figure 1: GDP (constant prices, % change)



Sources: Statistics Sweden and NIER

With the global financial crisis in mind, it is useful to refer to Hein (2012) by distinguishing between two (or sometimes four<sup>2</sup>) types of capitalism under financialisation, when attempting to classify countries in accordance with rising current account imbalances in Europe, as well as in the world economy.

During the decade running up to the global financial crisis, ‘debt-led consumption boom’ countries (Greece, Ireland, Spain and the UK) were characterised by property booms and/or high increases in wealth-income ratios. High growth contributions of private consumption and domestic demand were mirrored in current account deficits. The

<sup>2</sup> Between the two extreme groups, Hein also identifies a third (consisting of France, Italy and Portugal) that could be considered as ‘domestic demand-led’, as well as a fourth comprising ‘weak export-led’ economies.

countries were also characterised by relatively high real GDP growth rates, as well as increases in inflation rates and nominal unit labour costs.

According to this classification, however, Sweden firmly positioned itself within the opposite group: namely among the 'export-led mercantilist' European economies (along with Austria, Belgium, Germany and the Netherlands). These countries were characterised by current account surpluses stemming from weak private consumption and domestic demand, as well as surpluses in the balances of goods and services. Property booms and/or increases in wealth ratios were prominent in Belgium, the Netherlands and Sweden, but not in Austria and Germany. The countries were also characterised by relatively low increases in inflation rates and nominal unit labour costs. With Sweden being the exception, the real GDP growth was consistently weaker among the countries in the latter group during the early 2000s.

Table 1: Swedish GDP growth contributions of main demand aggregates

Growth contribution / cycle	Household consumption	General government consumption	Gross fixed-capital formation	Stock-building	Balance of goods and services	Real GDP growth
1960-1969	2.38%	1.45%	1.20%	-	-0.67%	4.37%
1970-1979	1.59%	1.20%	0.20%	-	-0.55%	2.45%
1980-1989	0.71%	0.62%	1.06%	-	-0.15%	2.23%
1990-1993	-0.65%	-0.27%	-0.26%	-0.31%	0.32%	-0.93%
1994-2000	1.63%	0.12%	1.14%	0.20%	0.56%	3.66%
2001-2007	1.25%	0.26%	0.84%	0.00%	0.66%	3.01%
2008-2009	-0.06%	0.47%	-1.41%	-1.15%	-0.67%	-2.82%
2010-2013	1.18%	0.38%	0.79%	0.41%	0.26%	3.01%

Sources: NIER, Statistics Sweden and author's calculations.

However, as can be seen from Table 1, the three decades prior to the Swedish banking crisis during the early 1990s were characterised by high, but gradually slowing, GDP growth. Household and government consumption were key drivers of growth, as was the private corporate sector during the 1960s and 1980s. The balance of goods and services was negative. Thus, it could be argued that Sweden, prior to the era of financialisation, could broadly be classified as a 'debt led consumption regime'.

During the last two decades, the growth contribution of government consumption has been very weak, whereas the balance of goods and services has seen a sharp reversal. Apart from during the crisis-eras of 1990-93 and 2008-09 (which have been isolated as separate 'cycles' for the sake of clarity), the growth contribution of household consumption and gross fixed-capital formation has been moderately positive. It has generally been high in comparison with other export-led mercantilist European economies, but lower than for debt-led consumption boom countries.

This radical regime shift with regards to Sweden also becomes clear if we examine the sectoral financial balances (flows) during the equivalent cycles from 1980. As Table 2 shows, Sweden shifted to an export-led regime immediately after the domestic crises in the early 1990s.

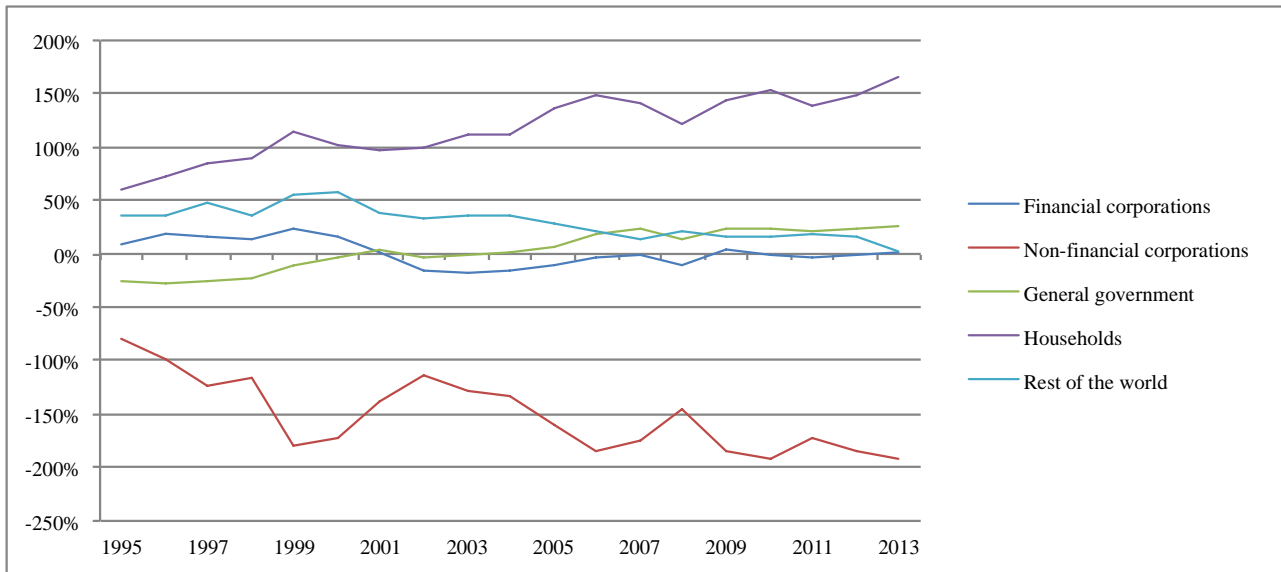
Table 2: Swedish sectoral financial balances (flows), % of GDP

Financial balances / cycle	Public sector	Household sector	Corporate sector	External sector
1980-1989	-1.09%	-1.08%	2.10%	0.08%
1990-1993	-3.68%	2.00%	0.11%	1.53%
1994-2000	-2.30%	1.61%	3.98%	-3.52%
2001-2007	1.00%	1.56%	3.72%	-6.65%
2008-2009	0.59%	3.87%	3.16%	-7.69%
2010-2013	-0.53%	4.42%	2.37%	-6.42%

Sources: AMECO and author's calculations.

With regards to the net financial positions of the main economic sectors in Sweden, Figure 2 shows the development since 1995. As can be seen, the situation at the beginning of the period was as follows: households were net lenders of financial funds, as were financial corporations and the rest of the world. The main net borrower was the non-financial corporate sector, whereas the government sector absorbed the remaining part of funds.

Figure 2: Financial balance sheets by sector (% of GDP)



Source: OECD, own calculations

Since then, households have improved their net financial position. During the same period, the government and financial corporations have also become net lenders, whereas the rest of the world has maintained its net (although slightly reduced) positive position. Consequently, non-financial corporations remains the only net borrower, having increasing their net indebtedness fivefold from 1995 to 2013. As the following sections will show, Sweden has gone through a transformation towards an export-led mercantilist economy that mirrors the demise of the old Swedish model and the rapid and widespread financialisation process during the recent decades. The country's experience during the global financial crisis echoes this transformation.

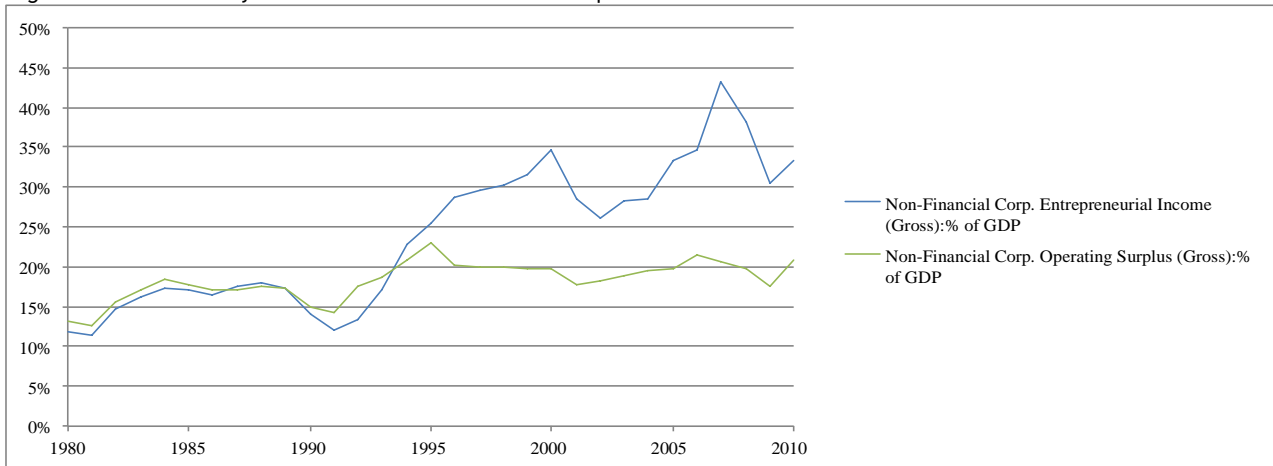
### 3. Long-run Effects of the Swedish Financialisation

#### 3.1. Financialisation and Investment

There are several ways in which the processes of financialisation might impact real investment. According to Hein (2010) and Hein & van Treeck (2010), this largely takes place through two different channels. First, during the era of financialisation and increasing market-orientation, shareholders have had a tendency to impose higher distribution of profits on firms. A higher dividend payout ratio reduces the internal means of finance for real investment, and thus the ability to invest is reduced (the 'internal means of finance channel'). Second, remuneration schemes within firms (based upon short-term profitability and financial market results) shifts the focus from investment in capital stock towards financial investments that are likely to generate short-term profits (the 'preference channel').

The entrepreneurial income and gross operating surplus of Swedish financial corporations has been fairly low and stable since 1980 in relation to GDP (Stenfors, 2014a). This, however, is in sharp contrast to the corresponding figures for non-financial corporations, where the gross operating surplus has increased from below 15% to around 20% of GDP, and the entrepreneurial income from a similar level to around 35% of GDP (Figure 3).

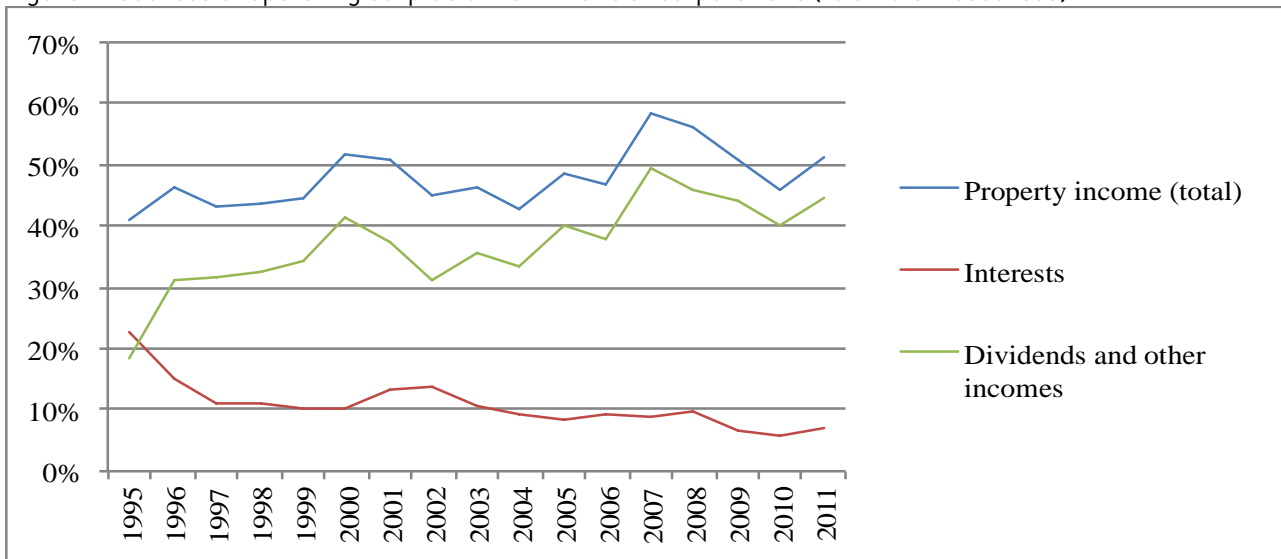
Figure 3: Profitability of Swedish non-financial corporations (% of GDP)



Source: Statistics Sweden

Figure 4 shows that, throughout the period 1995-2011, property income (consisting of interests, dividends and other financial rents) has increased significantly as a share of total resources for Swedish non-financial corporations (from 40.9% in 1995 to 51.4% in 2011, with a peak of 58.5% in 2007). This trend has been driven by an increase in dividend payments and other financial incomes obtained by non-financial corporations, and declining interest payments. This is not surprising considering the low level of interest rates in recent years (see Figures 21 and 43). The high proportion of property income obtained by Swedish non-financial corporations is fairly high compared to other countries.

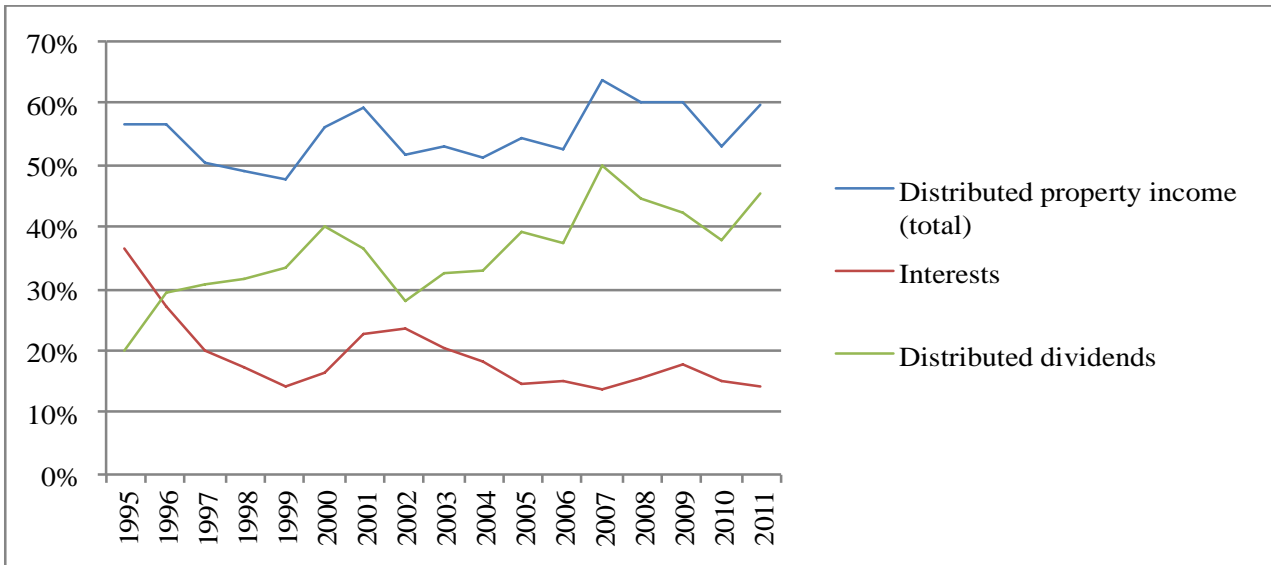
Figure 4: Sources of operating surplus of non-financial corporations (% of total resources)



Source: OECD, author's calculations

With regards to the use of resources, the share of profits distributed to shareholders by non-financial corporations can be interpreted as an indicator of the increasing shareholder value orientation by management. At the same time, retained profits affect investment in capital stock, as they represent an important source of financing. Figure 5 shows that the share of distributed property income of the total resources has increased slightly since the mid-1990s. The share of distributed income of corporations in terms of dividends has increased sharply, whereas the share of interest payments has declined.

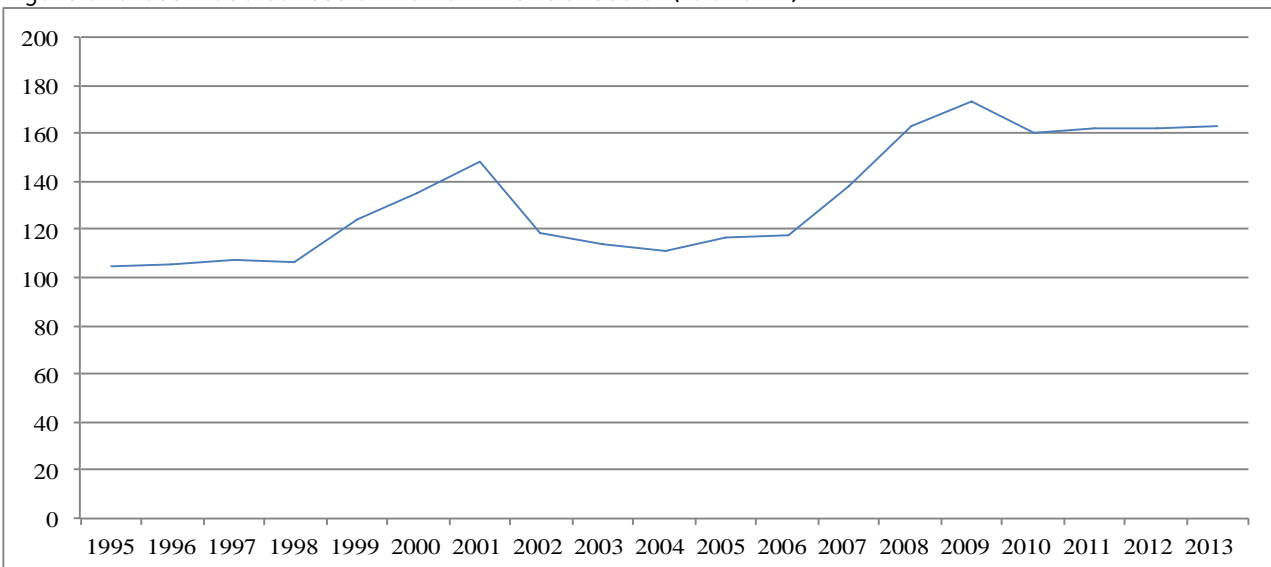
Figure 5: Uses of resources of non-financial corporations (% of total resources)



Source: OECD, author's calculations

The gross indebtedness of the Swedish non-financial sector has increased from just over 100% of GDP in 1995 to over 160% of GDP in 2013 (Figure 6).

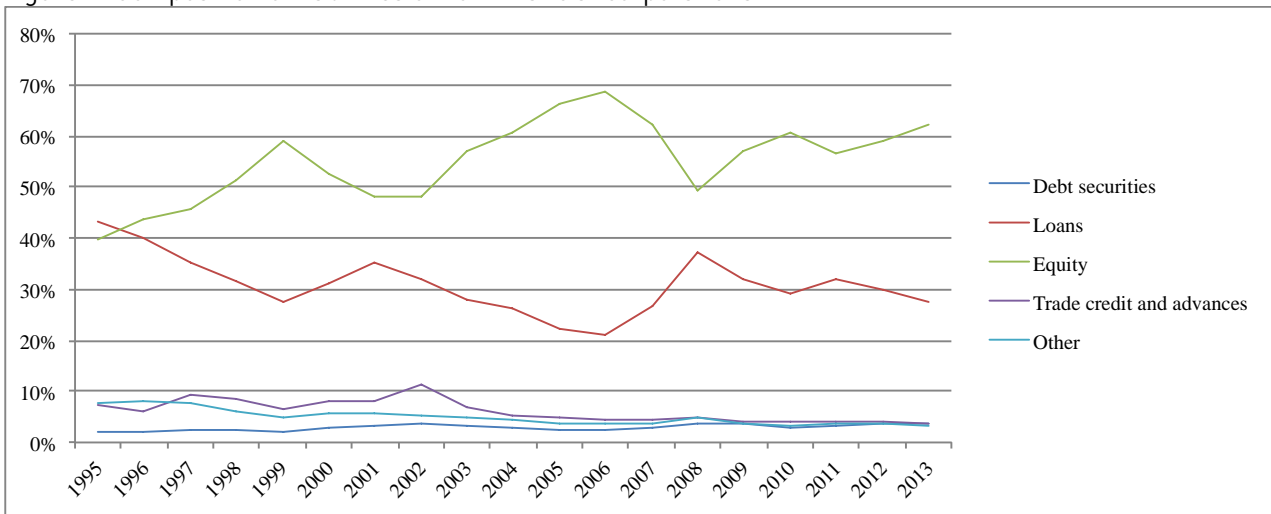
Figure 6: Gross indebtedness of the non-financial sector (% of GDP)



Source: Statistics Sweden, own calculations

Sweden has traditionally been seen as a bank-based system. However, as Stenfors (ibid) notes, the country has in several respects increasingly gained characteristics of a more market-based system during the era of financialisation. For instance, the last two decades have seen a marked shift in the loans to equity ratio on the liability side of non-financial corporations (Figure 7).

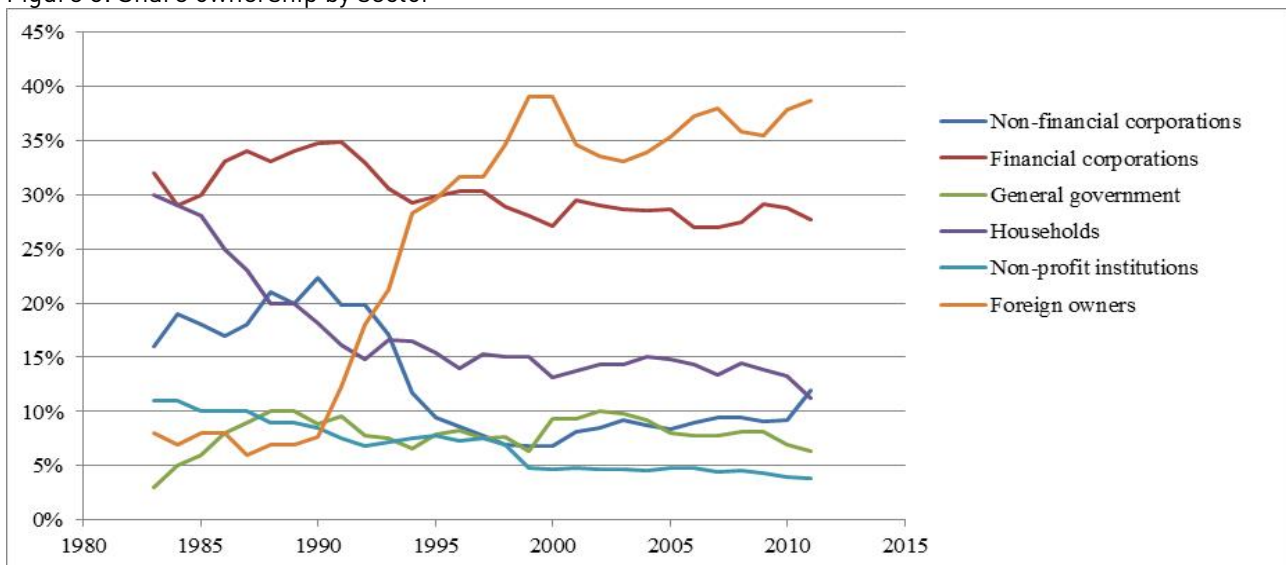
Figure 7: Composition of liabilities of non-financial corporations



Source: Statistics Sweden, own calculations. Note: 'Other' includes pension fund reserves; financial derivatives and employee stock options; and other accounts receivable/payable excluding trade credits and advances.

Nonetheless, the growth contribution of gross fixed capital formation to GDP has remained fairly stable at around 1% during each era since the 1960s, apart from during the Swedish banking crisis and the immediate aftermath of the global financial crisis (see table 1). Given the dramatic impact the Swedish deregulation process during the 1980s came to have on the domestic stock market and the corporate ownership landscape, this consistency might appear puzzling. For instance, as Figure 8 shows, foreign owners now represent around 40% of the Swedish stock market, compared to less than 8% by the late 1980s.

Figure 8: Share ownership by sector



Source: Statistics Sweden



The remarkable increase in stock market capitalisation and turnover in relation to GDP (see Figure 18 in Section 3.3) might suggest that the corporate landscape might be considerably more exposed to short-termism - that in turn would be reflected in the level of real investment. However, it should be noted that the Swedish financial system has had some characteristics that are not entirely consistent with this view.

First, state ownership has been fairly limited in comparison to, for instance, France and Germany. Contrary to the perception by (often) foreign observers, government ownership was never seen as particularly desirable – not even *prior* to the deregulation process.

Second, consensus-based politics between the state, trade unions and bank-related business groups has been at the core of the Swedish model, having had a significant impact on the shaping of the financial system. The government has largely been absent from the collective bargaining process in wage-negotiations. Consequently, the strong trade unions (on behalf of the employers as well as the employees) should not be seen as having put constraints on market forces generally (and thus hindering a process towards a more market-based financial system). Rather, they acted precisely *as if* market forces ultimately determined wage levels. The government did intervene with regards to labour market policies, but rarely in the wage mechanism itself.

Third, and perhaps most importantly in this respect, powerful investment companies such as Investor (part of the Wallenberg group and thus SEB) and Industrivärden (part of the Handelsbanken group) rather than banks have fulfilled the banks' role as provider of funds to industry (Reiter, 2003). Thus, banks have played an indirect, rather than direct, role in what could be regarded as the Swedish-style bank-based system.

Swedish corporate governance, i.e. the system in which companies are directed and controlled, can be seen as an extreme form of the so-called 'Rheinland model', with a regulatory mix stretching back far back in history. The country has been a coordinated market economy dominated by a few large industrial groups promoting organic growth (Habbard, 2008). Supported by a consensus-driven political setting, the stability and concentration of the ownership structure has remained remarkably stable, even *after* the deregulation phase two decades ago. An extensive use of controlling enhancing mechanisms is central to Swedish corporate governance - in other words the disconnection between share ownership and control right in terms of voting rights. The country stands out by having disproportionately large holders of A-shares (with 10 times more voting rights than B-shares). It is important to note that new important investors, such as foreigners and pension funds generally hold B-shares. The impact of this should not be underestimated. For instance, the Wallenberg family 'only' owned 1% of the total value of listed shares on the Swedish stock exchange in 1998. However, Investor (the Wallenberg-owned investment company) had control over approximately 42% of the total stock market value. Seen from another perspective, Investor and the other major

investment company Industrivärden owned around €20 billion worth of shares on the stock exchange in 2005. They could, however, exert significant influence over 15 OMXS companies with a total market capitalisation of €144 billion.

From the outside, the corporate governance structure in Sweden (favouring a few powerful and wealthy) could be seen as incompatible with the Swedish model. However, this paradox can mainly be explained by the fact that the export industry was fundamentally seen as the economic motor required for full employment. The unique ownership structure was seen as stable and long-term focussed, and incentives were welcomed where family fortunes were re-invested in the companies and organic growth prevented short-termism and capital flight. The deregulation process was an important factor leading to the gradual erosion of this old system of Swedish corporatism. To a large degree, the importance of bank-related investment companies has been reduced, as they have been forced to consolidate their holdings in a smaller number of companies in order to keep a controlling share. Foreign investors, on the other hand, have increased substantially – suggesting the influx of more anonymous and short-term oriented owners. Likewise, pension funds and insurance companies have become increasingly important actors on the Swedish stock market. Thus, despite profound changes in other parts of the financial system as a result of the rapid deregulation process in the 1980s and 1990s, the corporate governance regime has managed to remain relatively intact. The system has allowed the controlling entities to remain powerful, with their voting rights immune against the influx of new (and foreign) investors (Habbard, 2008). Moreover, the pension reform in 2000 did increase the importance of the AP pension funds, but without a corresponding dilution in ownership concentration.

All in all, it appears to be unclear whether the level of real investment in Sweden has suffered as a result of the 'preference channel' or the 'internal means of finance channel' as in other countries. Undoubtedly, several points indicate that the Swedish non-financial sector has become increasingly market-oriented and 'financialised'. Incentive structures such as stock option plans have also become commonplace in large multinationals, as well as SMEs. However, a unique corporate governance structure, combined with a tax system that does not directly favour managerial short-termism, could be seen as examples where Sweden has chosen a different path from Anglo-Saxon countries.

### 3.2. Financialisation and Distribution

Financialisation is often associated with a falling labour income share and growing inequality. In the Swedish case, this needs to be seen in the light of the solidaristic wage strategy that prevailed under the 'old' Swedish model. Three features were notable in this regard. The first feature was the centralised wage bargaining system, which was characterised by a very high level unionisation among workers generally, coupled with

strong unions on both the employees (LO) and the employers' (SAF) side. The second feature was the 'solidaristic wage strategy' – namely an inherent desire to achieve and sustain full employment without creating inflationary pressures. This also suited the employers as it promoted industrial peace and wage restraint. The third feature was the prevalence of the government in actively implementing labour market policies to smooth the transformation in industry, for instance through employment exchanges, retraining schemes, wage subsidies and measures to enhance labour mobility. It is important to note that the collective bargaining process in itself was highly self-regulated and not subject to government intervention. As such, the 'Rehn-Meidner model'<sup>3</sup> acknowledged the existence of market failures, and the trade-off between inflation and full employment (Marshall, 1996).

This model was, however, largely replaced in the early 1990s. Several factors point to the demise of the former institutional mechanism, and the re-emergence of a system based upon decentralised bargaining.

First, the inflation record was poor, with economic stagnation and increasingly uncontrolled inflation becoming the norm in the 1970s. Sweden experienced a decade of very high and volatile inflation running up to the mid-1980s. The 12-month average CPI-based inflation rate gradually rose from around 2% to 13% during the 1970s. After a drop below 7% around the turn of the decade, the inflation increased to 14% during the early 1980s, for then to gradually fall back below 4% in 1987. As a consequence, the Swedish krona kept on appreciating in real terms and the policy response was a series of devaluations from 1978 onwards to restore the real exchange rate. However, coupled with weak government finances, the real appreciation continued – prompting renewed devaluation expectations reflected in money market and FX forward rates (Englund, 1999).

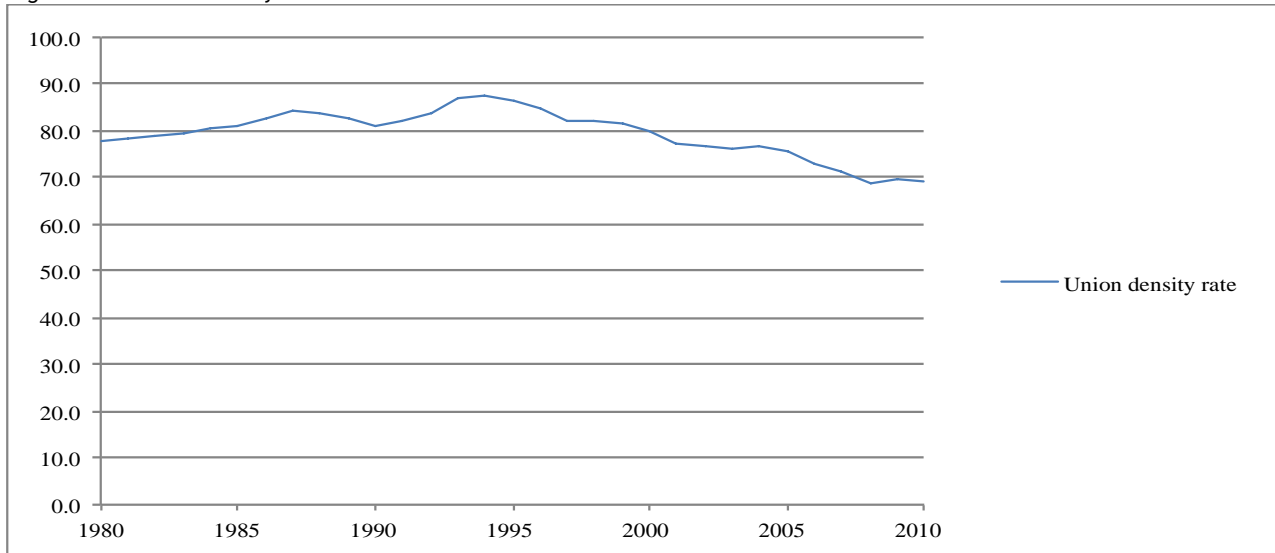
Second, the unionisation structure became increasingly fragmented. The importance of blue-collar unions decreased at the expense of a significant increase in white-collar trade union membership in both the private and public sectors, which led to a growing inter-union rivalry. On the whole, white-collar unions were in opposition to reduced wage differentials between blue-collar and their own workers. Although the union membership

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<sup>3</sup> The model, which came to be central to the economic policy agenda of the Social Democratic Party, was created by the two LO economists Gösta Rehn and Rudolf Meidner in the early 1950s (LO, 1951). Whereas the Swedish model more broadly was referred to as a synthesis between capitalism and socialism, the Rehn-Meidner model could more specifically be seen as a 'third way' – by rejecting monetarism and questioning Keynesianism. A solidaristic wage policy was at the heart of the model. People doing identical work ought to be rewarded equally, regardless of the profitability of the company. This would put pressure on firms and sectors with low profit margins, and stimulate a structural change. Firms and sectors generating excess profits as a result of the policy would expand. However, with a restrictive economic policy and the promotion of labour market mobility, the policy overall would prevent a wage drift in the booming sectors and thus not be inflationary. Hence, the Rehn-Meidner model did not strive to wage equalisation in general, but aimed to achieve four goals simultaneously within economic policy: full employment, low inflation, economic growth and even income distribution (Erixon, 2002)

rate remains very high in Sweden, Figure 9 shows the decline since the peak during the mid-1990s.

Figure 9: Union density rate in Sweden (%)

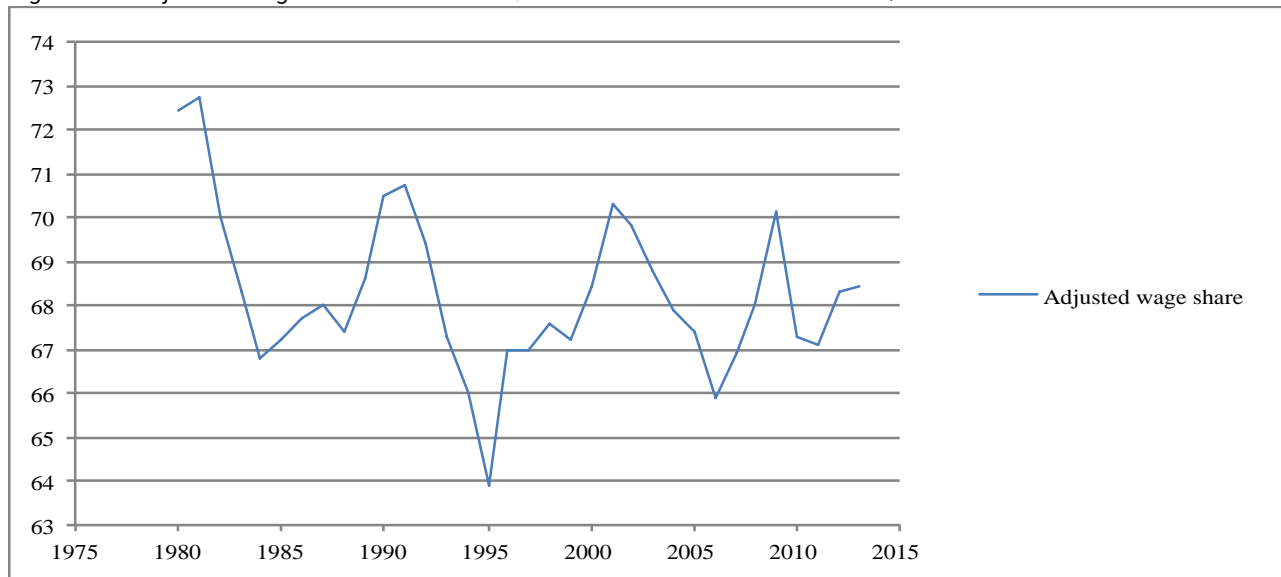


Note: net union membership as a proportion wage and salary earners in employment. Source: Visser (2009).

Third, the deregulation process during the 1980s, particularly with regards to capital flows, put significant international constraints upon domestic wage-negotiating strategies.

Consequently, the employers' unions began to demand more flexibility in the wage negotiation process. As such, the Agreement on Industrial Development and Wage Formation (also known as 'Industriavtalet', or the Industrial Agreement) of 1997 marked the most important innovation in wage bargaining relations since the Saltsjöbaden Agreement of 1938, when LO and SAF accepted voluntary restraint on their resort to industrial action. The new system introduced private mediation, and came to act as a model for other sectors of the labour market. At the heart of the agreement was a consensus view that the Swedish industry – highly dependent on exports within a deregulated EU market - needed to remain competitive and profitable in order to achieve full employment. Taxation should thus become more aligned with international standards to stimulate work, education and enterprise; research and development should be encouraged; and education should be geared towards the needs of the industry (Elvander, 2002). It could thus be argued that the wage strategy has fewer characteristics today that would make it seem 'solidaristic'. This shift has taken place in tandem with a range of market-oriented reforms affecting individuals and households (such as housing, pensions and health care).

Figure 10: Adjusted wage share in Sweden (% of GDP at current factor cost)



Source: AMECO

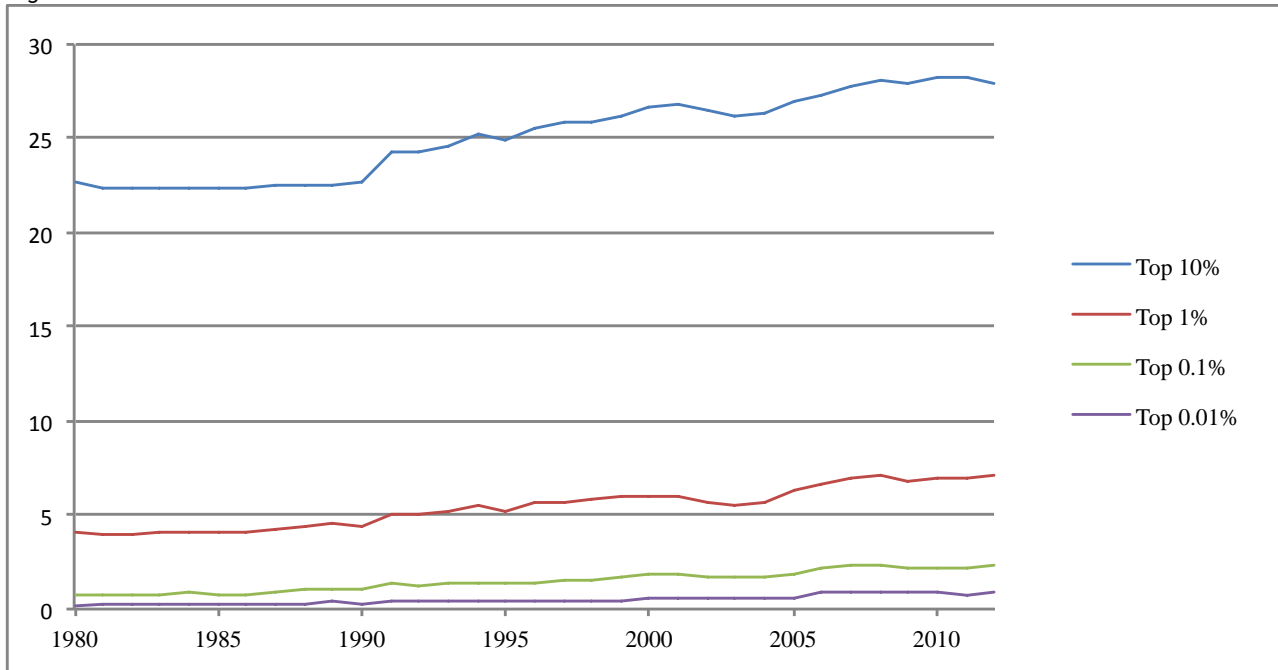
Despite being a highly volatile indicator, the adjusted wage share in Sweden has been falling during the recent decades, as shown in Figure 10.<sup>4</sup> However, whereas Sweden remains one of the most equal countries in the world, income inequality has undoubtedly surged rapidly during the last two decades. Roine & Waldenström (2008), studying the top income shares in Sweden during the period 1903-2004, find that most of the decrease in top income shares prior to 1980 took place during the first half of the 20<sup>th</sup> century, i.e. prior to the expansion of the Swedish welfare state. In fact, the decreasing share of the various top percentiles shows a fairly similar trend to that of rest of Western Europe. From 1980 onwards however, there appears to be a clear break in comparison to other countries. Whereas top-income shares have increased significantly in Anglo-Saxon countries, the development in Continental Europe has been considerably more stable. Sweden stands out insofar as the top income shares resemble that of Anglo-Saxon countries if realised capital gains are included, but that of Continental Europe if left out of the equation. The authors suggest that an explanation for this could be that *'Sweden over the last 20 years has become a country where it is more important to make the right investments than to earn a lot to become rich'* (ibid, p. 366).

As shown in Figure 11, the income share of the top earners in Sweden has risen since the latter half of the 1980s. For the top 10%, the income share has increased from 22.73% in 1980 to 27.90% in 2012, and for the top 1% from 4.05% to 7.13% during the same period.

<sup>4</sup> For an empirical analysis of the effect of financialisation on the adjusted wage share, see Dühaupt, 2013.

The increase for the highest earners (the top 0.1% and 0.01%) has been even more pronounced: from 0.74% to 2.37% and from 0.17% to 0.93% respectively.

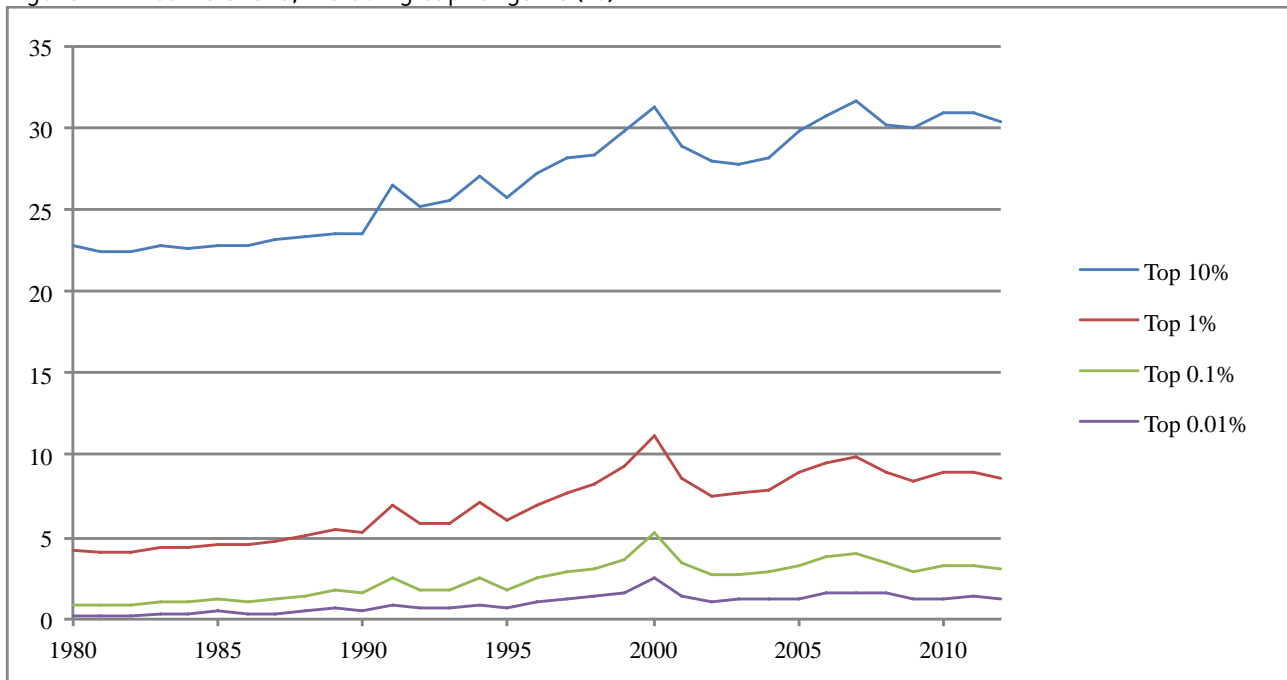
Figure 11: Income share (%)



Source: Roine & Waldenström (2010)

When capital gains are included in the data set (shown in Figure 12), the rise in considerably more pronounced (but also more volatile). Seen from this perspective, the income share of the top 10% rose from 22.82% in 1980 to 30.45% in 2012. For the top 1%, the income share rose from 4.13% to 8.67%, for the top 0.1% from 0.79% to 3.15% and for the top 0.01% from 0.19% to 1.27%. This has also been reflected in a higher Gini coefficient for Sweden. Between 1995 and 2006, the Gini coefficient for Sweden rose from around 0.21 to 0.26 if capital gains are excluded, and from 0.23 to 0.29 if capital gains are included (Fiscal Policy Council, 2013).

Figure 12: Income share, including capital gains (%)



Source: Roine & Waldenström (2010)

Thus, the increase in average income (including capital gains) in Sweden during this period has been highly uneven. Whereas the bottom 90% of the working population has seen an inflation adjusted increase of 57% from 1980 to 2012, the corresponding figure is 132% for the top 10%, 265% for the top 1%, 595% for the top 0.1% and a remarkable 1062% for the top 0.01%. The results are also in line with a study on wealth concentration by the same authors (Roine & Waldenström, 2009). Here, a clear break in the long-term equalisation of wealth around 1980 is demonstrated, with a current trend towards increasing inequality.

In fact, according to the OECD (2011), Sweden occupies the top spot when it comes to growth in *inequality* between 1985 and the late 2000s. According to Statistics Sweden (2012a), the increasing social stratification during this period is prominent across the board. The economic standard for gainfully employed persons (aged 20-64) increased by 41%, while those not gainfully employed had an increase of 9%. In 2011, the economic standard for those not gainfully employed was 58% of those who were gainfully employed. In 1999 the corresponding figure was 75%. The youngest persons (<20) have experienced better developments than the oldest persons (>75): an increase of 46% and 26% respectively. Further, foreign-born persons did not have as large an increase as Swedish born persons. Adult (>20) foreign-born persons saw their economy grow 27%, compared to 41% for Swedish born persons. Income has increased at all income levels but the increase is significantly larger for those with the highest incomes. Income increased by 55 % for the richest 10%, whereas the poorest 10% had an increase of just 21%. The percentage of the

population with a 'low economic standard' increased from 8.4% in 1999 to 14.4% in 2011. For singles with children this share has increased from 11% to 31%.

To sum up, the solidaristic wage strategy that was at the heart of the Swedish model was gradually abandoned in conjunction with the rise of the financialisation process. Although it is unclear whether this has directly led to a falling labour wage share, the growing income inequality with regards to income distribution (with or without capital gains) appears to be directly linked to a growing trend from welfare- to market-promoting policy decisions.

### 3.3. Financialisation and Household Consumption

The effect of the Swedish deregulation process on house prices and the subsequent banking crisis during the early 1990s is well documented (see, for instance, Stenfors, 2014a). As mentioned in Section 2, however, the debt-led consumption boom that prevailed in the run-up to the crisis was almost immediately replaced by an export-led mercantilist regime. Nonetheless, the contribution of household consumption to the Swedish GDP growth during the last decade has been higher than in other comparable European export-led mercantilist regimes. In fact, the financialisation process in Sweden *after* the banking crisis appears to have recreated a domestic housing boom that has neither been halted by the global financial crisis, nor the Eurozone sovereign debt crisis.

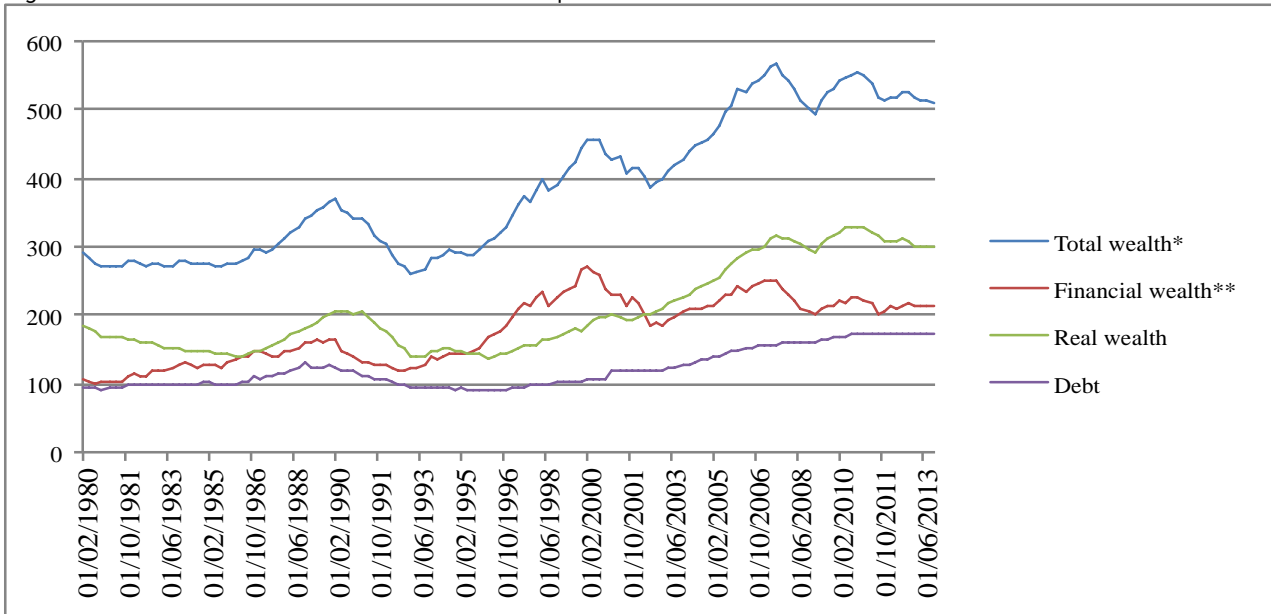
During the last few decades, the wealth and debt composition of Swedish households has seen a vast change in relation to disposable income. Figure 13 shows the development according to the Riksbank's measurement methodology<sup>5</sup>. Five broad trends are notable.

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<sup>5</sup> Here, 'real wealth' not only includes single-family dwellings and second homes, but also tenant-owned apartments (which is defined as a financial asset in the data by Statistics Sweden). 'Financial wealth' excludes tenant-owned apartments and collective insurance schemes.



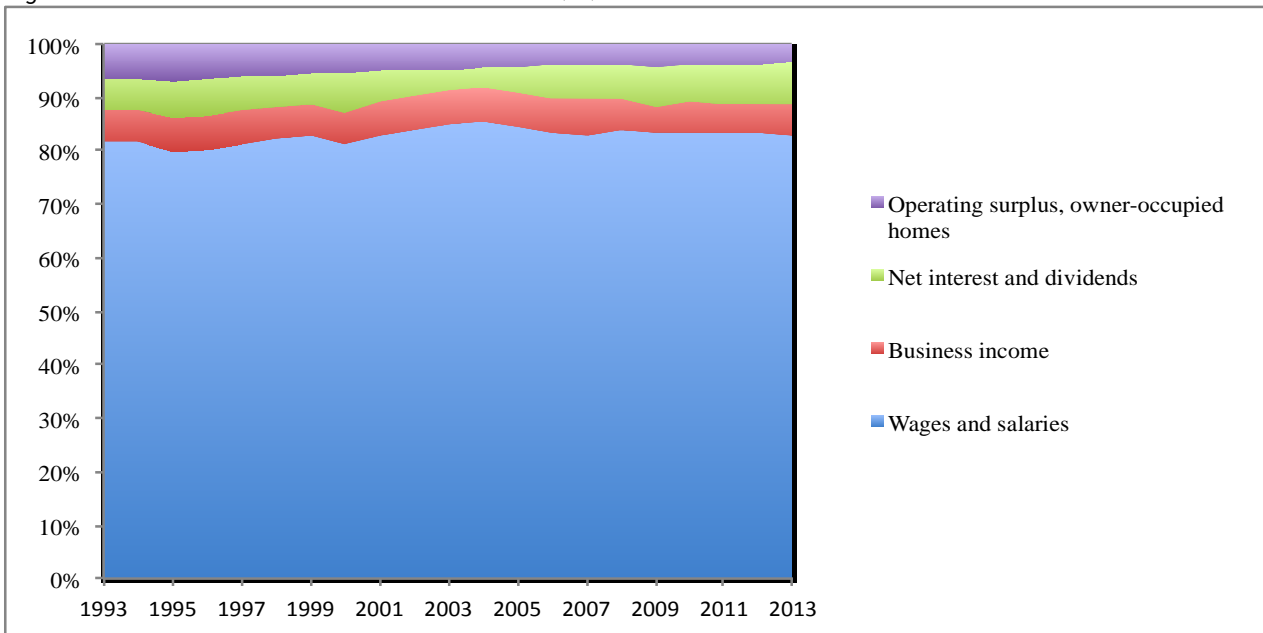
Figure 13: Household wealth and debt (% of disposable income)



Notes: 'Total wealth' is excluding collective insurance savings; 'Financial wealth' is excluding tenant-owned apartments and collective insurance schemes. Sources: Statistics Sweden and Sveriges Riksbank.

First, wages and salaries make up the vast majority (over 80%) of household factor income (see Figure 14).

Figure 14: Sources of household factor income (%)

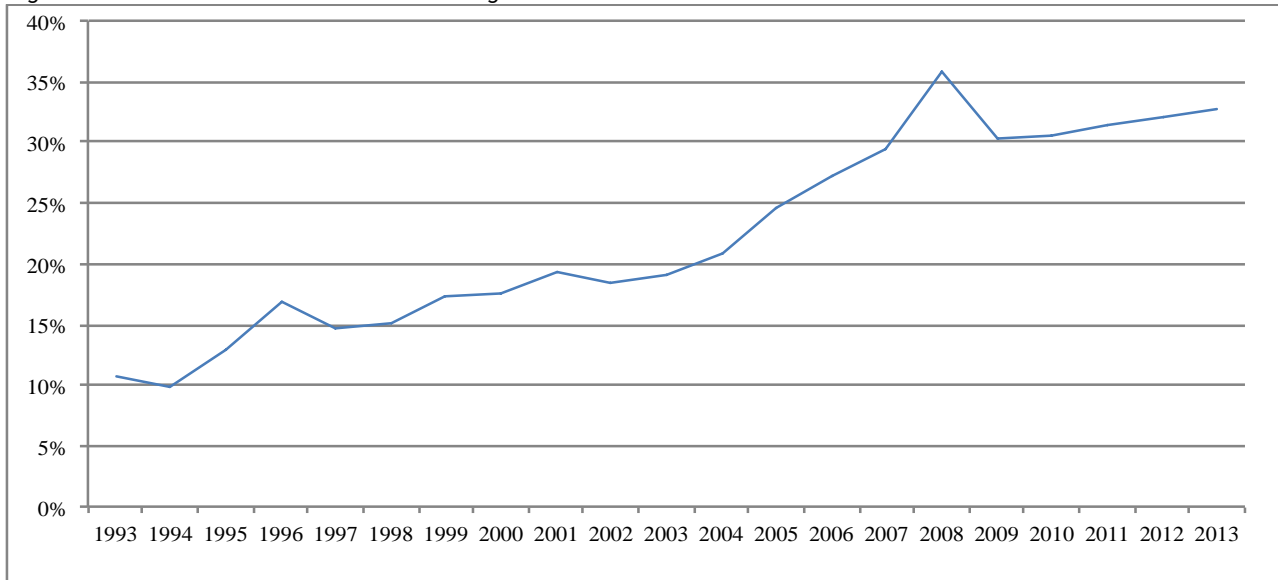


Sources: Statistics Sweden, NIER and author's own calculations

At the same time, however, the share of dividend income as a percentage of the total non-wage factor income has increased substantially during the last two decades. Whereas the

ratio was around 10% after the Swedish banking crisis, it stood at over 30% in 2013 (see Figure 15).

Figure 15: Dividend income (% of non-wage factor income for households)

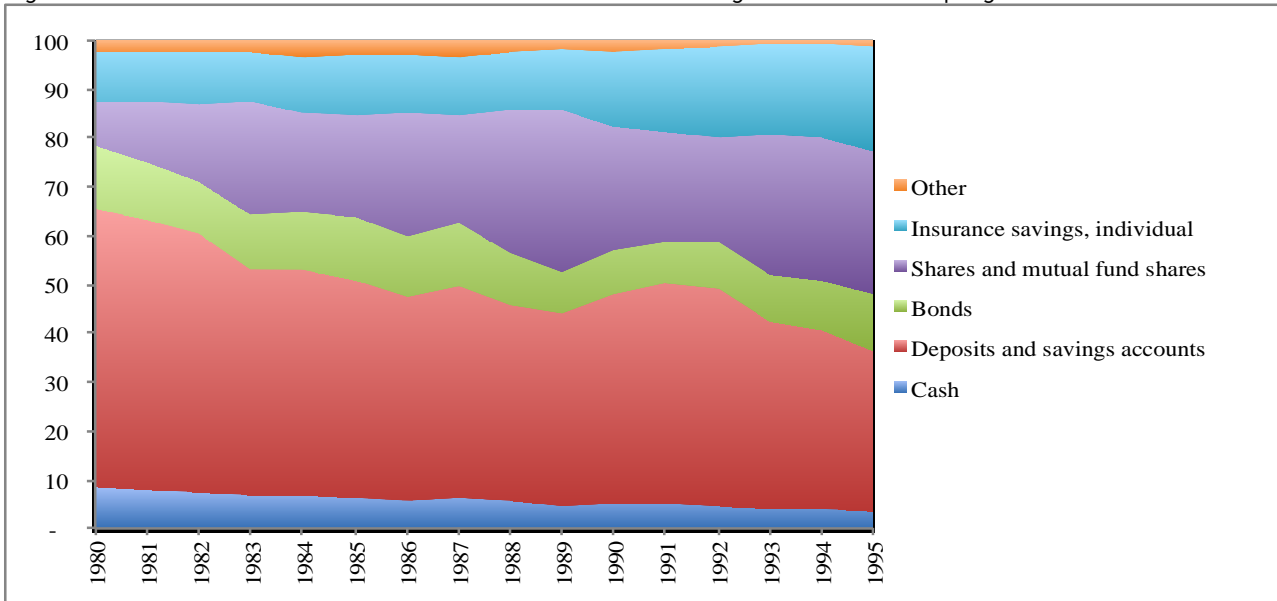


Sources: Statistics Sweden, NIER and author's own calculations

Second, household 'financial wealth' (as defined by the Riksbank above) roughly equalled household disposable income in 1980. Following the deregulation process, this ratio has gradually increased from 1 to 2.5. After a dip around the dot-com crisis, it has been fairly stable at around twice the disposable income.

Third, the distribution of household financial assets has seen a remarkable shift from what could be seen as relatively risk-free investments (such as deposits, savings accounts and bonds) towards riskier assets (as shares and mutual funds). In addition, the share of insurance savings has increased substantially. From Figure 16 we can see the changing pattern of households' financial assets (excluding tenant ownership rights) between 1980 and 1995. The share of deposits and savings accounts gradually fell from around two-thirds in the 1980 to one-third in 1995. The decrease is largely offset by an increase in individual insurance savings, shares and mutual funds.

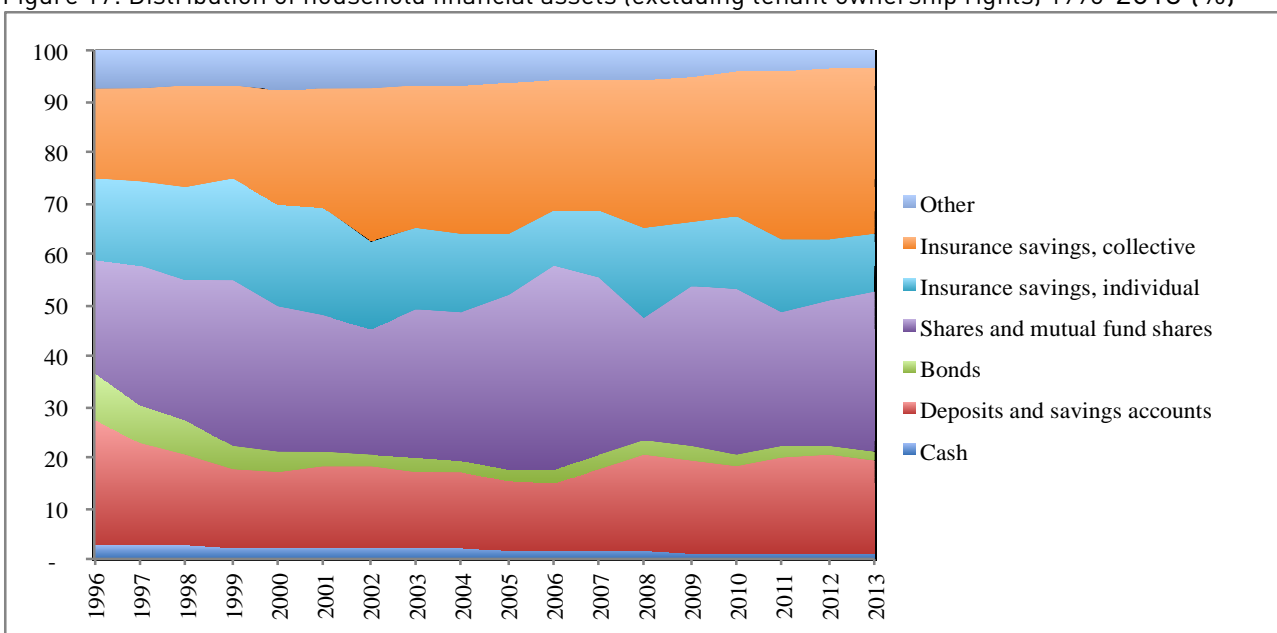
Figure 16: Distribution of household financial assets (excluding tenant ownership rights) 1980-1995 (%)



Sources: Statistics Sweden and author's own calculations

From 1996 to 2013, collective insurance saving is also included in the household assets as reported by Statistics Sweden. Figure 17 shows the continuing decline in deposits, savings accounts, but also bond holdings. The proportion invested in shares and mutual funds continues to increase, as well as total insurance savings. In 2012, around half of the mutual funds' assets consisted of equities, whereas a quarter was interest rate funds. The remaining part was made up by mixed funds (19%) and hedge funds (around 5%).

Figure 17: Distribution of household financial assets (excluding tenant ownership rights) 1996-2013 (%)



Sources: Statistics Sweden and author's own calculations



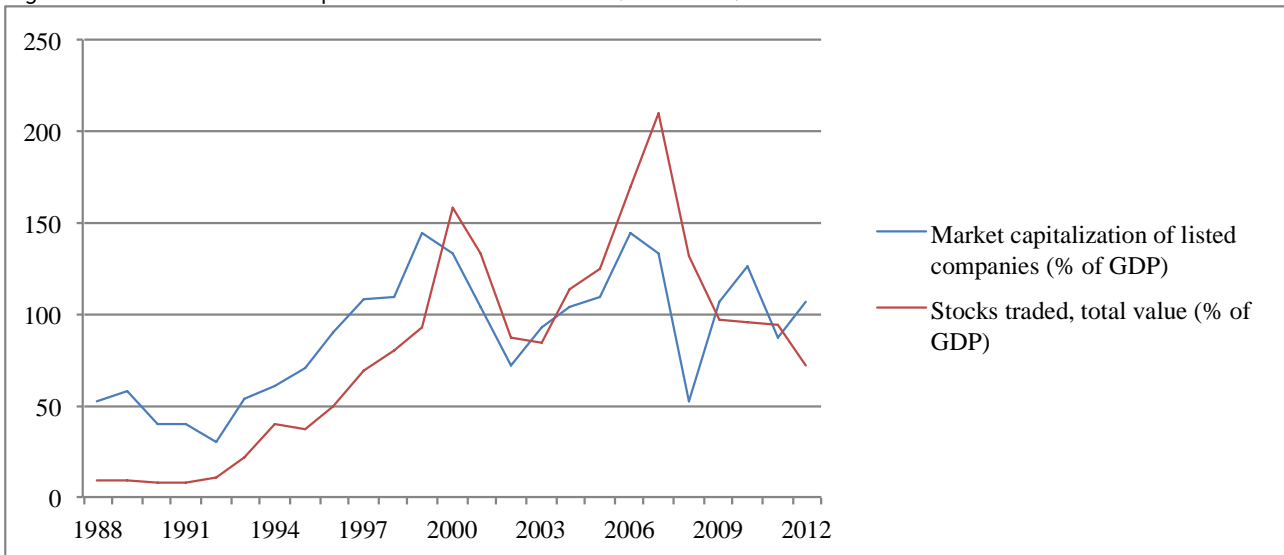
In 2012, around three-quarters of the Swedish population invested in mutual funds (excluding the Premium Pension). It is important to note that mainly as a result of the new pension system, almost all adult Swedes are exposed to mutual funds directly or indirectly. During the early 1990s, the old pension system came to be perceived as unsustainable, with its assumptions of considerably lower life expectancies, a steadily growing labour force and a real growth rate of 4%. The deep recession following the banking crisis, leading to a significant fall in the contribution rate, prompted a debate about an urgent – and radical – reform of the pension system. The new system, passed by the Parliament in 1994, had four goals: a fair treatment of persons with different contribution histories, a transparent redistribution, long-term financial stability and an aim to create financial saving managed by private financial institutions (Palmer, 2000). It was based upon three pillars: First, the guaranteed People's Pension was changed into a basic and means-tested Guarantee Pension. Second, the ATP system (which provided full benefits for those having worked full-time for 30 years on the basis of the 'best' 15 years) was replaced an Income Pension, which was based upon a 16% contribution of individual annual earnings. The third component was the Premium Reserve System ('Premiereservsystemet', PRS), built upon savings from 2.5% of individual annual earnings. Here, pension savers were urged to select their own portfolio of up to 5 from hundreds of unit trust funds with varying risk profiles.

The new model separates the capital accumulation phase from the annuity phase in institutional terms. A separate body, the Premium Pension Authority (PPA), was set up in 1998 to act as a 'clearing house' during the investment phase (when the individuals select and 'trade' their investments) and during the annuity phase (when, being retired, individuals are provided the funds). The new Swedish pension system has no guarantees with regards to the rate of return, nor are there any additional regulations with regards to the funds allowed to act as outlets for the individuals' investments. Although there is a public fund for 'non-choosers' (that holds a mixed portfolio of bonds and domestic and foreign equities), there is no doubt that the new system has had an overall tendency to transfer risk from state and employers to the individual. Pension saving has hereby been transformed towards a kind of active portfolio and risk management by the individual, with an increasing dependency on the performance and volatility of the financial markets. The incentives to save privately have increased, as have the requirements to gain financial literacy (Belfrage & Ryner, 2009). Indeed, as pointed out by Belfrage (2008), the Swedish pension reform is extremely risk-privatising also by European standards.

Already in the 1980s, fund saving was stimulated as a result of favourable tax rules. However, it was the deregulation process that truly got the Swedish stock market soaring. From having a turnover of just SEK 7 billion in 1980 (Reiter, 2003), it showed an increase of almost 2500% in less than 10 years. The market capitalisation increased from SEK 558 billion in 1990 to SEK 3,717 billion by the end of the decade. Seen in comparison to the

Swedish GDP, stock market turnover rapidly increased from less than 8% to over 200% (before the outbreak of the global financial crisis). Stock market capitalisation of listed companies in relation to GDP has more than doubled during the period and now accounts for around 100% of the Swedish GDP (see Figure 18).

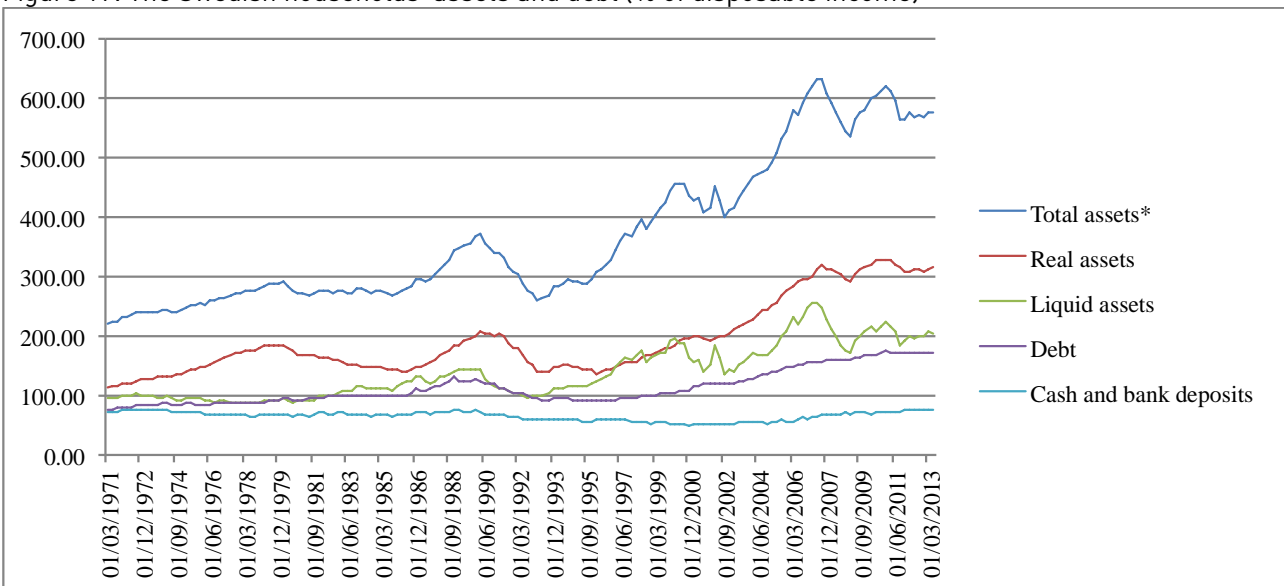
Figure 18: Stock market capitalisation and turnover (% of GDP)



Source: The World Bank

Figure 19 shows the Swedish households' assets and debt as a percentage of disposable income since the early 1970s. A steady increase in asset holdings starting from the aftermath of the Swedish banking crisis can be seen.

Figure 19: The Swedish households' assets and debt (% of disposable income)



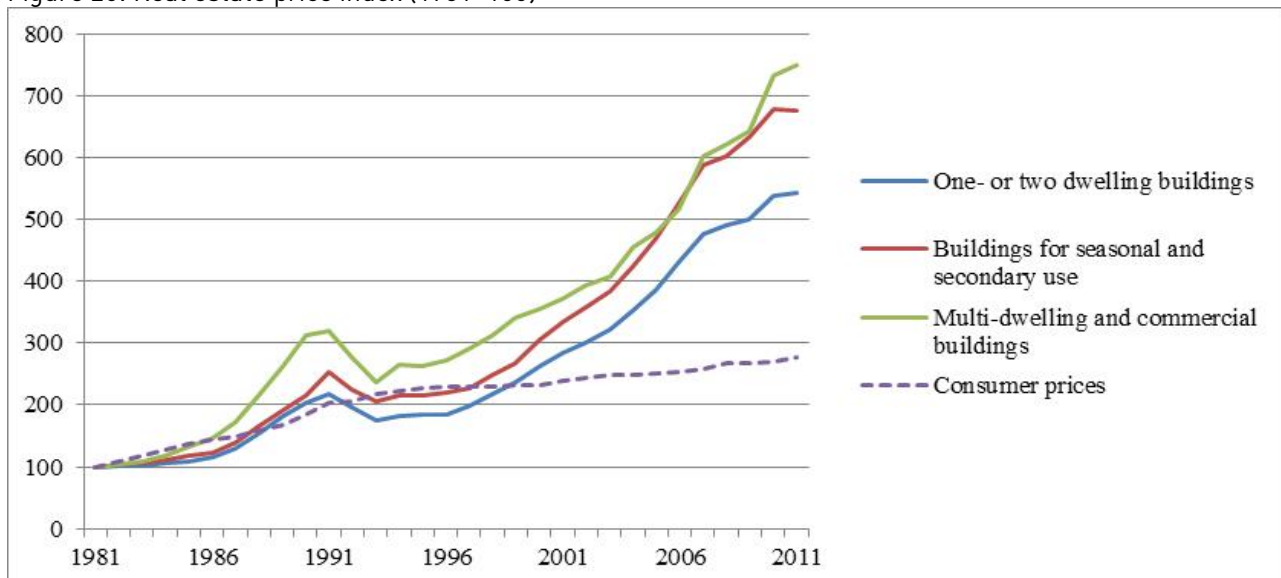
Sources: Statistics Sweden and Sveriges Riksbank. Note: 'Liquid assets' refers mainly to cash, bank deposits, bonds, mutual funds and shares. The figures for liquid assets have been revised upwards from the

beginning of the second quarter of 2002. Real assets are for example houses. \*) Excluding collective insurance.

However, it has to be noted that 'liquid assets' are of volatile nature, as they are highly correlated with the development of the Swedish stock market.

The fourth notable change relates to the housing market. Figure 19 above clearly shows the impact of the Swedish banking crisis on housing prices (and consequently real assets) during the early 1990s. The development of the property market was dramatic during this period (see Figure 20). However, the boom years came to an end during the autumn of 1989, with a large price correction. By the end of 1990s, the real estate index had fallen by 52% against its peak the previous year. Since 1993, however, real wealth has steadily increased from around 150% of household disposable income to over 300%. Again, whereas household financial asset returns are closely correlated with the development of the Swedish stock market, household real asset returns are equally dependent on the development of the housing market. Considering the magnitude of the banking crisis, however, the property and mortgage markets manage to recover quickly. In fact, the increase in property prices has been considerably higher than inflation since the mid-1990s.

Figure 20: Real estate price index (1981=100)



Source: Statistics Sweden

Today, more than 70% of the Swedish households own their property. Of these, 96% have a mortgage. This figure is high in an international comparison. In 2012, the total loans secured on residential property amounted to SEK 2,874 billion (Svenska Bankföreningen, 2013). However, it is important to highlight that rents have risen considerably faster than the cost of living in occupancy, let alone inflation, during this period (Bergensträhle, 2006). As such, this process has benefitted property ownership at the expense of tenants in

rental housing. As Hedin et al (2012) point out, tenure neutrality was a cornerstone of the old Swedish housing policy model. This is clearly no longer the case.

During the last few decades, the Swedish housing sector has been transformed from one of the most regulated in Europe to one of the most market-oriented (Hedin et al., 2012). As Lind & Lundström (2007) note, state engagement is now considerably less pronounced than in the UK and the US, traditionally seen as prominent proponents of market liberalism.

Up until the 1930s, the Swedish housing sector was relatively free from government intervention. The so-called 'krisprogrammet' (the 'Crisis Programme') of 1933, however, resulted in a radical change towards state support of the sector. In line with the ideology of the Social Democratic Party, the housing policy during the following decades came to be of general, rather than selective, character - with aims including an elimination of the housing shortage, a large scale modernisation, affordable rents throughout and a non-profit maximising housing management. The shift was also motivated by a Keynesian economic thought process (Englund, 1993). Thus, a number of regulations aimed at stimulating the housing sector were introduced during the early 1950s, following the conclusions of a commission of major inquiry into social housing (Sveriges Riksbank, 2014). This also led to the famous 'miljonprogrammet' (the 'Million Programme') - namely an ambitious plan to create one million new homes between 1965 and 1975. The programme came to be implemented quite literally (Englund, 1993).

During the early 1990s, however, a range of neoliberal housing policy reforms began to be implemented. For example, one of the first things the Moderate Party came to do when seizing power in 1991 was to dismantle the Department of Housing, which had been one of the political pillars of the Swedish welfare system. Hereby, the gradual transformation towards a commoditisation of housing started. The abolishment of the Housing Provision Law, the Housing Assignment Law and the Land Condition Law paved the way for a new system with radically reduced subsidies and allowances (Hedin et al., 2012). Although the Social Democratic Party quickly returned to power, no attempt was made to reverse, or even slow down, the process. As Clark & Johnson (2009) argue, this structural shift came to have significant consequences in a range of areas: a decline in new construction and a rise in vacancies; an increase in crowded housing conditions; an increase in privatisation and outsourcing of housing planning; an increasing segmentation in terms of gaps between different forms of tenure; the closing of municipal housing agencies and the abandonment of social housing commitments; an increase in profit-maximising public housing companies; and a social polarisation manifested in growing 'supergentrification' and low-income filtering. Housing construction was rapidly halted in the aftermath of the Million Programme in 1975. Since the end of the banking crisis in the early 1990s, construction has been particularly slow. For instance, production in new dwellings dropped from 70,000 in 1990 to just around 10,000 in 1997, the lowest since World War II

(Hedin et al., 2012). Homelessness more than doubled in Sweden between 1999 and 2005 (Socialstyrelsen, 2006).

The change of in the Swedish housing market can also be seen through the lens of the mortgage market. Until the mid-2000s, mortgages were generally funded through the issuance of unsecured mortgage bonds. At the time, commercial banks were primarily geared towards the business sector and long-term mortgages were instead issued by mortgage institutions and housing-finance institutions (such as savings banks and building societies). Interest regulations ensured mortgage rates were set below market interest rates. Strict liquidity ratios, on their hand, regulated the amount of mortgage bonds banks and insurance companies were required to hold on their balance sheets. The government also introduced a range of interest-rate subsidies to households and construction companies in order to encourage the creation of new housing (Sveriges Riksbank, 2014). With a limited array of savings alternatives for the households prior to the deregulation process during the 1980s, household savings were thereby channelled back to the mortgage bond market via the banks. The creation of the ATP system and the AP funds (the public pension funds) led to the latter quickly becoming the largest investor in the government and mortgage bond markets. In 1976, the total value of the fund amounted to SEK 100 bio (close to 30% of the Swedish GDP, and around half of the Swedish capital market). At the time, the AP fund owned mortgage bonds amounting to SEK 41 bio, comfortably more than the holdings of the Swedish banks combined (ibid). Thus, government policy prior to the deregulation process promoted not only the construction of housing, but it also intervened in the functioning of the closely connected mortgage bond market through a range of direct institutional regulations.

A number of factors can be attributed to the trend in house prices, as well as the increase in mortgages, during the era of financialisation. On the mortgage demand side, the deregulation process was undoubtedly important, as it solved the credit-rationing situation that had existed previously. On the supply side, increasing competition with regards to mortgage rates, cash down payments and amortisation requirements has enabled a more 'efficient' mortgage market to emerge.

Another important factor spurring demand for mortgages has been the downward trend in Swedish interest rates. As can be seen from Figure 21, mortgage bond yields have fallen from around 9% in 1996 to 1-2% in 2013. Mortgage institutions and banks have faced increasingly lower funding costs, and found new funding alternatives. Importantly, a significant portion of borrowing takes place in foreign currency: through the international wholesale markets, and then swapped into Swedish kronor. Cheaper funding rates have obviously made property purchases more attractive.

Figure 21: Repo rate, 3M STIBOR, 2Y mortgage bond yield, 5Y mortgage bond yield (%)

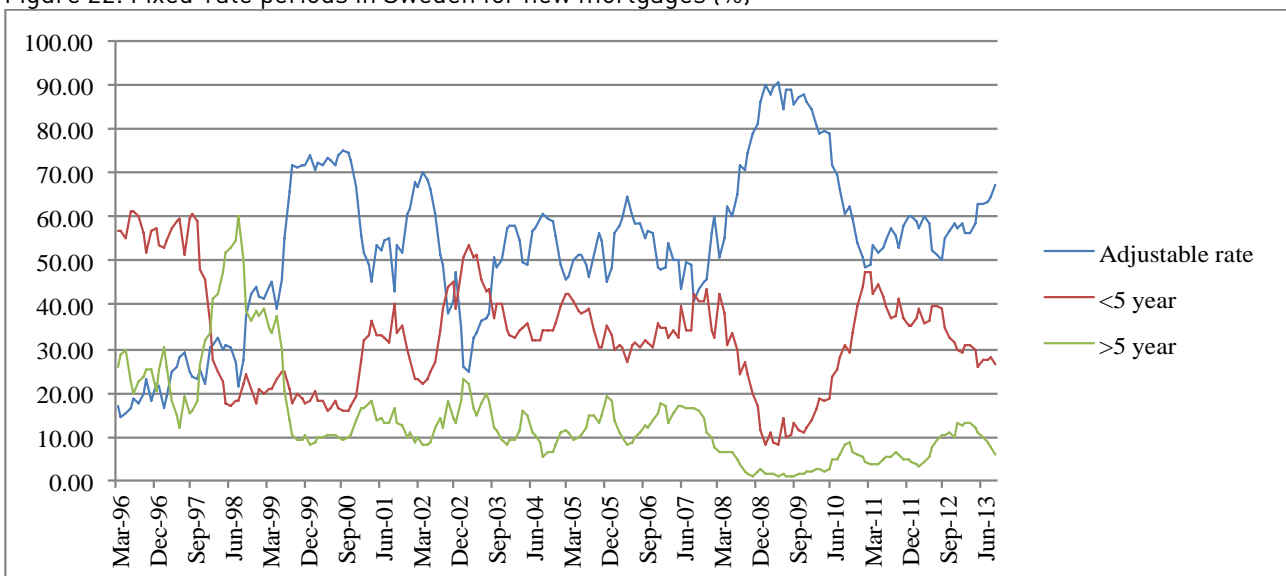




Source: Sveriges Riksbank

Historically, fixed-rate mortgages were been prominent in Sweden. This is no longer the case. Due to low inflation, the central bank has kept repo rates relatively – or even very – low, prompting a gradual increase in demand for floating-rate mortgages. This change is noticeable from Figure 22, showing a drastic shift towards floating mortgages from about 10% in the mid-1990s to around 70% in 2013. It is also notable that fixed-rate mortgages have tended to have shorter maturities. Mortgages with maturities over 5 years are now almost negligible. This trend has markedly increased the exposure of households to the volatility of short-term interest rates.

Figure 22: Fixed-rate periods in Sweden for new mortgages (%)



Source: Statistics Sweden, Sveriges Riksbank

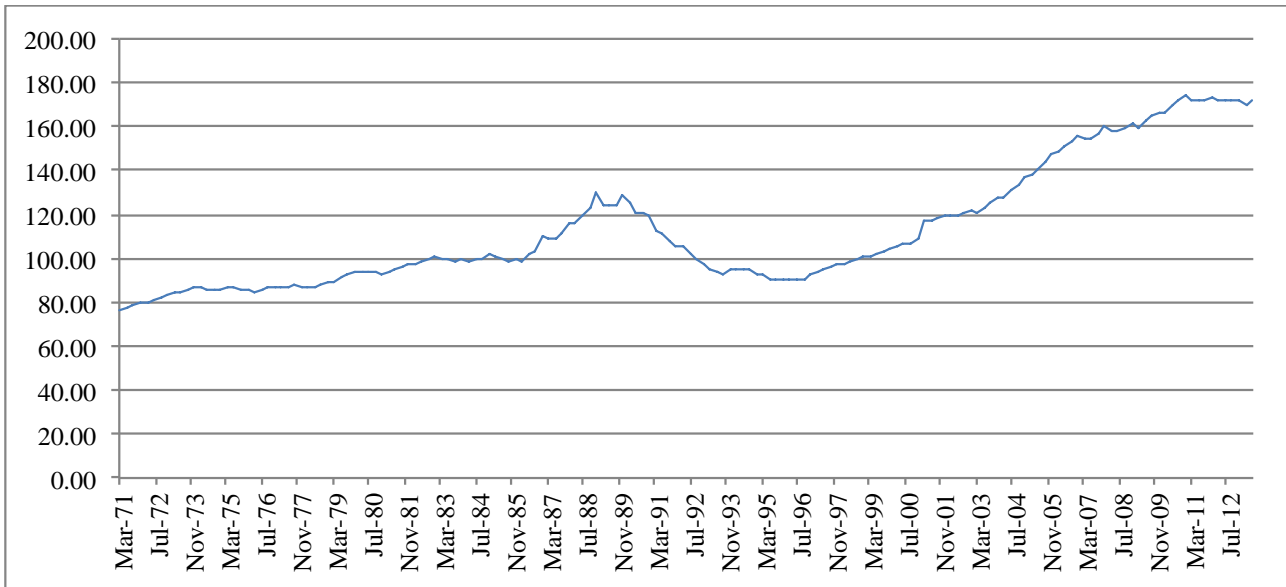
Relatively generous tax rules have also contributed to increasing credit demand. During the 1980s, around 50% of interest expenditure was tax deductible. Although this was reduced to 30%, low after-tax real interest rates have undoubtedly played an important role. Similarly, the property tax reform in 2008 has acted to increase confidence in the property market.

The housing shortage has contributed to the phenomenal rise in property prices (particularly in the large urban areas) since the market recovered after the banking crisis. Higher prices (i.e. more collateral) have also enabled existing mortgage-holders to increase their borrowing during the last two decades. Noticeably, Sweden did not experience a major correction in house prices in conjunction with the global financial crisis. By contrast, prices are higher than in 2007 both in the major cities, as well as in Sweden as a whole.

The mortgage market is by no means alone in having had a major impact on the development on the Swedish financial system during the last few decades, and in the way households have become increasingly connected to it. The 'old' model could be seen as having been driven by artificial demand of mortgage bonds, as the government directly promoted funding of mortgage institutions using mortgage bonds, and by forcing banks and insurance companies to invest in those bonds. Both households' ability to take out loans, as well as mortgage institutions' means of funding these loans, was subject to strict control. The channelling of household funds into mortgages in the 'new' model is more indirect, as it often takes place via pension funds and mutual funds. It should therefore come as no surprise that household pension and mutual fund saving has increased more in Sweden than in other comparable countries during the recent decades.

The fifth point relates to household debt. As can be seen from Figure 23, household debt (in particular mortgages) has increased considerably faster than disposable income. From 1970 to 2000, Swedish households had a debt / disposable income-ratio of around 100% (with the notable exception of around 130% prior to the banking crisis). Since the turn of the Millennium, however, this ratio has steadily increased and now stands at around 170%.

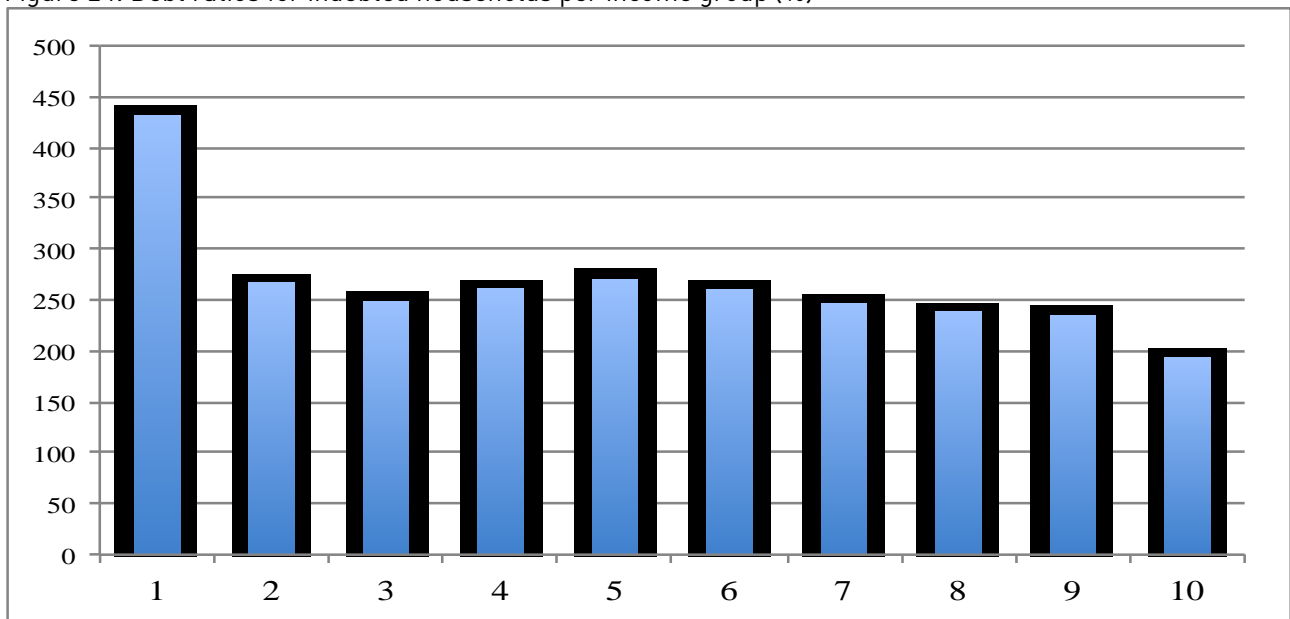
Figure 23: The Swedish households' debt ratio (total debt as % of disposable income)



Sources: Statistics Sweden and Sveriges Riksbank

A recent study by Winstrand & Ölcer (2014) show that the debt ratio of *indebted* households stood at 263% in July 2013, whereas the equivalent ratio for households with mortgages amounted to 313%. Moreover, households with the lowest incomes have a disproportionately high debt ratio. Figure 24 shows the ratio for each income decile in July 2013 (1 being the lowest and 10 the highest).

Figure 24: Debt ratios for indebted households per income group (%)



Source: Winstrand & Ölcer (2014)

To sum up, the Swedish deregulation process during the 1980s was a key ingredient in the subsequent house price bubble and banking crisis during the early 1990s. Since then, five

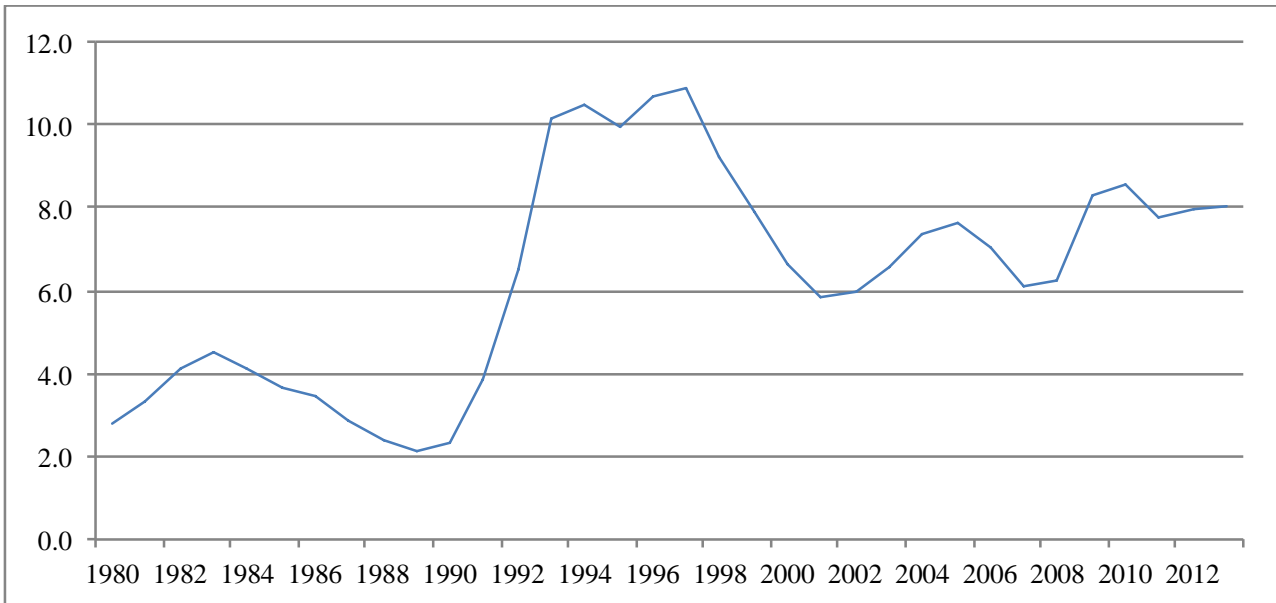
important financialisation trends have been prominent in relation to household consumption. First, household income has become more dependent on the development of the financial markets. Second, financial wealth in relation to disposable income has roughly doubled. Third, the distribution of household financial assets has tended to increasingly include risky and volatile assets. Fourth, Swedish households have become increasingly exposed to a housing market that has not seen a major price correction in over 20 years. Fifth, (particularly low-income) households have become increasingly indebted in relation to disposable income. Thus, despite being an export-led mercantilist regime, the Swedish household also displays some symptoms of a debt-led consumption boom.

### 3.4. Financialisation, Sovereign Debt and the Current Account

Although Sweden currently positions itself firmly within the category of export-led mercantilist countries according to the classification by Hein (2012), it is important to note that this is a fairly recent phenomenon – particularly when it comes to the current account. During the decades running up to the Swedish banking crisis, the drivers of GDP growth were strikingly different, with significant contributions from household and government consumption. The growth contribution of the balance of goods and services was low and often negative. This section examines the significant policy changes that enabled Sweden to switch from a current account deficit regime to a current account surplus regime during the early 1990s.

During the 1950s and 1960s, Sweden had experienced a ‘golden era’ with low inflation, high GDP growth and an unemployment rate steadily around 2%. However, after the collapse of the Bretton Woods system in 1971 and the oil crisis soon thereafter, Sweden began to experience similar inflationary pressures as other countries. Following a mixed strategy of incomes policy, fiscal policy and exchange rate policy, the results were not overly successful in lowering inflation. Public expenditure as a share of GDP rose from 45% in 1973 to 65% in 1982. The GDP growth fell significantly below that of previous decades and even below the OECD-average. Budget and current account deficits became a new norm, and the government debt rose from 20% of GDP to 60% of GDP in just one decade. Inflation remained high and the krona was devalued repeatedly. However, the main policy target at the time – namely unemployment – remained stubbornly low at around 2%.

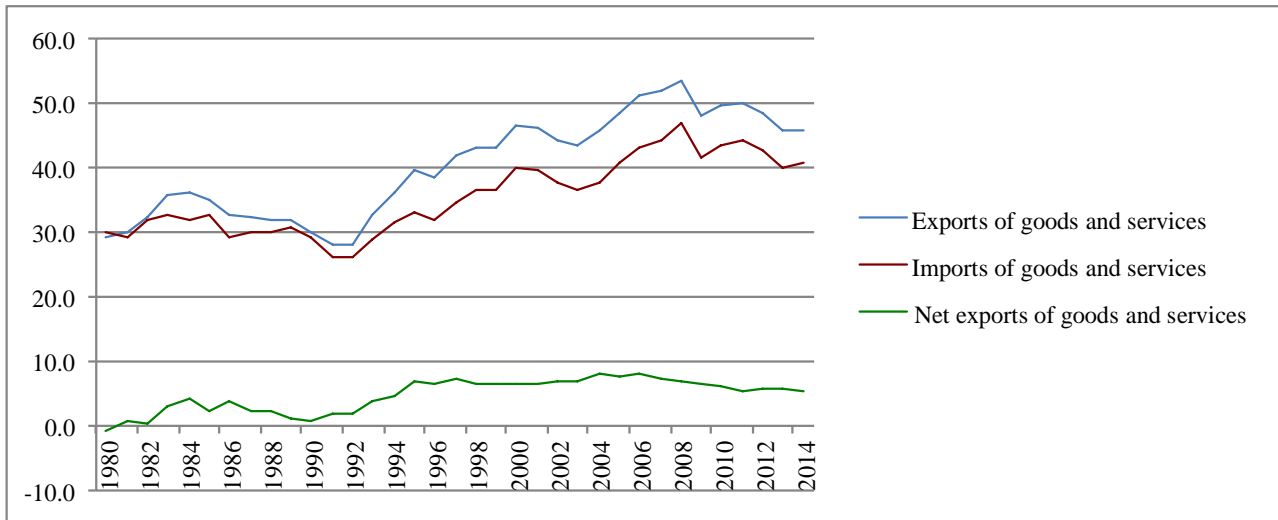
Figure 25: Unemployment (%)



Source: NIER. Note: Unemployed, aged 15-74 years, % of labour force.

During the late 1980s, it became clear that the combination of rapid deregulation of the financial sector, removal of exchange rate controls, high inflation expectations and low after-tax interest rates had become unsustainable. The very low unemployment rate, which even dropped below 2% during 1987-90, began to be reflected in higher wage pressures – causing the wage growth to increase from 7% in 1987-88 to 10% in 1989-90. The trade surplus began to diminish, as depicted by Figure 26.

Figure 26: Swedish trade (current prices, % of GDP)



Sources: Statistics Sweden and NIER

The combination of deregulation, low interest rates with generous tax-deductibility rules and high inflation expectations led to a property and asset price boom. With the Swedish exchange rate policy having lost its credibility after a series of devaluations, higher German interest rates and another devaluation by the Bank of Finland (following a post-Soviet export shock), a series of rate hikes followed. Separately, interest rate tax deductibility was cut from 50% to 30%. Within a year, real interest rates rose from below zero to over 5%. Bankruptcies followed in quick succession and banks' credit losses, having been a couple of billion SEK per year, increased to SEK 10 billion in 1990 and SEK 36 billion in 1991 (around 4% of total lending) – leading to one bank being fully nationalised in the summer of 1992, and another going bankrupt and becoming nationalised in September the same year (Flodén, 2013). Depositors and creditors were issued with a general guarantee, and banks were rapidly recapitalised. The culmination of the Swedish banking crisis, however, coincided with the ERM currency crisis. After a series of speculative attacks against the krona, and the infamous interest rate hike to 500% by the Riksbank, the Swedish krona became free floating on 19 November 1992.

Domestic demand fell rapidly in the aftermath of the banking and currency crises, and the unemployment rate rose to 8% in 1994 (on top of around 5% that were in labour market policies). Lower tax revenues coupled with higher public spending (to support the banks, unemployed etc.) led to higher budget deficits and an increase in government debt from 44% of GDP in 1990 to 77% of GDP in 1994.

This episode can be seen as the turning point when Sweden was transformed from a debt-led consumption boom to an export-led mercantilist regime. However, the platform had already been laid. The collapse of the Soviet Union and increasing European integration had already spurred the military neutral and non-EU members Sweden and Finland to make structural adjustments to a new European landscape. An intention to join the EU was announced in 1990, requiring fundamental changes to macroeconomic policy in order

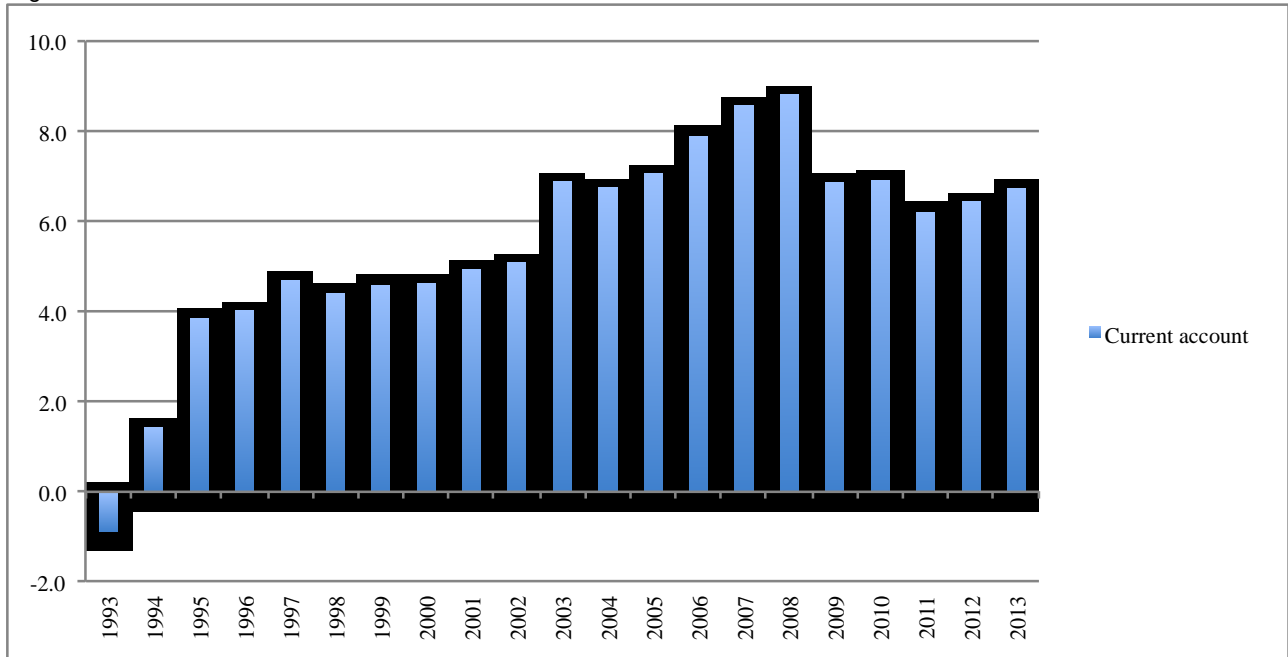
to comply with the Maastricht criteria and to boost confidence in the Swedish economy. In the fiscal plan of 1991, the government declared that low and stable inflation was to be prioritised ahead of 'other ambitions and demands'. Formally, this was the first time that a Social Democratic government had downgraded employment from its list of priorities in economic policy. The new overriding target - price stability – also became widely accepted among the political opposition, the trade unions and the public. The shift came to coincide with the Conservative government having gained power. Subsequently, an ambitious program with regards to market-oriented reforms (including deregulation, privatisation, public spending cuts and tax cuts) was laid out.

The change from a fixed to a floating exchange rate regime came to have profound effects on foundations of the stabilisation policy in Sweden. Sveriges Riksbank announced an inflation target in January 1993, which came to apply from 1995. To regain credibility, a law was passed to formalise the independence of the central bank. The framework for fiscal policy was also radically changed. The government term was extended from three to four years in order to enhance stability. A top-down budget process, with a nominal expenditure ceiling, was introduced in 1996. A year later, a surplus target for general government net lending came into effect, and in 2000 a balanced-budget requirement was introduced for local governments (Flodén, 2013). In 2007, a fiscal-policy council was formed in order *"[...] to review and assess the extent to which the fiscal and economic policy objectives proposed by the Government and decided by the Riksdag are being achieved [...]"* (Fiscal Policy Council, 2013).

As can be seen from Figure 1 in Section 2, growth returned to the Swedish economy after the banking crisis 1991-93 – in line with the upswing internationally. The 'dot-com' crisis of early 2000s had a fairly mild impact on the Swedish GDP. The recent global financial crisis, however, was marked by a sharp, but short, downturn in GDP growth.

A more dramatic shift can be seen with regards to the account balance (see Figure 27).

Figure 27: Current account 1993-2013 (% of GDP)

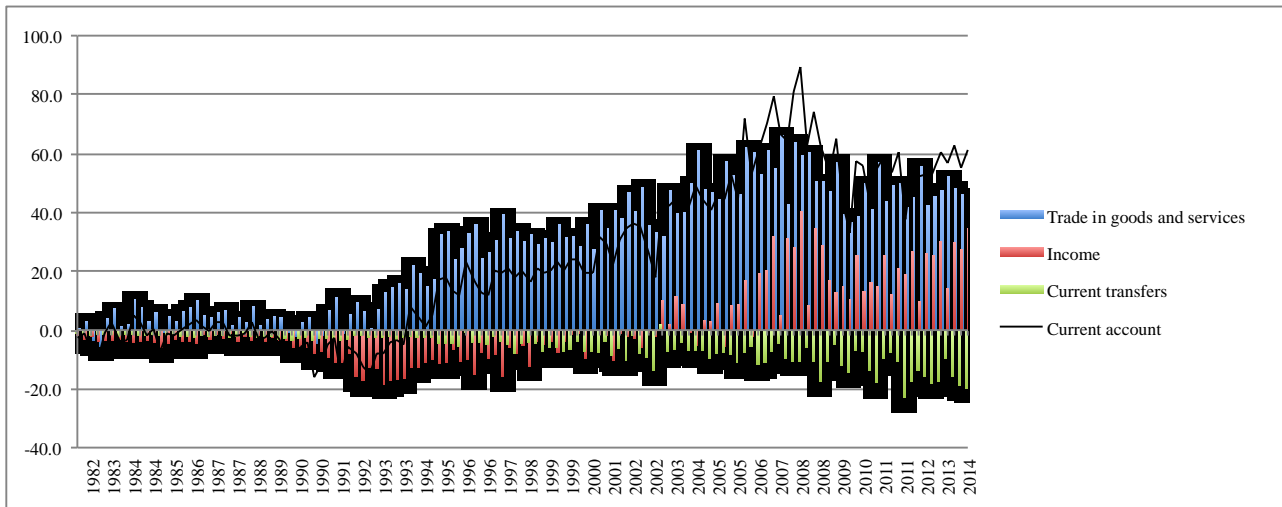


Sources: Statistics Sweden and NIER

During the early 1980s, Sweden showed a balanced budget, with small income deficits offset by small trade surpluses. From the late 1980s to the early 1990s, Sweden began to record slight deficits mainly due to the increase in income net outflows (see Figure 28). Since the mid 1990s, by contrast, the Swedish economy has registered a remarkably solid current account surplus stemming mainly from the trade balance. A similar trend is visible with regards to the income balance, which shifted into positive territory from having been negative throughout the 1980s and 1990s. The current transfer balance (primarily EU contributions and development assistance) has continued to remain negative.

Figure 28: Current account Q1 1982 – Q1 2014 (quarterly, %)





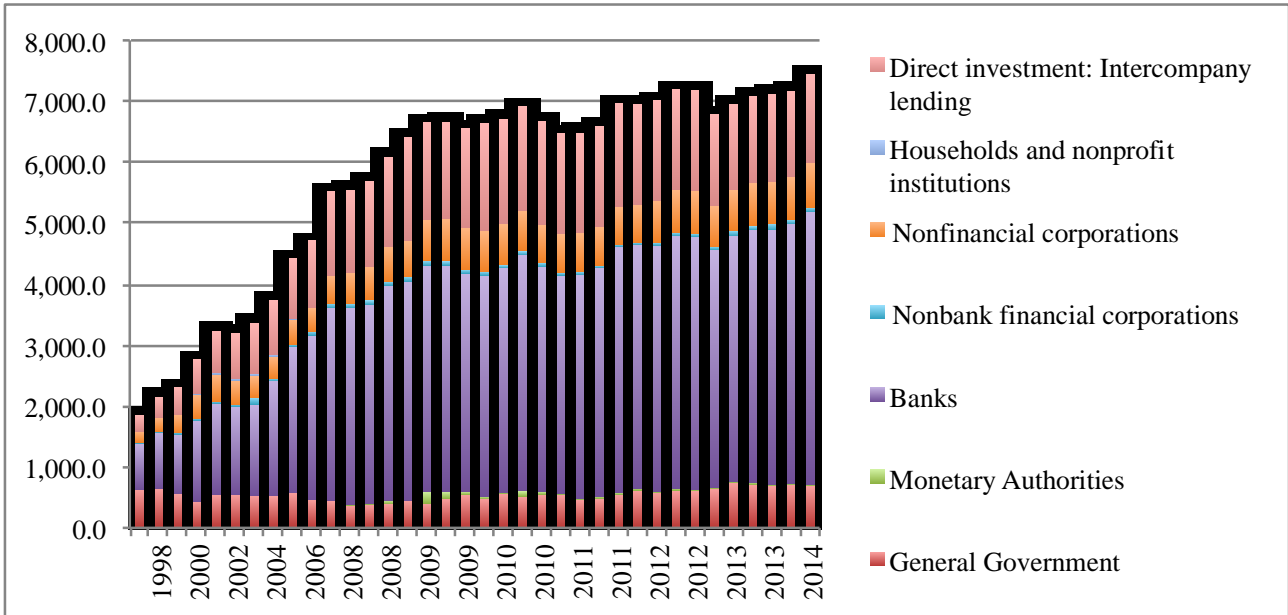
Source: Statistics Sweden

The Swedish government sector has registered primary balance surpluses from the mid-1990s onwards, whereas the interest burden has decreased steadily. This, in turn, has been allowed by solid current account surpluses recorded by Sweden since 1994. The three economic downturns experienced by advanced economies since the early 1990s have only had a limited impact. Except for 1995-1997, 2002-2003 and 2009, the Swedish government balance has been in surplus.

The fiscal burden has historically been high in Sweden. However, there has been a decreasing trend since the 1990s. Accordingly, the tax revenue ratio has decreased from 52% of GDP in 1990 to 44% of GDP in 2011. The decrease has largely been a result of a corresponding decrease in income and profit taxation, whereas the share of other taxes (indirect taxes, property taxes, etc.) has remained fairly steady. Government expenditure as a share of GDP has been reduced from 64.9% in 1995 to 52.2% in 2011 (Stenfors, 2014a).

Sweden's gross external debt has increased from around SEK 1,800 billion in 1997 to over SEK 7,000 billion in 2012. Bank debt (115% of GDP in 2012) and intercompany lending (47% of GDP in 2012) have played a central role, whereas non-financial corporate and government external debt have remained fairly steady. Similarly, household and financial corporate external debt has remained negligible (see Figure 29).

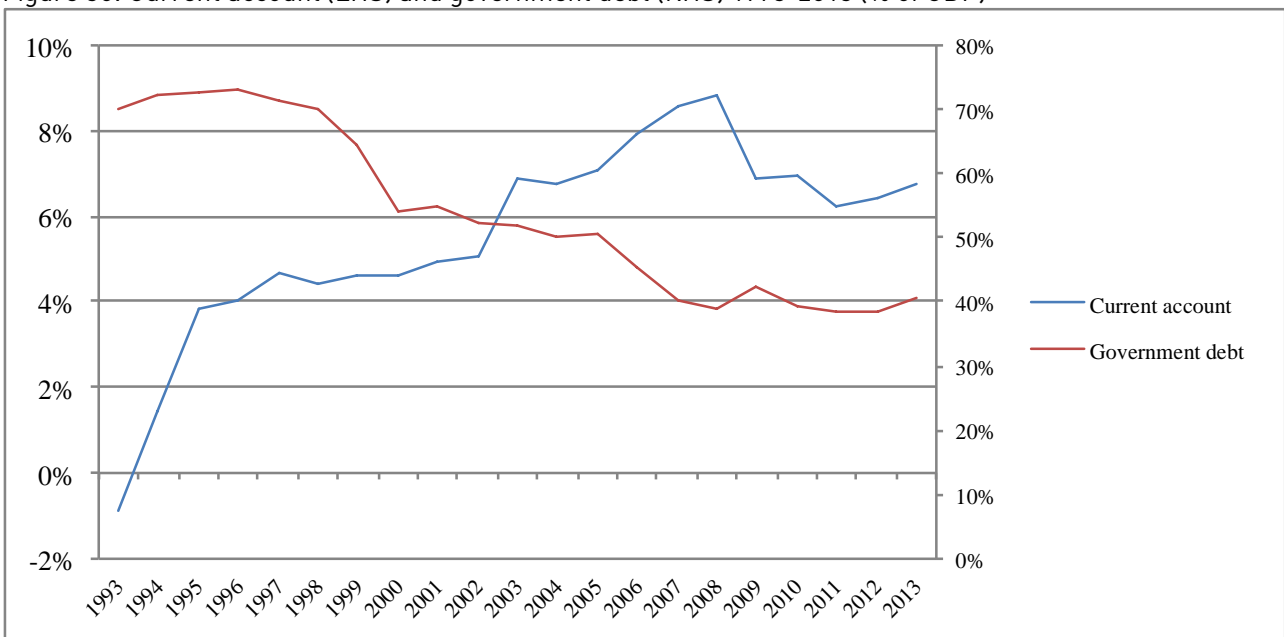
Figure 29: Gross external debt position by sector (quarterly, SEK bio, current prices)



Source: Statistics Sweden

The total gross external debt to GDP ratio has not only remained rather high, but has also increased sharply since the mid-1990s (from 96% of GDP in 1997 to over 200% of GDP in 2012). Notably, however, the Swedish government decreased its external debt position from 33% of GDP to just 17% during the same period. The government debt to GDP ratio, however, has decreased sharply during the last two decades, from around 75% of GDP during the mid-1990s to around 40% by the outbreak of the global financial crisis. As can be seen from Figure 30, the government debt has remained remarkably stable since 2007.

Figure 30: Current account (LHS) and government debt (RHS) 1993-2013 (% of GDP)



Sources: Statistics Sweden and NIER

It is difficult to single out the precise factors that caused this regime shift to take place in the aftermath of the banking and currency crisis. The rapid recovery would most likely have been difficult without the quick recapitalisation of the Swedish banking system, and the upswing in the country's main export markets at the time. At the same time, the export sector benefitted from the sharp depreciation of the Swedish krona following the abandonment of the fixed exchange rate regime in 1992 (Figure 31).

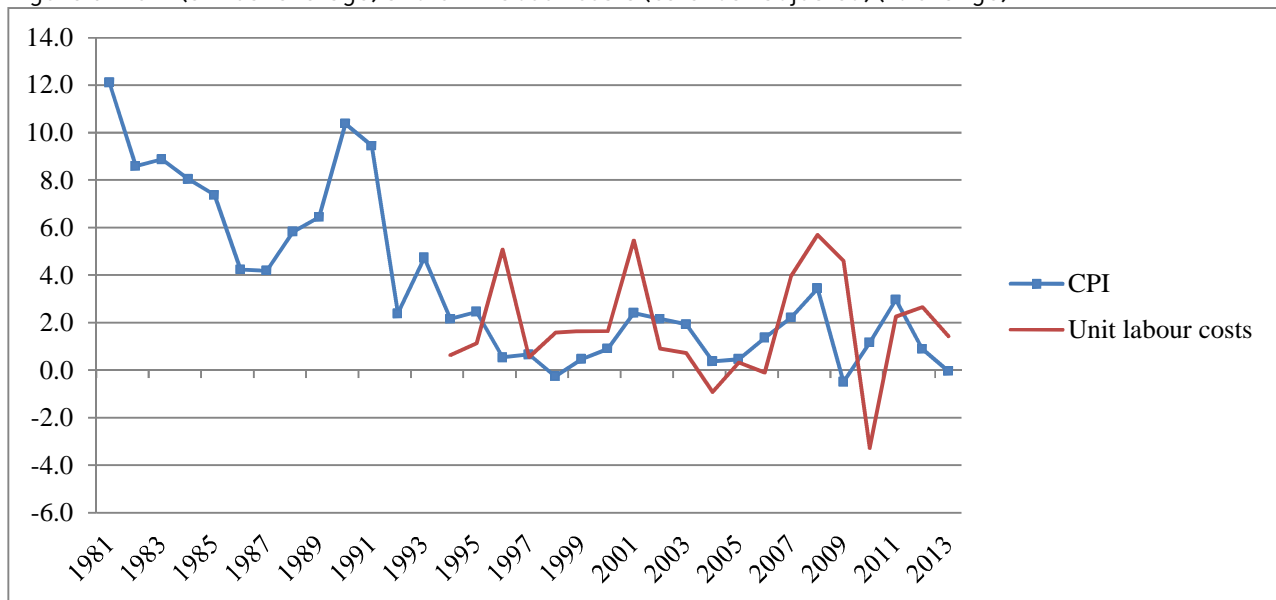
Figure 31: SEK TCW-index



Source: Sveriges Riksbank

Since, the Swedish industry has experienced high productivity and strong growth. From an international perspective, the inflation and growth in unit labour costs have been low since the adoption of inflation targeting (see Figure 32).

Figure 32: CPI (annual average) and Unit labour costs (calendar adjusted) (% change)



Source: Statistics Sweden and NIER

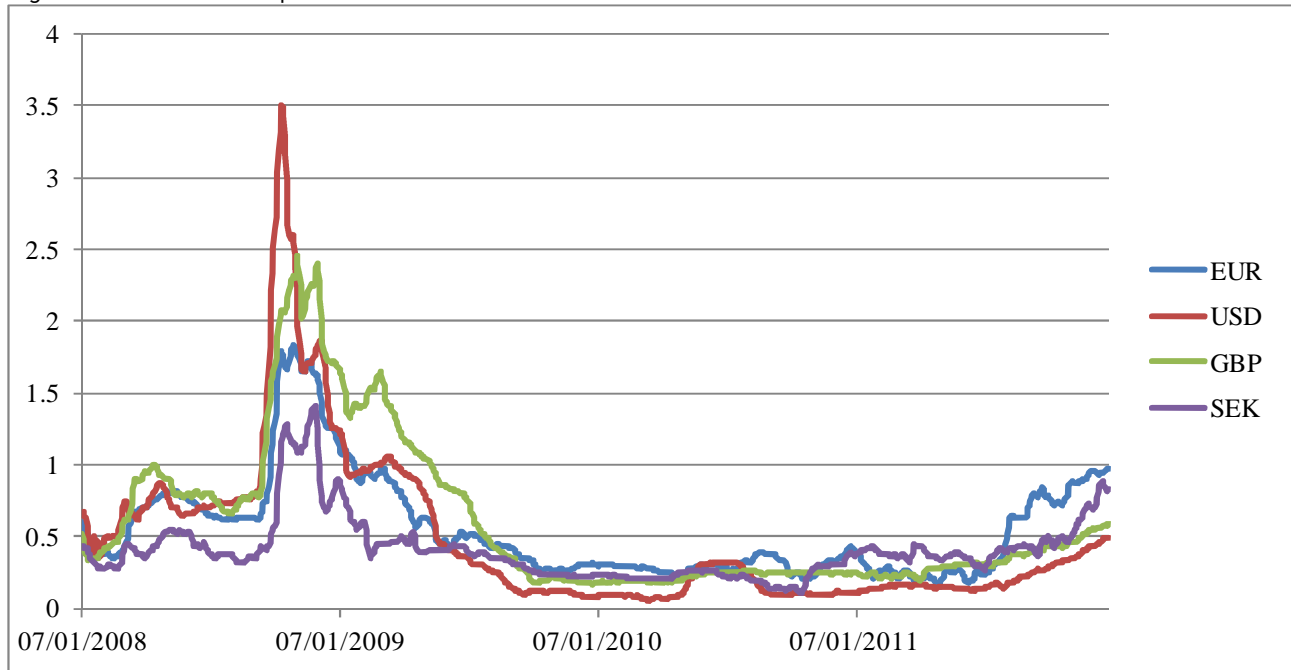
There is no doubt, however, that measures that traditionally have been associated with the promotion of financialisation have been equally central to the Swedish policy mix that has led to low government debt and high current account surpluses. Thus, the regime shift stems from the combination of a favourable environment for the export industry, a series of market-friendly reforms and radically altered fiscal and monetary policy frameworks founded in pragmatism and political consensus.

## 4. Swedish Financialisation and the Global Financial Crisis

### 4.1. The Money Markets and the Banking System

During 2008, the transmission of the global financial crisis to Sweden could be seen through the surging money market risk premia. Here, the LIBOR-OIS spread has widely been used as 'barometer of fears of bank insolvency' (Thornton, 2009), reflecting the risk that the borrower defaults (credit risk) and the ease with which the bank can raise funding (liquidity risk) (Stenfors, 2014b). Figure 33 shows the 3-month money market risk premia from 2008 to 2011.

Figure 33: LIBOR-OIS spreads 2008-2011 (%)

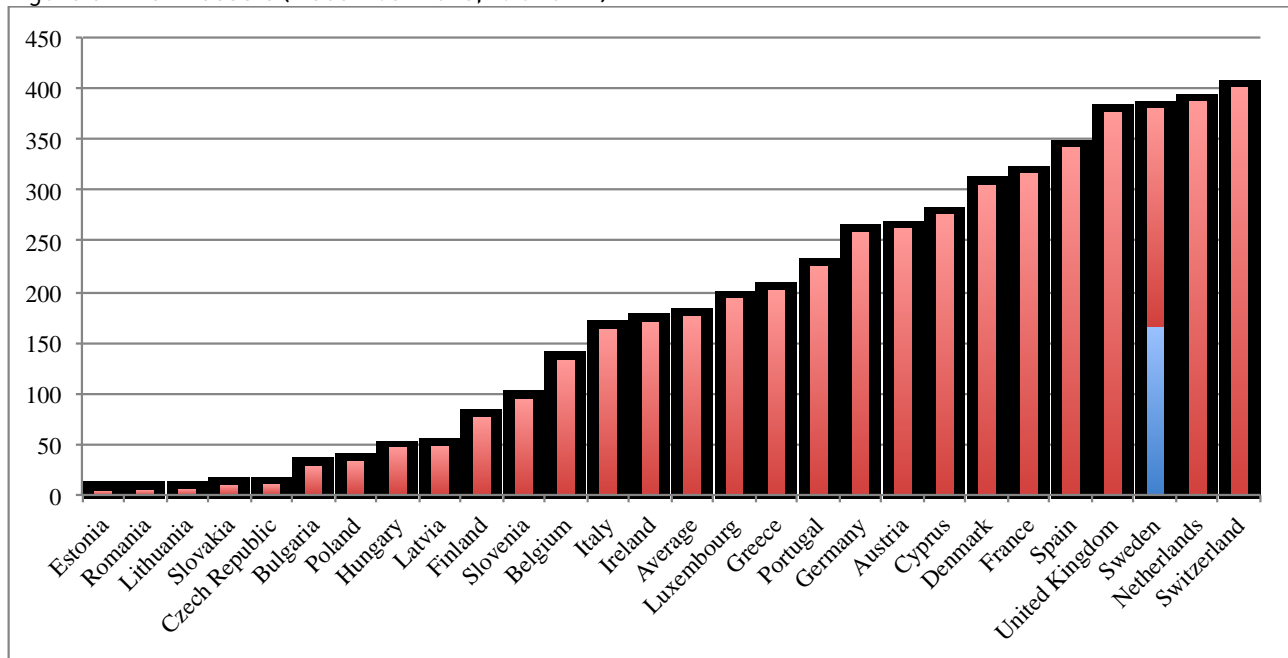


Source: Reuters. Note: LIBOR and OIS are used for USD; STIBOR (Stockholm Interbank Offered Rate) and STINA (Stockholm Tomnext Interbank Average) for SEK being the Swedish LIBOR-OIS equivalents; EURIBOR (Euro Interbank Offered Rate) and EONIA (Euro Overnight Index Average) for EUR; and LIBOR and SONIA (Sterling Overnight Interbank Average Rate) for GBP.

As can be seen from the graph, the STIBOR-STINA spread (the Swedish money market risk premium) was hardly affected by the initial turmoil of the global financial crisis, not even after the collapse of Bear Sterns in March 2008, which caused major uncertainty in the global money markets. The Lehman bankruptcy in September 2008, however, led to an immediate spike in the STIBOR-STINA spread by around 100 bps and suggested a breakdown of the first stage of the monetary transmission mechanism. Nonetheless, the impact was considerably smaller than for risk premia in major currencies, such as the sterling and the U.S. dollar. Likewise, the improved sentiment in the global markets in 2009 had a fairly rapid impact on the Swedish risk premium, with the major currencies showing a lag towards the more 'normal' levels seen before the outbreak of the crisis.

Swedish banks also faced specific difficulties in raising USD in the Eurodollar markets, like their peers in the rest of Europe.

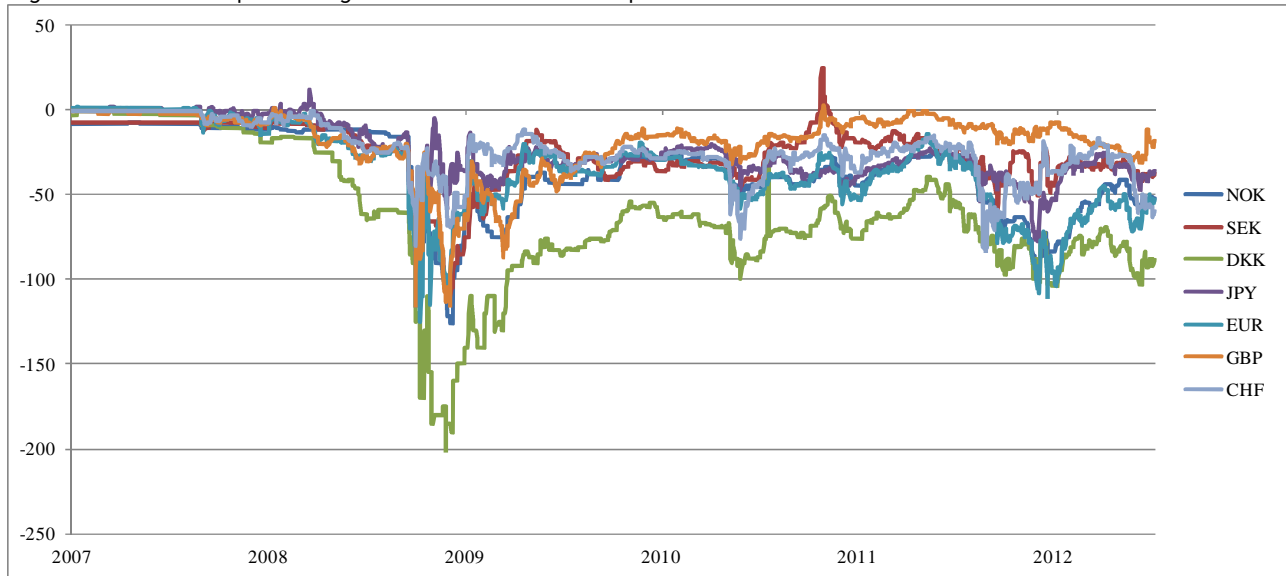
Figure 34: Bank assets (December 2013, % of GDP)



Sources: ECB, the European Commission, the Swiss National Bank and the Riksbank. Note: In banking assets are included all of the assets of the national banking groups, that is both foreign and domestic assets. The blue bar shows the four major banks' assets abroad in relation to Sweden's GDP. The data for Switzerland is from December 2012.

Funding in currencies other than SEK had increased during the previous decade and now made up 60% of total market funding (Sveriges Riksbank, 2011). Swedish banks were thus facing a serious 'USD funding gap' (Kaltenbrunner et al., 2010). This led to a rush towards the USD money markets. However, as this avenue closed fairly quickly, the focus turned towards the FX swap and cross-currency swap (CRS) markets which remained open throughout the crisis. However, the demand for U.S. dollars led to an unprecedented deviation of the covered interest rate parity (CIP), which was usually measured against the LIBOR. The deviation came to be systematic, which partly reflected the understating of real borrowing costs by LIBOR-banks, but also the relentless demand for the currency European (including Swedish) banks were in desperate need of: the U.S. dollar. Prior to the global financial crisis, the CRS spreads had been close to zero – indicating that the CIP held. Figure 35 depicts the 1-year CRS spreads for a range of currency from 2007 to mid-2012. The impact of the global financial crisis is staggering, particularly during Q4 2008. The effects of the Eurozone sovereign debt crisis from 2010 is also significant for the EUR/USD CRS spread – however, very much less so for the Swedish krona equivalent.

Figure 35: 1Y CRS spreads against USD 2007-2012 (bps)

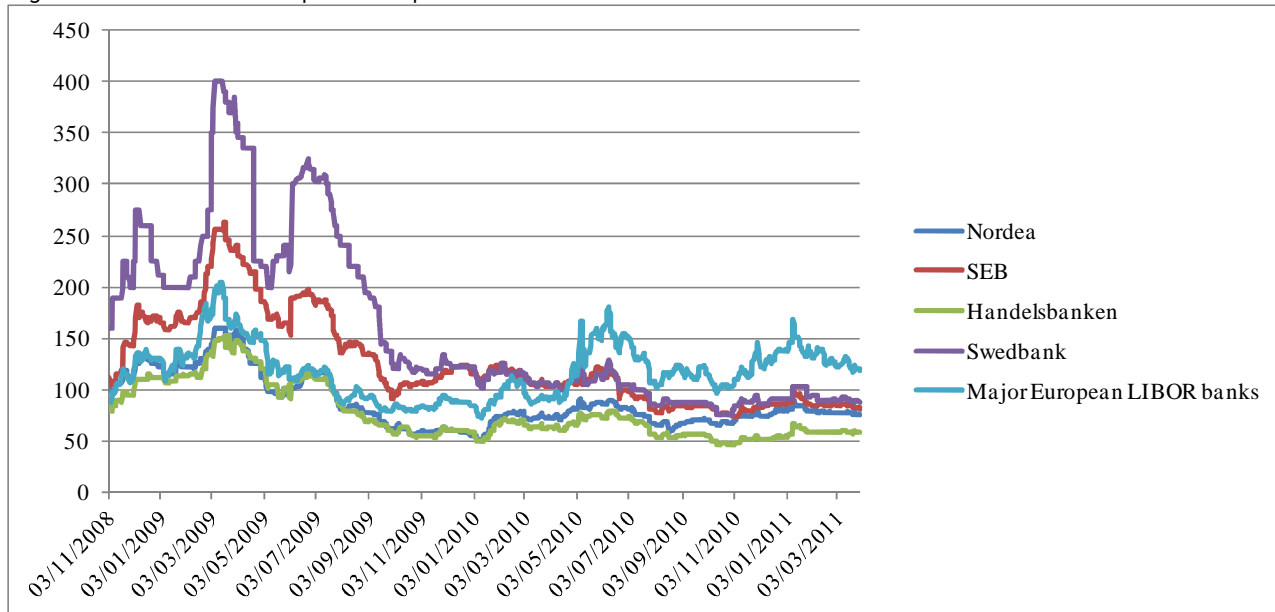


Source: Reuters

Although Swedish banks and investors had minimal direct or indirect exposure to the U.S. sub-prime mortgage market, the global financial crisis was transmitted to the country as the international money markets froze. Importantly, Swedish banks entered the crisis with relatively sound finances, as well as with the benefit of having a relatively recent experience from the domestic banking crisis during the 1990s. The credit default swaps (CDS) market is a measure of perceived creditworthiness of a particular 'entity' by market participants, rather than by, for instance, credit rating agencies. Figure 36 depicts the 5-year CDS spreads for banks from the aftermath of the collapse of Lehman Brothers up until the early period of the Eurozone crisis. Here, the CDS spreads of the big four Swedish banks are compared against the average of the large European LIBOR-panel banks<sup>6</sup>. Hence, the proxy does neither include non-European banks, nor banks domiciled in countries most affected by the Eurozone crisis.

<sup>6</sup> Barclays, HSBC, Lloyds, RBS (UK); BNP, Cr dit Agricole, Soci t  G n rale (France), Deutsche bank, Westdeutsche Landesbank (Germany), Cr dit Suisse, UBS (Switzerland) and Rabobank (the Netherlands)

Figure 36: 5Y bank CDS spreads (bps)



Source: Datastream, author's own calculations

As can be seen, the CDS spreads for all banks increased sharply post-Lehman Brothers. Swedbank and SEB were particularly hard hit, with their CDS spreads rising above 400 and 250 bps respectively in March 2009. Nordea and Handelsbanken, on the other hand, fared slightly better than their European peers. The exposure of Swedish banks (in particular that of Swedbank and SEB) to the Baltic countries became a major concern towards the end of 2008, with the CDS spreads of the two banks showing another set of spikes during the summer of 2009. SEB and Swedbank had expanded aggressively into the three neighbouring countries. At the time, 80% of the Estonian, 60% of the Latvian and 55% of the Lithuanian markets were dominated by SEB and Swedbank with their subsidiaries and branches. The Baltic countries absorbed 15% of the total lending by Swedbank, whereas the corresponding figures for SEB was 13% and Nordea 3%. Consequently, Swedbank had credit losses amounting to 19 billion SEK during the first three quarters of 2009, of which 60% were related to losses in the Baltic countries. The credit losses by SEB were smaller (9 billion SEK). Nonetheless, 75% came from the Baltic region (Sveriges Riksbank, 2010). The extraordinary monetary policy measures introduced by central banks across the globe managed to reverse the decline in perceived creditworthiness of banks, resulting in a significant fall in CDS spreads during 2009. Spreads continued to fall until the advent of the Eurozone crisis in 2010, when the perceived creditworthiness of *all* the big four Swedish banks surpassed those of the large European banks.

In sum, seen through the lens of money market risk premia, the transmission of the global financial crisis to Sweden was less pronounced than to the major European economies. However, the large exposure of Swedish banks to the crisis-affected Baltic countries (coupled with a dependency on market funding in foreign currency) promoted a sharp and

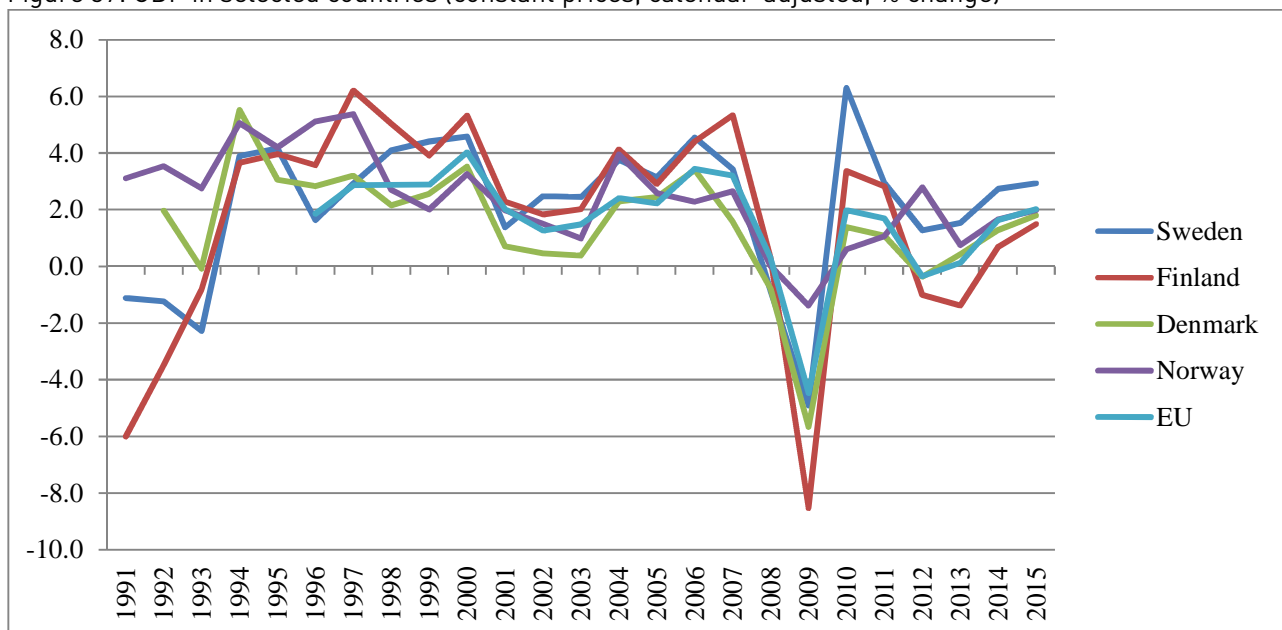


negative reaction from the international financial markets in 2009. The situation improved quickly, however, and the Swedish banks and money markets largely managed to avoid the subsequent turbulence in conjunction with the subsequent Eurozone crisis.

## 4.2. Sovereign Debt and the Real Economy

The Swedish real economy, being heavily dependent on the export industry, was immediately affected by the weakening international economic activity as a result of the global financial crisis. The Swedish GDP fell by close to 4% during the last quarter of 2008, and by a further 5% during 2009 (Elmér et al., 2012). However, the severe downturn was rapidly reversed and Sweden overcame the crisis of 2008 faster than neighbouring (except for Denmark) and other EU countries. Although the onset of the Eurozone crisis had a dampening effect on Swedish growth, the economy has clearly outperformed the euro area.

Figure 37: GDP in selected countries (constant prices, calendar-adjusted, % change)

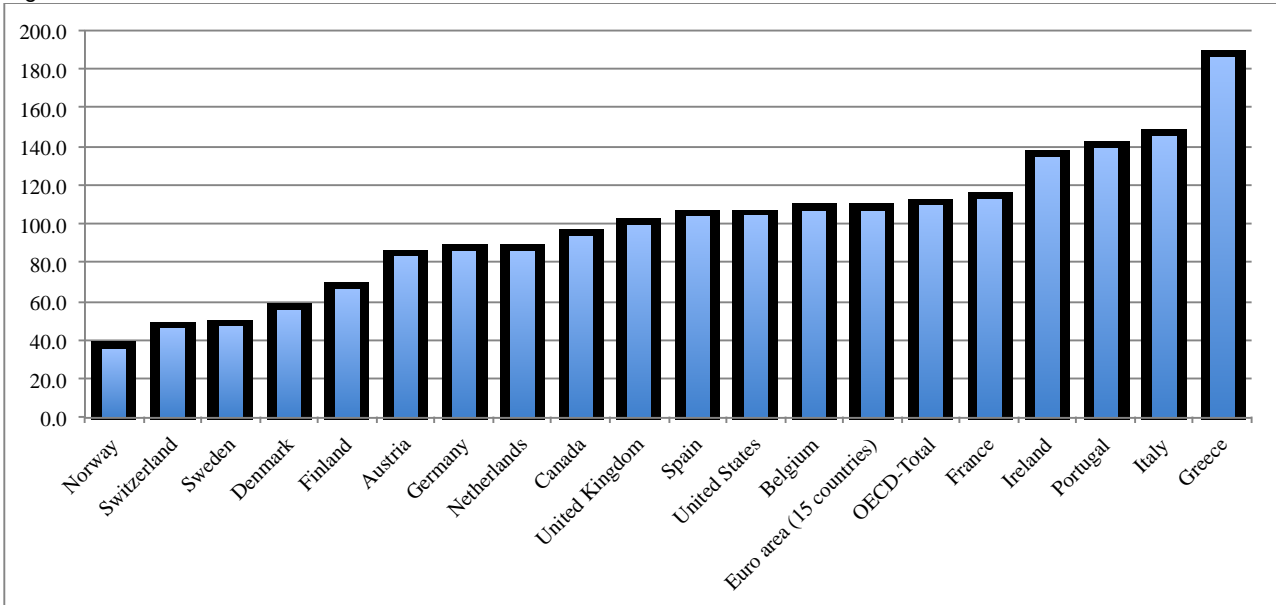


Sources: Eurostat, OECD, IMF, national sources, and NIER

The onset of the global financial crisis also resulted in a reduction of the current account surplus in 2009 (see Figure 28). Trade in goods and services, as well as income, was immediately affected, and thus corporate profits – which in turn impacted returns for companies working in direct investment (Statistics Sweden, 2009). However, the current account surplus has remained high and above 6% of GDP throughout the global financial crisis and the Eurozone debt crisis.

As Bergman (2011) points out, Sweden entered the global financial crisis with strong public finances – with one of the lowest government debt / GDP ratios in Europe (see Figure 38). Government net lending for 2013 was -0.2% of GDP (the second lowest in the EU), compared to EU-average of -3.2% (Jonung, 2014).

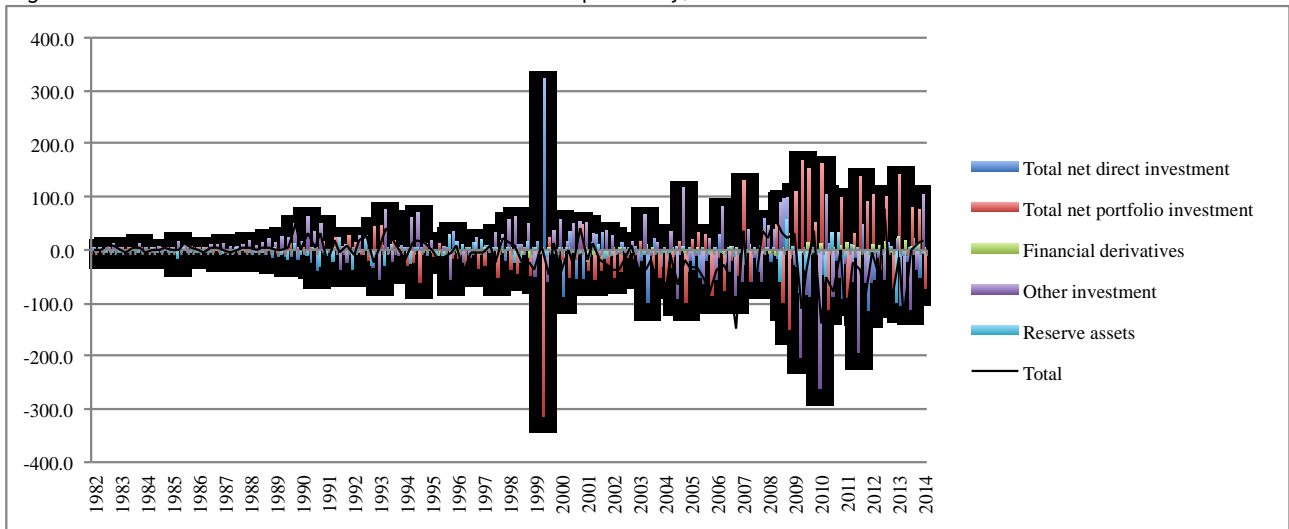
Figure 38: Government debt of selected countries (December 2013, % of GDP)



Source: OECD

Turning to the financial account, we can clearly see the effects of the global financial crisis in Figure 39. From 2008, the total net portfolio inward investments have increased substantially as Swedish banks have made net amortisations of their foreign debt. In addition, foreign investors have flocked to the Swedish bond market as a result of the flight to safety triggered by the debt crisis in the Eurozone (Statistics Sweden, 2012b; 2013). At the same time, Swedish banks have increased their lending to other countries (and foreigners decreased their lending to Sweden), as shown by the outflow of other investments.

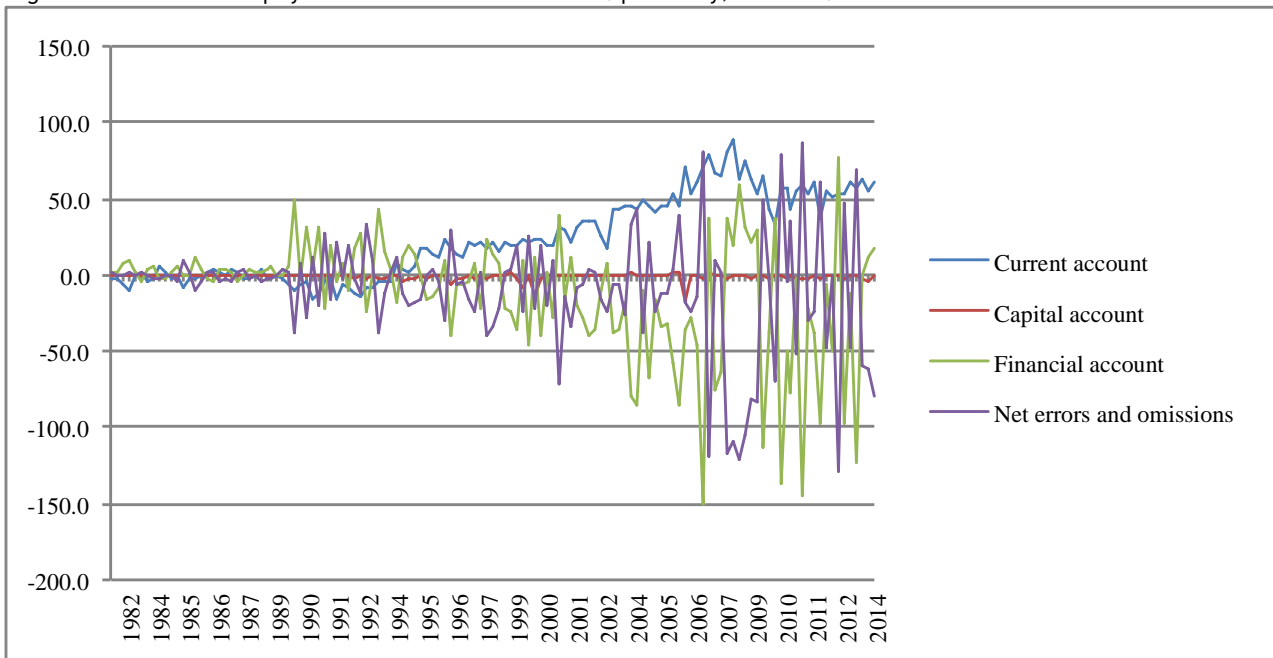
Figure 39: Financial account Q1 1982 – Q1 2014 (quarterly, SEK bio)



Source: Statistics Sweden

As Figure 40 depicts, the capital account has been fairly negligible and mainly consists of EU contributions and development assistance for investments, but also transfer of rights (patents, copyrights etc.) (Statistics Sweden, 2013).

Figure 40: Balance of payments Q1 1982 – Q1 2014 (quarterly, SEK bio)

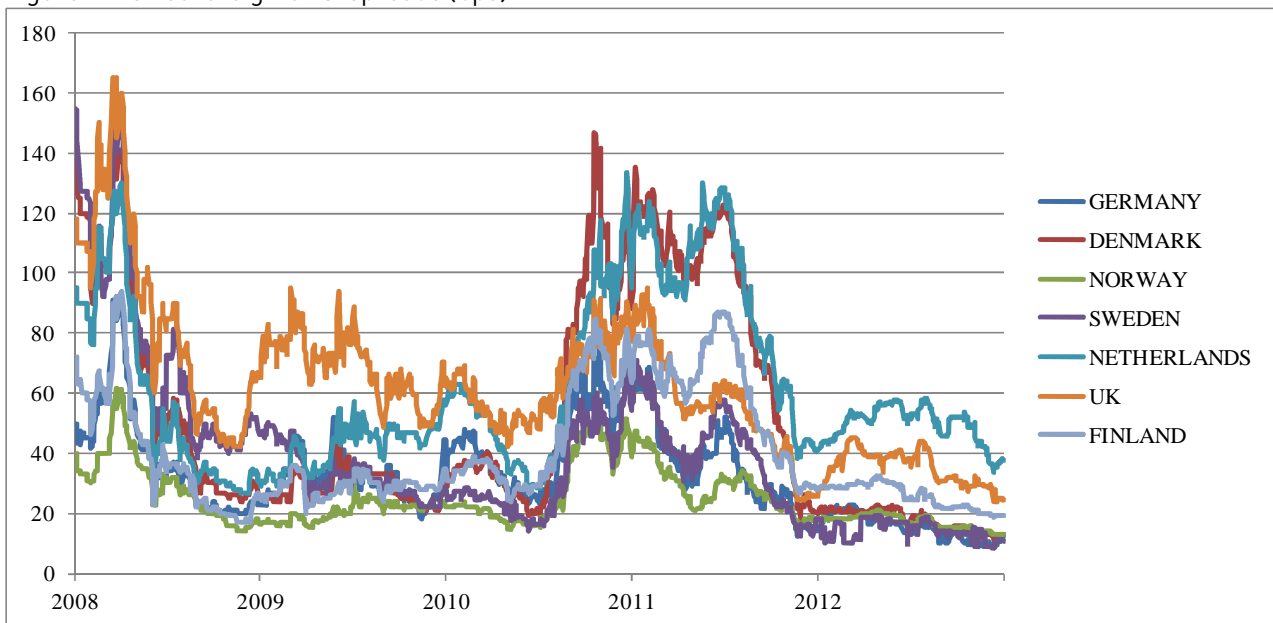


Source: Statistics Sweden

Another indication of how Sweden fared during the Eurozone crisis can be seen in the sovereign CDS-spreads. As has already been well documented, the peripheral Eurozone countries (Greece, Portugal, Spain, Italy and Ireland) were badly hit, resulting in surging CDS spreads. Consequently, the 'core' Eurozone countries (Germany, Finland, Austria and

the Netherlands) became safe havens with the currency area, often showing offsetting dips in their government bonds yields as those of the peripheral countries rose. Figure 41 shows the 5Y CDS spreads for the Kingdom of Sweden and selected European sovereigns. All have to some degree been portrayed as safe havens during the Eurozone crisis with Germany, Finland, the Netherlands and Austria (not shown) generally been regarded as the core Eurozone countries.

Figure 41: 5Y sovereign CDS-spreads (bps)



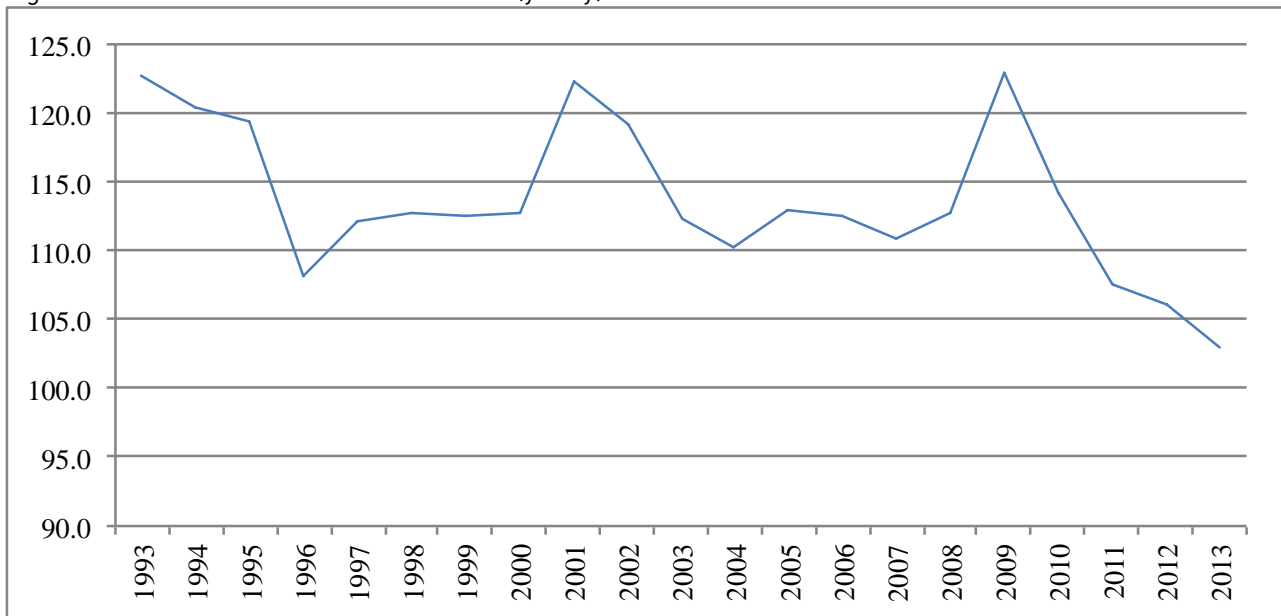
Source: Datastream

Since mid-2009, Sweden has outperformed most other European countries in terms of sovereign CDS spreads, even those considered to be core Eurozone countries. The combination of persistent current account surpluses, low government debt and non-Eurozone membership have undoubtedly played a crucial role.

The sharp bounce in the Swedish GDP in 2010 was certainly aided by the weaker exchange rate. Both the Swedish krona and the Norwegian krone had, up until and including then, for decades been subject to volatility and depreciation in conjunction with turbulence in the financial markets (for instance during the 'dot-com' crisis around 2000). Perhaps not always justified for macroeconomic reasons, their relatively lower liquidity often prompted an exodus by investors and speculators alike in line with general market uncertainty. The reaction to the Lehman bankruptcy was similar, even amplified. However, the reaction to the Eurozone crisis was quite different. It resulted to a general flight to safety *outside* the currency area (such as the U.S. dollar) and *within* the Eurozone (for instance to Germany). Moreover, investors desiring an exposure to Western and Northern Europe (without an exposure to the Eurozone) flocked to the Swiss franc and Swedish, Norwegian and Danish currencies. Thus, on the whole, the Swedish krona appreciated as a result of the Eurozone

crisis, as illustrated by the Swedish KIX-index in Figure 42, which is adjusted over time according to the trade patterns of the country.

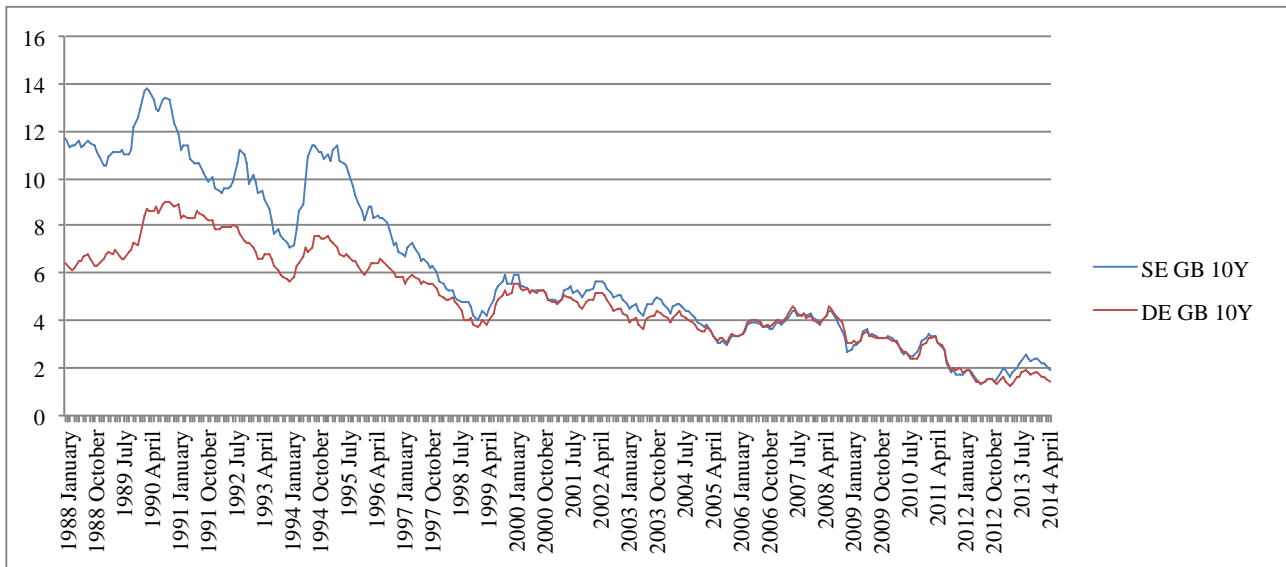
Figure 42: KIX-index for the Swedish krona (yearly)



Source: NIER

Sweden has also been immune to the surge in long-term yields in a range of Eurozone countries. As Figure 43 shows, between 1987 and the launch of the euro, the Swedish 10-year government bond yield spread over Germany gradually decreased from around 500 bps to close to zero, with a temporary spike during the aftermath of the currency crisis in the early 1990s. The combination of low inflation, low central bank rates, low government debt, current account surpluses and an own currency has been favourable for Sweden throughout the crisis with regards to bond yields.

Figure 43: 10Y Swedish and German government bond yields (monthly averages, %)



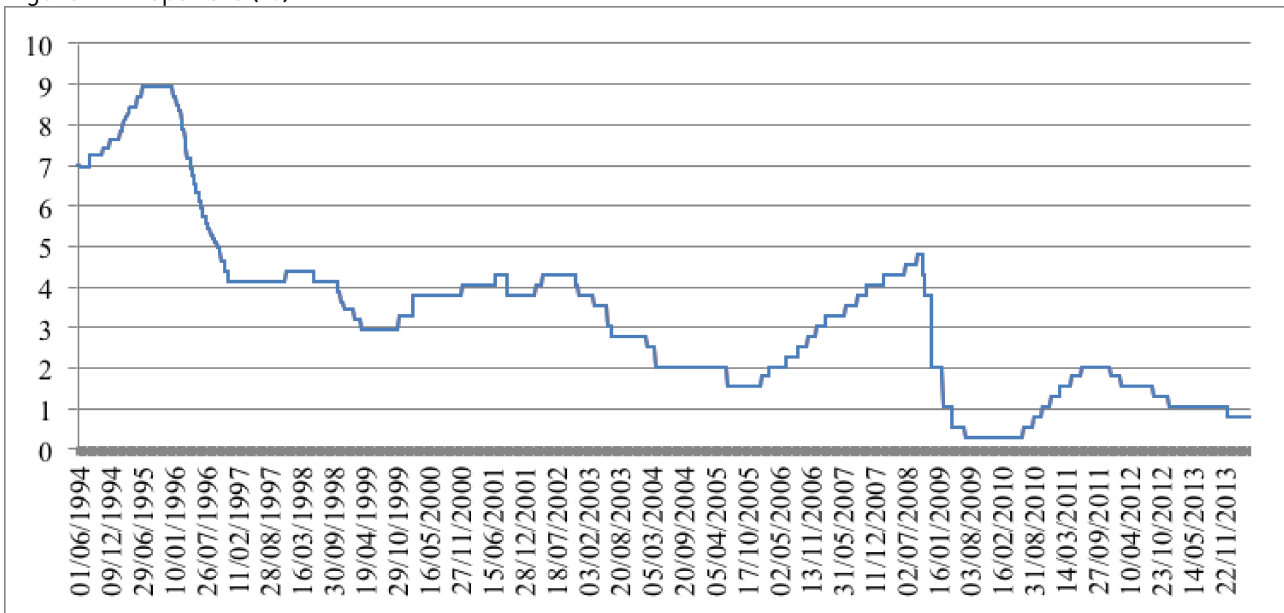
Source: Sveriges Riksbank

Although the Swedish economy has shown signs of slowing down recently, the robust development during the height of the Eurozone crisis might be surprising given the sharp appreciation of the currency. However, it has to be noted that although the Swedish export industry is heavily geared towards the Eurozone (40.2% in 2011), the country has a fairly diverse export market (Norway 9.3%, Denmark 6.5%, UK 7.4%, US 5.5% and emerging markets 22.8% in 2011). The so-called PIIGS countries stand for less than 6% of the Swedish export market (Konjunkturinstitutet, 2012). Moreover, as discussed in Section 3, the Swedish non-financial sector had gained competitiveness ahead of the recession.

### 4.3 . Policy Measures

During the height of the global financial crisis, the Riksbank introduced a range of extraordinary measures to alleviate stress in the Swedish banking system (Elmér et al., 2012; Sveriges Riksbank, 2012). Between October 2008 and July 2009, the repo rate was cut by 450 basis points in total – to an all time low of 0.25% (see Figure 44).

Figure 44: Repo rate (%)



Source: Sveriges Riksbank

The Riksbank also began to offer loans in SEK with maturities up to three and six months, and later offered three fixed rate loans with a 1-year a maturity of around one year, totalling SEK 296.5 billion. The fixed and variable loan volume in SEK amounted to approximately 9% of GDP. The intention of the Riksbank was that these measures would reduce the spread between the record low repo rate and the market rates actually charged by households and companies (ibid).

As discussed earlier, Swedish banks also had difficulties raising funds on U.S. dollars. As only the Federal Reserve could print U.S. dollars, temporary reciprocal currency arrangements in the form of foreign exchange swap lines were established with the Federal Reserve in order to channel dollars to banks in other jurisdictions (Baba & Packer, 2009; McGuire & von Peter, 2009). In December 2007, swap lines were set up with the European Central Bank and the Swiss National Bank. After the collapse of Lehman Brothers, a range of other central banks was included in the swap network – including the Riksbank.

The Eurozone crisis from mid-2010 expectedly came to result in wider EURIBOR-EONIA spreads (as the EURIBOR panel mainly consisted of banks within the Eurozone). By contrast, the Swedish financial markets had namely begun to show signs of recovery during 2010, and access to market funding had once again become possible. The economy as a whole was very strong: the GDP increased by 6.1% in 2010 and the unemployment rate began to fall. The reaction by the Riksbank was to gradually phase out the extraordinary schemes it had introduced during the earlier parts of the global financial

crisis. Monetary policy was tightened and, most importantly, the final outstanding fixed-rate term loan to banks that expired in October 2010 was not renewed.

Whereas the focus of the Riksbank was on the liquidity squeeze in the financial system, measures adopted by the Government in the aftermath of the Lehman bankruptcy were largely aimed at preventing a Swedish credit crunch. A stability plan was presented on 20 October 2008 and the Government Support to Credit Institutions Act was passed by the parliament only nine days later. According to an evaluation by the Financial Crisis Committee in 2013, the results were overall positive. First, a strengthened depositor protection scheme served to maintain confidence in the Swedish financial sector. Second, as the government to step in as a guarantor of the banks' loans (through the 'guarantee programme'), the ability of banks to borrow for longer maturities and without collateral increased. Third, although only used by one bank (Nordea), a 'capital injection programme' contributed to market confidence and financial stability. Fourth, the Stabilisation Fund<sup>7</sup>, seen as an appropriate budgetary solution, started with a substantial contribution and gave the Government a mandate to execute unlimited measures and payments in accordance with the Government Support to Credit Institutions Act. Although these assessments refer more to the indirect impact of the measures, it has to be noted that lending to corporates only showed a marginal decline, whereas household lending continued to increase. Moreover, as the measures largely consisted of risk transfers from the private sector to the public sector (at a fee), the net impact for the Swedish taxpayers is estimated to be positive - amounting to around SEK 10 billion (SOU, 2013).

## 4. Conclusions

Sweden's previous debt-led consumption boom regime came to an abrupt end in 1993, after the banking crisis and the ERM crisis. Having switched to an export-led mercantilist regime, the global financial crisis and the Eurozone sovereign debt crisis affected the country differently. The Swedish economy was hit hard by the global financial crisis, but rebounded quickly. Although the country was not immune to the Eurozone sovereign debt crisis, it fared considerably better than most EU member states. At the same time, however, the Swedish economy has come to show symptoms of a renewed debt-led consumption boom through the housing market, and has benefitted from the productivity

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<sup>7</sup> The main objective of the Stabilisation Fund was to be an effective tool for financing central government support measures in case of a banking crisis. The Government has targeted the size of the Fund to 2.5% of GDP in 2023 (Swedish National Audit Office, 2011).



in the non-financial sector and a depreciation of the real exchange rate at 'the right moment in time'.

The regime shift has largely mirrored the Swedish financialisation process – which has been rapid and widespread. State involvement in pensions, education, health care and housing has been replaced or complemented by a range of market-based solutions. Shareholder orientation in the corporate sector has increased, at the same time as inequality has increased, and households have become significantly more exposed to the direction and volatility of the international financial markets. An overriding political ambition to achieve and maintain full employment was replaced in 1991 by that of a low and stable inflation. The banking system was quickly recapitalised, and a fiscal framework was put in place resulting in a budget surplus, rather than deficit, bias. Perhaps paradoxically, the Swedish banking and currency crisis, quickly following the deregulation process and fiscal reform, as well as the ability to conduct a flexible and pragmatic policy outside the euro area, appears to have shielded Sweden from some of the recent turbulence.

To some extent, this has also been aided by the change in perception of Sweden from the perspective of the international financial markets. Whereas the Swedish financial markets had come to be identified with volatility and crises during the 1980s and 1990s, the picture that emerges after the global financial crisis and the Eurozone sovereign debt crisis is remarkably different. Here, Sweden appears to have weathered the storms very well – to the extent that the country, at least colloquially, sometimes has been referred to as a new 'safe haven'. Evidence does not yet provide conclusive support that such a shift has taken place. However, underlying fundamentals do suggest that Sweden has at least clearly moved in such a direction – in line with the country's transformation towards an export-led mercantilist economy.

Whereas the financial crises since 2008 could be seen as *outcomes* of financialisation in a number of countries, similar previous experiences appear to have served to *reinforce* the momentum of financialisation in Sweden. As Bi & Leeper (2010) note, the fiscal policy infrastructure that was put in place after the Swedish banking crisis has come to 'institutionalise a public fiscal discourse'. As such, several of the pillars of the Swedish financialisation process are rooted in pragmatism and consensus - as indeed was the 'old' Swedish model.

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## **THE ABSTRACT OF THE PROJECT IS:**

The research programme will integrate diverse levels, methods and disciplinary traditions with the aim of developing a comprehensive policy agenda for changing the role of the financial system to help achieve a future which is sustainable in environmental, social and economic terms. The programme involves an integrated and balanced consortium involving partners from 14 countries that has unsurpassed experience of deploying diverse perspectives both within economics and across disciplines inclusive of economics. The programme is distinctively pluralistic, and aims to forge alliances across the social sciences, so as to understand how finance can better serve economic, social and environmental needs. The central issues addressed are the ways in which the growth and performance of economies in the last 30 years have been dependent on the characteristics of the processes of financialisation; how has financialisation impacted on the achievement of specific economic, social, and environmental objectives?; the nature of the relationship between financialisation and the sustainability of the financial system, economic development and the environment?; the lessons to be drawn from the crisis about the

nature and impacts of financialisation? ; what are the requisites of a financial system able to support a process of sustainable development, broadly conceived?'

## THE PARTNERS IN THE CONSORTIUM ARE:

<b>Participant Number</b>	<b>Participant organisation name</b>	<b>Country</b>
1 (Coordinator)	University of Leeds	UK
2	University of Siena	Italy
3	School of Oriental and African Studies	UK
4	Fondation Nationale des Sciences Politiques	France
5	Pour la Solidarite, Brussels	Belgium
6	Poznan University of Economics	Poland
7	Tallin University of Technology	Estonia
8	Berlin School of Economics and Law	Germany
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12	Middle East Technical University, Ankara	Turkey

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13	Lund University	Sweden
14	University of Witwatersrand	South Africa
15	University of the Basque Country, Bilbao	Spain

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