

ERA OF REGULATION

POST-WAR FEARS

PEACETIME PROSPECTS were discussed well in advance. According to finance minister Wigforss (1954), ‘as of 1942, opinion shifted fairly steadily towards expectations of a final victory for the Allies’. On 19 March 1943 the government authorised him to assess how the economy would perform after a cessation of hostilities.

The government had acquired instruments for increased intervention and economic policy was more coordinated. Housing controls were introduced on rents and mortgage interest rates. The Riksdag approved emergency powers to control credit and foreign exchange.

In autumn 1943 the government sent Gunnar Myrdal to Washington. Keeping in touch with the Americans was important because neutral countries were viewed with suspicion. Myrdal’s impressions were published the

323

During the crises in the 1930s and the Second World War, international economic activities are increasingly regulated. Sweden’s domestic policy focuses on full employment and housing. The Riksbank administers controls for achieving internal and external balance. More and more market intervention is needed to keep interest rates down. When the Bretton Woods system collapses in the early 1970s, the regulated economy becomes harder to manage. The closing years of the era of regulation are marked by the first oil crisis, wage inflation and a growing budget deficit.

1944 The labour movement’s post-war programme. Low interest rates, high taxation.

1946 The krona is revalued, by 17 per cent against the dollar.

1948 Governor Rooth resigns in protest at the low-interest-rate policy and is succeeded by Klas Böök. The Marshall Plan.

1949 The krona is devalued, by 30.5 per cent against the dollar.

1951 Sweden joins the Bretton Woods system. Mats Lemne is appointed governor of the Riksbank.

1952 Liquidity ratios are introduced.

1955 Per Åsbrink is appointed governor of the Riksbank.

1957 Åsbrink’s interest rate coup.

1958 The krona becomes convertible.

1964 The Riksdag institutes the Bank of Sweden Tercentenary Foundation.

1968 The Riksbank’s tercentenary. The Alfred Nobel Memorial Prize in Economic Sciences is founded.

1970 The ‘idiotic squeeze’.

1973 Krister Wickman is appointed governor of the Riksbank.

1973-6 Bridging the international recession.

1976 Carl-Henrik Nordlander is appointed governor of the Riksbank.

1976-7 Three devaluations of the krona.

1979 Lars Wohlin is appointed governor of the Riksbank.

1981 The krona is devalued.

324 following April as 'Warning against peacetime optimism', a warning for which Lundberg (1983) considers there were good grounds:

Just the actual *shock* to national economies in connection with an end to the war was likely to be exceptionally great. Wartime expenditures in the United States – direct and indirect – had in 1944 reached a magnitude of almost 50 per cent of GDP. Cutbacks during the first year of peace, that is 1945–6, were estimated to entail a reduction in federal spending equivalent to one third of GDP and a demobilisation of 12 million men from war service. Simply the shock from the absence of orders for war materiel and the discharge of millions of employees in the war materiel industries would be overwhelming. Similar shocks would hit all the other belligerent countries. Then there was the problem of surplus capacity, particularly in heavy industry following its marked expansion during the war. Neither could the enormous damage wreaked by the war be counted on to counterbalance this; the chaotic state of transport systems and trading links, plus an absolute uncertainty about the future, was likely to paralyse entrepreneurial initiatives.

Myrdal was appointed to head a commission for post-war economic planning on 11 February 1944; the secretary to the commission was the economist Karin Kock, who became the first woman in a Swedish government, as a minister without portfolio in 1947 and then as the minister of supply the following year.

Alongside the official planning, the social democrats and the trade union movement were formulating their approach to a peacetime economy. The 1940 party congress had called for a review of the party programme in time for 1944; when the general principles had been formulated, a list of 27 points was drawn up and became the framework for 'The labour movement's post-war programme'.

The discussion was influenced by the political achievements during the 1930s crises and the wartime shortages. To leading social democrats, the most vital and feasible goal was full employment. While fluctuations in demand might then lead to overheating and inflation, the government could manage this with the wartime controls and promote a smooth economic development.



Karin Kock (1891–1976), an economist who in 1947 was the first woman to be included in a Swedish government.
Caricature by Nils Melander.

The most radical impulses came from Myrdal and economists at the Trade Union Confederation (*Landsorganisation, LO*). In an article in the LO publication *Fackföreningsrörelsen* in 1944, Myrdal wrote: 'When society takes over more of the responsibility for economic development and in doing so works above all to abolish depressions, society should also perform the function which the depressions would have performed but to date have performed so badly, namely the reconstruction and rationalisation of the business sector.' The LO economist Rudolf Meidner considered that when peace came, some of the wartime regulations could be removed but others could prove useful – 'affirm the regulated society'. He informed the 1946 LO congress that what was needed was 'not legal provisions [concerning the right to work] but a transfer of key industries and other significant branches of business to public ownership, greater public control of the business sector and a constructive policy for employment' (Ekdahl, 2001).

Although the radical statements in and around the post-war programme alarmed the business community and the non-socialist parties, the latter did not formulate any equally appealing proposals, though bourgeois circles did come up with the slogan 'resist a planned economy' before the general election in 1948.

When Wigforss presented the draft budget for fiscal 1948/49 at the Economic Society, his designated opponent, Jacob Wallenberg, advocated a monetary policy that was less regulated than the line which the government and the Riksbank proposed:

The alternative to this [Wallenberg's] policy is a further extension of the system of controls. I fear that if everything in this country is to be steered and directed by commissioners, things will go as they did in Germany before the war: entrepreneurs think less and employees work less because no one believes it pays to make an effort. It is possible that we could arrive at a balance even in this way but it would be at a lower level.

When the 1948 election was followed by a favourable economic development, the visions and the fears both faded. Many of the controls remained in place but the political objectives for which they were intended became more down to earth.



L. to r.: Ernst Wigforss (1881–1977), Gunnar Myrdal (1898–1987) and Richard Sterner (1901–78) at Wigforss' summer home, drafting a programme for the post-war economy.

A price and wage freeze had checked inflation during the war and the question was how prices would develop in peacetime. In May 1943 the Riksbank's board assembled a group of experts to assess the situation. Besides Rooth and Hammarskjöld, it included director-general Klas Böök and two professors of economics, Erik Lindahl and Arthur Montgomery. The secretary to the group was Mats Lemne, a future Riksbank governor, at that time a third secretary at the finance ministry.

The group considered that monetary policy should aim for stability in nominal wages and other incomes. An improvement in real earnings was foreseen when an end to blockades and rising productivity led to lower prices. In the past, productivity gains had tended to benefit real wages by pushing down the price of goods and services (Lundberg, 1953); the group hoped this pattern would be repeated. Myrdal's commission welcomed the proposal, the government presented a bill in 1944 and the Riksdag unanimously approved the monetary policy programme.

Opinions had differed in the preliminary debate; the liberal leader Bertil Ohlin wanted the government to let productivity exert even more downward pressure on prices and wages; otherwise holders of defence bonds would suffer a loss from earlier inflation – deflation would protect small savers. This was the 'fair arrangement' that Wicksell had advocated at the time of the First World War. However, when the new monetary policy programme was discussed by the planning commission and the Riksdag, Ohlin was not in Sweden to voice his criticism (Kock, 1962).

Some time passed before those in charge realised that events were taking a completely different turn. Dag Hammarskjöld had transferred to the foreign ministry to serve as a financial expert prior to the major post-war international economic negotiations. A visit to Washington in summer 1946 convinced him that when the American price controls came to an end, there was a risk of large price increases that might well spread to other countries.

On his return, Hammarskjöld presented the risk of US inflation to the Riksbank's board, of which he was still chairman. In a speech in Halmstad on 30 June 1946, premier Per Albin Hansson had outlined the government's economic policy together with measures for checking price increases. Hammarskjöld raised the notion of countering external inflationary impulses



Ernst Wigforss in 1948 with his under-secretary Mats Lemne (1919–97), who was Riksbank governor from 1951 to 1955.



As chairman of the Riksbank's board, Dag Hammarskjöld initiated the revaluation of the krona in 1946.

330 by revaluing the krona; at the board meeting on 2 July he proposed keeping a close eye on developments in the United States and deferring a decision until the beginning of August.

Events took a different turn. Next weekend, a revaluation of the Canadian dollar contributed to speculation in a revaluation of Sweden's currency, which meant that in principle the Riksbank was precluded from buying foreign exchange. When the government and the advisory council on foreign affairs had discussed the exchange rate issue, a 17 per cent revaluation of the krona was formally decided by the Riksbank's board on 12 July, thereby lowering the dollar rate from 4.20 to 3.60 kronor. The political parties backed this but the driving force came from Hammarskjöld.

The purpose of the appreciation was to ward off price increases abroad. The board underscored that its decision presupposed 'that Sweden's domestic economic policy is designed so that an independent internal price rise does not endanger the maintenance of the new exchange rate'.

Hammarskjöld had already pointed to the risk of domestic inflation. In a memorandum to the government on 17 May, his fifteenth and concluding point had been:

Growing pressure on prices in an upward direction is being registered over the entire field that has been reviewed here. This is partly a consequence of measures taken in the public sphere. From the viewpoint of monetary policy, the situation can be said to be the most serious since the outbreak of war. It seems that the government can only exert stronger counter-pressure by means of investment controls, price controls and exchange rate policy [...]

Inflationary pressure was mounting. When the war ended, banks had stepped up lending and funded this by selling the bonds and treasury bills which they had acquired during the wartime shortage of investment opportunities. The normal market reaction to a greatly increased supply would be higher returns but the government feared that this would contribute to inflation. Instead, the government debt had to be taken up by the Riksbank, whereupon the additional liquidity boosted demand even more.

A 'Memorandum concerning inflation' was finalised on 2 December by Erik Lundberg as head of the National Institute of Economic Research.

It was intended for Wigforss a week later and may have been discussed with Hammarskjöld. The concluding items for checking price increases, reproduced by Metelius (1987), were: 331

1. Effective information about the nature of the situation
2. Increased exports; higher export prices
3. Import restrictions
4. Cutbacks in investment
5. Restrictions on consumption (by subduing the rate of income growth, compulsory saving and possibly direct rationing)
6. Higher taxes on consumption; central and local government spending cuts
7. A controlled one-off price rise

This bitter cure was also Hammarskjöld's line at the board meeting on 5 December. That evening, Gunnar Myrdal, now minister for trade, opened a discussion at the Economic Society on 'The reconstruction of world trade and Sweden's trade policy'. Myrdal was well aware of the risks of inflation and the ongoing currency outflow. Traditional commodities such as coal and steel were in short supply in war-torn Europe. Many purchases were switched to the United States and had to be paid for in dollars; this strained the exchange reserves because of the difficulty in swapping other currencies for dollars. Myrdal warned his audience:

Unless we count on a very marked retardation of the ongoing increase in incomes and purchasing power within the country, during the coming year we will simply be obliged to depart from our relatively free trade as regards imports and, like the great majority of other countries, by means of direct controls limit those imports we can judge to be dispensable.

Government ministers are seldom so outspoken. Those who were present relate that the businessmen among them left in a hurry to bring import orders forward. Still more foreign exchange left the country.

Others shared Myrdal's concern. The Riksbank's board had repeatedly stressed the need to control imports. When the drain on exchange reserves continued, the board requested the government to take action on 13 March;

332 general import controls took effect two days later. This turned into a major political issue (Wigforss, 1954):

What led the opposition to believe its attacks could attract broader support than before was [minister of supply] Gjöres' announcement, simultaneously with the ban on imports, that coffee would be rationed. Domestic stocks of coffee were quite large but the risk of further imports being blocked or obstructed made it fairly certain that hoarding would deplete importers' stocks. So rationing was a way of protecting loyal consumers. But it could clearly serve just as well for propaganda against a government that had not foreseen or prevented such a disastrous situation.

At a board meeting, Hammarskjöld reviewed the underlying causes. He exonerated the measures for which he and the Riksbank were accountable; neither the revaluation nor the credit supply need have led to overheating. The fault lay in wage policy, which constituted 'a very deplorable departure from a desirable course', and in 'the measures, likewise truly deplorable from a purely monetary point of view, for continuing to dismantle the wartime controls, abolish turnover tax and already at this stage undertake to raise public sector wages and ameliorate social programmes.'

His criticism concerned post-war government measures but other forces had driven the decisions, particularly the abolition of turnover tax. Wigforss and the finance ministry had been doubtful but the Trade Union Confederation had pressed for what it saw as a tax cut that would make wages go further. Although the risks of inflation were becoming increasingly clear, the liberal leader Bertil Ohlin had exploited the situation for a motion to abolish the tax; a biographer (Larsson, 1998) concludes that 'popular measures outweighed stabilisation policy in the run-up to the 1948 election'. The parliamentary committee's social democrat majority, aware of the risk of being seen as supporting the tax, sided with Ohlin and proposed its termination as of 1 July 1947. The government gave in and advocated an earlier date, the turn of 1946. This resulted in a marked stimulus to total demand in 1947.

A natural alternative would have been to raise the interest rate but that was something the government hoped to avoid. That social democrat ministers and economists were so averse to this may seem remarkable. One



Bertil Ohlin (1899–1979), professor of economics and leader of the Liberal Party, managed after the war to get the turnover tax abolished earlier than the social democrat majority had intended.

In 1977 he was awarded the Riksbank's Prize in Economic Sciences in Memory of Alfred Nobel together with the English economist James Meade.

334 explanation lies in Myrdal's argument in 1944 in a volume in honour of Eli Heckscher; in a text headed 'High taxes – low interest rates' he had advocated an entirely new interest rate policy: in the post-war world there would be many reasons for keeping interest rates down. The crux of the matter was the function of interest rates as a regulator of investment; would it not be better to use taxation instead?

It is also evident that taxation, if it really is deliberately constructed for this purpose, offers possibilities of a far smoother and more discriminatory control of investment than interest on capital could ever achieve. Control via taxation could thus be built up to function over time as a highly effective instrument for stabilisation while in each phase it provides every opportunity of giving investment the direction – locally, socially and business economically – that is considered politically desirable. The idea should therefore be not without interest for macroeconomic planning.

Purely theoretically, there is thus no objection to a reorganisation of our tax system whereby interest on capital is gradually replaced by taxation as a regulator of investment, so that the afore-mentioned level of interest is brought down to 2 per cent, 1 per cent or even less.

In keeping with Myrdal's programme, the government introduced new ways of subduing inflationary pressure. A charge for smoothing export prices was approved in 1945 and the 1948 Riksdag agreed to a partial sterilisation of corporate profits by transferring them to blocked accounts in the Riksbank. Another important instrument for government policy in the coming decades was various types of contracyclical investment reserves.

The low interest rate policy was not questioned at first by any of the parties in the Riksdag. In May 1947 the government invited business and labour market organisations to talks about how the currency outflow could be checked; when the discussion deadlocked, the government chose cuts in investment and government spending, tighter price controls and restrictions on share dividends.

The business community did criticise the government's reluctance to use monetary policy. The low interest rate was considered to encourage

unnecessary investment. A major factor behind the plentiful money supply 335 was the Riksbank's bond purchases to support the market and keep interest rates down. Jacob Wallenberg, one of the keenest critics, highlighted the significance of liquidity; ending the Riksbank's supportive purchases would check investment more effectively than public investment controls.

ROOTH RESIGNS

The interest rate was a source of growing tension between the government and the Riksbank's governor. Rooth (1988) states that he was already working for a tighter credit market at the end of 1946; however, Kock (1962) notes that in a memorandum to the governing board on 15 February 1947, Rooth still strongly objected to higher interest rates. Instead he wanted investment controls and talks with the banks about voluntary limits to the supply of credit.

Later that year Rooth had changed his mind. An article in the conservative newspaper *Svenska Dagbladet* on 12 September sounded the alarm, predicting additional restrictions and calling for a different interest rate policy. When Rooth contacted the finance ministry to discuss a discount rate increase, he was told that the wave of speculation was not a sufficient reason. The social democrat majority on the governing board declared that 'occasional movements in the money and capital market were to be disregarded even if their magnitude was considerable'.

Despite his objections to the low interest rate, Rooth remained at his post. During 1948 he attempted to terminate the supportive bond purchases. David Hall, the governing board's deputy chairman and leader of the Social Democrats in the Riksdag, had given his word that the Riksbank would be able to lower the purchase price of bonds after that year's general election; interest rates would then go up.

When the election was over, however, he returned and said: 'I'm sorry, Ivar, but I can't keep my word because some of the leading men in the party had forgotten this and promised that the interest rate would not be changed, so we cannot go along with it.'
(Rooth, 1988)

On 8 October Hall suggested getting credit institutions to agree to reduce

336 bond sales; fewer supportive purchases would then be needed. A precondition was that the governing board declared its adherence to the 3 per cent interest rate. Rooth objected and cited the absent Hammarskjöld's opinion that an interest rate increase was a necessary condition for negotiations with the banks. Hall and the majority were adamant, however, and made decisions which kept the rate at 3 per cent. After the next board meeting on 11 November, Rooth tendered his resignation in terms that amounted to a severe criticism of economic policy:

For more than a year I have presented my opinion, orally and in writing, to the governing board in the first place and also to the finance minister and the bank committee. But I have failed in my attempts to obtain a majority of the board for my opinion. I have not gained support for the economic policy I have advocated. I am not able to participate in the policy for the Riksbank that is now being initiated. All that therefore remains for me to do is to hand in my letter of resignation.

The Riksdag granted his application on 4 December 1948. Hammarskjöld's resignation as board chairman had been accepted the day before; judging from the literature, he does not seem to have explained his reasons. He has generally been seen as the government's representative in the Bank but the information that he supported Rooth's proposal to raise the discount rate (Kock, 1962) could mean that in this matter he and the Riksbank's governor saw eye to eye.

Rooth was succeeded by Klas Böök, who had joined the Bank in 1937 and been appointed deputy governor seven years later. In an amendment to the Instrument of Government in 1949, the title of first deputy was renamed Riksbank governor.

DEVALUATION IN 1949

Sweden's economy had been expanding in 1946 and 1947; external demand resulted in an export surplus at first but after the devaluation in July 1946, imports picked up. The current-account deficit for 1947 was equivalent to 6 per cent of GDP, the highest post-war figure for many years to come. The upward phase ended in 1948 and gave way to a downturn the



The 5-kronor banknote commemorating the 90th birthday of Gustav V in 1948 was signed by Dag Hammarskjöld and Ivar Rooth as Riksbank board chairman and governor, respectively; 120×70 mm.

338 following year. With weaker import demand, the current account swung to a surplus.

The liberal leader Bertil Ohlin advocated devaluation in November 1948. During his final weeks as head of the Riksbank, Rooth got in touch with other central bank governors and friends abroad; he appeared before the Riksdag's standing committee in an attempt to counter expectations of devaluation.

One of the biggest problems was the shortage of dollars; in January 1949 the foreign ministry therefore examined the legal aspects of treating the dollar separately. France and Italy had arranged devaluations in that way, writing down their currency and rationing dollar exchanges. That would not have worked if trade and the foreign exchange market had been free (a more costly currency can then be exchanged for one that is cheaper, or the goods can be purchased via a third country). The tight controls in the early post-war years enabled some countries to operate with exchange rates that differed from currency to currency.

The US recession in 1949 triggered speculation on a devaluation of the krona in the spring. The post-war inflationary boom was ending, which meant fiercer international competition. Trade was hampered by the dollar's status as a reserve currency; European countries had difficulty in acquiring the dollars they needed to purchase American products for reconstruction. Due to the shortage of foreign exchange, trade was frequently based on bilateral clearing arrangements.

Governor Böök questioned a unilateral Swedish devaluation. It would make it harder to negotiate new agreements on currency rates and clearing arrangements. A partial devaluation against just the dollar was also rejected for fear of American countermeasures.

The United States used the Marshall Plan to facilitate a recovery in Europe. When US demand slackened, the Truman administration feared a further deterioration in Europe's balance of payments, which would mean still larger transfers. To avoid this, the administration urged countries in Europe to devalue their currencies to make their exports more competitive.

Partly as a result of American pressure, sterling was devalued by 30 per cent on 18 September 1949. Numerous countries followed suit to a greater or lesser extent. As a result, the official exchange rates approached the free market rates in Switzerland, which made it easier to relax the controls (Toniolo, 2005).



Klas Böök (1909–80) and Conrad Jonsson (1886–1964) succeeded Ivar Rooth and Dag Hammarskjöld as Riksbank governor and board chairman, respectively, in 1948 but the press knew that it was the finance minister,

Ernst Wigforss, who controlled both them and the chairman of the Riksdag's bank committee, Harald Åkerberg (1883–1950). Caricature by Nils Melander in *Svenska Dagbladet*, 1948.

340 In Sweden, opinions differed about the appropriate size of the devaluation. Wallenberg wanted no more than 25 per cent (Erlander, 1974). Hall, now finance minister, was inclined to agree. Of the party leaders, Ohlin for the liberals and Petrus Grånebo for the agrarians wanted to match the British devaluation; as head of the National Institute of Economic Research, Lundberg (1987b) recommended the same 'because in 1946 the government had demonstrated its inability to implement the tight policy that was required to maintain the krona's high external value'. When it became clear that this was also the Riksbank's line, Hall gave in on the grounds that it was a matter for the Bank to decide (Kock, 1962) and the board opted for 30 per cent. Even after the devaluation, Sweden continued to restrict dollar imports until some way into the 1950s.

The office of Sweden's finance minister changed hands twice in 1949. Wigforss had been intent on leaving the government for a long time and Per Edvin Sköld was regarded as his natural successor but could not be persuaded by Tage Erlander, who had succeeded Per Albin Hansson as prime minister in 1946. Instead, David Hall had left the Bank's governing board to become finance minister on 1 July. His time in that office was brief. During an internal dispute among Västmanland's social democrats he had tried to get his way by invoking the government's authority and been obliged to resign, whereupon he returned to the Riksbank as deputy chairman of the board. Sköld then agreed to succeed him. This was a change for the better according to Lundberg (1987b), who at the Institute's 50th anniversary recalled that 'After his arrival many things were done that made the devaluation a success'.

Wage determination attracted more attention after the war. While the Trade Union Confederation (*Landsorganisation*, LO) championed full employment, there was a risk that labour shortages in expanding industries would lead to inflation. Writing in the social democrat's periodical *Tiden* in 1948, LO's chief economist Rudolf Meidner warned that this issue could split the trade union movement. He therefore advocated increased cooperation between LO and the government on all aspects of economic policy:

Whether the trade union movement's organisation will be destroyed by disintegrated and uncontrolled wage formation or will manage to use wage policy as an instrument for increased output and efficiency

is a matter that depends on the government's ability to construct, and the various social groups' willingness to accept, the measures that lead to this goal.

341

LO resolved its dilemma by centralising wage negotiations, though the Metal Workers' Union (led by Arne Geijer, a future LO chairman) hesitated initially. Meidner and his colleague Gösta Rehn recommended a tighter fiscal policy to tax away the profits that would otherwise be available for wage increases; they also called for government support so that labour could move from less to more productive occupations.

The devaluation caused friction between LO and the government, which wanted LO to prolong the wage agreement for an additional year, i.e. for 1950. Devaluation in September 1949 made matters worse. According to Rehn (1977), LO had supported it in order to create 'possibilities of adjusting old and new wage injustices'. Prolonging the agreement would defer this chance and there was a risk of the devaluation leading to increased wage differentials. In his memoirs, prime minister Erlander relates that he thought of resigning when the LO leadership dug their heels in. By the turn of October, however, LO had agreed to a prolongation.

Another matter connected with the devaluation was the question of the banks' exchange profits. The banks had speculated in the 1946 revaluation, selling foreign exchange and in some cases even borrowing in order to gain from it; later, however, they had transferred the profits to the Riksbank (Olsson, 1986). Prior to the 1949 devaluation the banks had increased their foreign exchange holdings and the Riksbank now insisted on redeeming the surplus of dollars and Swiss francs at the pre-devaluation rates. When the banks refused, the Riksbank took legal action against Handelsbank, which had purchased most dollars during the year. The Riksbank lost the case – it was not illegal for commercial banks to try to anticipate exchange rate movements.

Wihlborg (1993) considers that the 1949 devaluation has sometimes been misrepresented. It was confined to the dollar, the Swiss franc and other currencies that did not follow sterling; there was no devaluation against the currencies of Sweden's major trading partners. It is therefore debatable whether the devaluation had all that much to do with the favourable development of Swedish exports in the 1950s and '60s. Sweden's intact industry flourished during Europe's reconstruction.

BRETTON WOODS

After the crises in the 1930s and the Second World War, the international economic system was in a sorry state. The demise of the gold standard and the controls on payments restricted the mobility of capital. Trade was largely arranged by barter or bilateral agreements. Some arrangements allowed unspecified trade up to a limit in kronor and the foreign currency; others combined trade in goods with the provision of credit.

This was disastrous for the international division of labour. Even so, productive capacity recovered fairly quickly after the war (Eichengreen, 2007); by 1947, Europe's capital stock seems to have reached much the same level as a decade earlier. The conditions for a recovery were soon in place (though uninterrupted growth at an annual rate of two per cent would admittedly have enlarged capacity by 20 per cent); the problem lay in the obstacles to trade and financial flows.

The first moves were international: with the end of the war in sight, the United States and other Allies started to prepare new global organisations for trade and economics. The notion of a worldwide economic and monetary order was first discussed in earnest in 1943 and this gave rise to an international conference the following year. The Bretton Woods agreement was reached after heated arguments, mainly between the United States and Britain. Keynes led the British delegation and favoured a system that would lead to increased liquidity in the global economy and facilitate exchange rate adjustments, so that surplus and deficit countries would share the burden. The US plan, whose chief author was Harry Dexter White, was stricter: exchange rate adjustments would require the approval of a fund, with the United States as much the most influential member. An adjustment by a country in distress would then probably be considerably harder; deficit countries would have to shoulder most of the burden by reforming their domestic economies.

The US negotiators gained the upper hand. The new system was based on the dollar as the reserve currency, fixed exchange rates and rules for consultations before a member state altered its exchange rate. The Bretton Woods institutions were to counter restrictions on trade and exchange rates. Oversight of the system was entrusted to the International Monetary Fund (IMF), while the World Bank (officially the International Bank for Recon-

struction and Development, IBRD) was to be responsible for assisting member states with reconstruction and development. With fixed exchange rates, international price movements would have domestic repercussions; however, somewhat freer capital flows did give member states some discretion in monetary policy.

With the creation of the IMF, the future of the BIS was in doubt. This was largely a political issue; some of the Allies considered that the BIS had not been strictly neutral during the war. In the end the BIS survived as a forum for the affiliated central banks. Starting with Rooth, the governor of the Riksbank has always had a seat on its board, which serves as a meeting-place for informal discussions between the leading central banks.

In an account of Sweden's road to Bretton Woods, Ahlström and Carlson (2007) emphasise how remarkable it was that the conference actually managed to agree on a new system that saw the light of day. There had been numerous previous international monetary conferences – from the time of Napoleon III onwards and not least in the inter-war years – but their outcomes had been disappointing.

The world trade negotiations were less successful. Agreement was reached on an International Trade Organisation (ITO) but the United States never ratified the decision and the idea was mothballed. It was replaced in practice by the General Agreement on Tariffs and Trade (GATT), with its seat in Geneva, as the centre for multilateral agreements on the abolition of trade barriers.

As a neutral country, Sweden was not a participant at Bretton Woods but tried to stay informed in both Washington and London. The Americans were not particularly friendly to start with; White was highly suspicious of Sweden's wartime connections with Germany. The British were more amenable, not least to build a European counterweight to the US influence.

Sweden's attitude was uncommitted. One factor was the cost of membership (in the end it was \$100 million each to the IMF and the IBRD). Hammarskjöld wrote that 'in the present situation [spring 1946], mainly considering the uncertain development of Soviet relations to Bretton Woods, Sweden should refrain from taking a westward monetary policy orientation any further' (Ahlström & Carlson, 2007).

Sweden's principal objection concerned monetary policy freedom. A fixed exchange rate had two drawbacks: adjusting the rate was more difficult and the country risked exposure to inflation abroad. In the same letter,

344 Hammarskjöld continued, 'I am also highly sceptical about binding exchange rates in a situation that, not least in the United States, contains large risks of marked price fluctuations'. Other economists expressed similar doubts, Erik Lindahl strongly, Bertil Ohlin in a milder tone with a preference for Keynes' more flexible arrangement.

When Sweden finally applied for membership, the decisive reason was that under the 1949 Annecy agreement, the ITO and GATT required a monetary undertaking that was equivalent in practice to membership of the IMF. Sweden was primarily interested in the promotion of free trade; if that entailed a loss of monetary policy autonomy, one might just as well acquire the influence IMF membership could confer, even though this cost over one billion kronor – 'a fantastic sum' in the eyes of Gustav Johansson, a communist member of the Riksdag who opposed the motion. Only a fraction of the total had to be paid in directly, however.

Sweden was welcomed as a member of the IMF and the IBRD on 31 August 1951. Ivar Rooth had recently been appointed head of the IMF and was succeeded in 1956 by another Swede, Per Jacobsson from the BIS.

THE EUROPEAN PAYMENTS UNION

Tangible results from Bretton Woods and GATT took time. The immediate problems in the international economic system required more concrete measures. Matters came to a head in 1947, when harvests failed in much of Europe. The combination of imported foodstuffs and a large investment requirement resulted in a balance of payments deficit that was equivalent to 5 per cent of Europe's gross national product. Such a deficit is manageable for a year or so if exports amount to around a third of GNP; after the war, however, exports from many countries in Europe were negligible; total imports were 65 per cent larger. To balance foreign trade, European exports would need to be increased by more than half. New arrangements were clearly needed.

Another obstacle was price controls. Many countries stuck to wartime regulations to prevent continued shortages from pushing prices up. Unfortunately this also depressed output; farmers and other producers saw no point in supplying more at prices which hardly covered costs. When price controls were abolished, output immediately rose; the effect was clearest in West Germany, where the authorities had also hesitated.



L. to r.: Harry Dexter White (1892–1948) and John Maynard Keynes (1883–1946) represented the United States and Great Britain, respectively, at the Bretton Woods negotiations, which largely focused on their different proposals.

346 In order to manage the Marshall Plan, the United States had taken the initiative for the Paris-based Organization for European Economic Cooperation (OEEC), later replaced by the Organization for Economic Cooperation and Development (OECD). The members of OEEC established a system for intra-European payments at an early stage; they went further on 1 June 1950 and created the European Payments Union (EPU), with \$500 million in initial capital from the Marshall Plan. Sweden was a founding member.

The Union's basic principle was that one member's surplus in the currency of another member could be used to settle bilateral trade deficits with other members. Surplus countries saw an advantage in the Union because it required members to endorse the OEEC's Trade Liberalisation Code, which stipulated the abolition of discriminatory measures. Members also undertook to remove barriers to trade, to begin with by 50 per cent. In the two decades after the birth of the EPU, world trade expanded at an annual rate of 8 per cent, a record high apart from some years after the trade agreement in the 1860s (Cameron, 2006).

Sweden's currency was not convertible; foreign trade was largely regulated by bilateral agreements. An agreement with Belgium from 20 May 1945, for example, provided mutual credit for a year at a time to cope with seasonal fluctuations. The krona's revaluation in 1946 led to disputes about profits and losses on the loans.

The Bretton Woods system and the EPU encouraged the development of an increasingly multilateral payment system. In December 1958, Sweden restored full convertibility for current payments, but capital transactions were still strictly controlled.

CENTRAL BANK SUBORDINATION

The status of central banks changed in the post-war era. Monetary policy was incorporated in a coordinated economic policy that gave precedence to fiscal policy, with the finance minister in charge. Central banks that had been wholly or partly in private hands were nationalised.

Besides drawing on Keynesian demand management, this was a reaction to wartime regulations. Moreover, as noted by Toniolo (2005) in a history of the BIS's early decades, central banks were criticised for their management of the depression in the 1930s; their policy and independence

were questioned. The conflict between higher interest rates and unemployment led to fiscal policy being seen as a more effective instrument. Leading Swedish economists disparaged monetary policy (Nycander, 2005). 347

An exception was the West German central bank, with a performance that was highly influential when the issue was reconsidered. Notwithstanding the Reichsbank's clumsy management of hyperinflation in the early 1920s, its post-war successor, the Bundesbank (initially Bank Deutscher Länder), was given considerable independence. This was a result of how the occupying powers organised the new German state; after some years, the federal government contested the Bank's independence.

The first skirmish occurred in October 1950 when the central council wanted to counter inflationary pressure from the Korean war by raising the discount rate two percentage points. Chancellor Adenauer urged the Bank to desist; however, its independence was still safeguarded by the law the Allies had drafted in 1948.

Five years later, when the Bank set out to reverse a long period of interest rate cuts, this protection no longer existed. Provided he could command a majority in the federal parliament, the chancellor was able to control the policy of Bank Deutscher Länder. This roughly coincided with preparations to establish the Bundesbank.

The Bank opened with a cautious increase of 0.5 percentage points in August 1955, which industrialists still claimed was harmful for growth. In November, Adenauer informed Wilhelm Vocke, the Bank's president, that he would be grateful if the Bank refrained from proposing or implementing any intrusive measures of credit policy without first consulting the federal government. Vocke immediately replied that intrusive measures of credit policy were a part of the central bank council's responsibilities.

When the Bank council advocated a further increase in March 1956, the two ministers present, Ludwig Erhard and Fritz Schäffer, moved for a temporary veto. The council ruled that the one-off veto had been used earlier and unanimously decided to raise the discount rate one percentage point.

On the next occasion, the bank first played along with Erhard and Schäffer when their stabilisation programme was presented to an uninformed cabinet meeting on 17 May; next day, a further discount rate increase of one percentage point was approved by the Bank council by eight votes

348 to two. The ministers who were present supported the decision and Adenauer had lost the trial of strength.

Even so, in a speech to German employers on 23 May, the Chancellor criticised both the increase and the Bank's independence: 'Here we have a body that is not accountable to anyone, neither to parliament nor to the government. A heavy blow has been struck at the German economy and those who suffer most are the little men [...] the guillotine falls on the man in the street, that is what grieves me most.' This elicited a reaction in the German press that was disastrous for Adenauer; the 'guillotine speech' was repudiated and the Bank gained support. Since then, no chancellor has questioned the Bundesbank's independence, although there have been conflicts over the construction of policy.

In Sweden, the Riksbank, unlike the Bundesbank, followed the trend towards decreased independence, though it retained its singular constitutional status. Hammarskjöld had declared in 1935 that 'in principle' it would be most acceptable for monetary policy to be managed by central banks that are 'removed from the direct influence of party politics' but during the war it was he who guided the coordination of economic policy. As an active chairman of the Riksbank's board, he took the initiative in decisive questions, not least the 1946 revaluation. The Bank's management took a back seat.

Hammarskjöld's position as chairman is reminiscent of Thegner's and Gyllenborg's in the Age of Liberty. After him, the chairman seldom intervened in matters of monetary policy to such an extent, or at least not so continuously. Coordination was arranged instead by the Riksbank's governor, who consulted with the government, primarily the finance minister or his officials, before virtually every important decision. Opinions differed from time to time but except for the interest rate decision in 1957, the government seems to have agreed with most of the Bank's measures. Moreover, government borrowing was directed in practice by the Riksbank, though the formal decisions and management were in the hands of the National Debt Office (Eklöf, 1990a).

The era of coordination is reflected in the selection of governors. Every governor since Rooth and Klas Böök (whose period in office was brief) has been thoroughly acquainted with the government offices. When Mats Lemne succeeded Böök at the age of 32, he had been Wigforss' under-secretary while still in his twenties. Most of his successors have been under-

secretaries, too: Per Åsbrink in the ministry of transport (and editor of the social democrats' periodical *Tiden*); Krister Wickman in the finance ministry (and chairman of the Riksbank's governing board and minister of industry); Carl-Henrik Nordlander in the ministry of agriculture (and head of the state-owned Kreditbank); Lars Wohlin in the ministry of economic affairs; Bengt Dennis in the ministry of trade; Urban Bäckström in the finance ministry; Lars Heikensten and Stefan Ingves had been directors-general in the finance ministry.

Besides being accountable for monetary policy, the governor of the Riksbank occasionally disciplined others on behalf of the government. Erik Lundberg was head of the National Institute of Economic Research, which at that time was governed by a board that included Gunnar Lange, under-secretary at the finance ministry, and the Riksbank's governor, Mats Lemne. Lundberg had questioned the abolition of turnover tax in autumn 1946 and criticised economic policy on a number of occasions. In autumn 1953, Lange and Lemne wanted the Institute to rewrite parts of an economic report; the former explained that Lundberg must be prepared 'to write what suits the board members who are accountable for particular parts of economic policy'. Lange went to a meeting in Paris and left Lemne to approve the report.

Afterwards Lemne explained that what had troubled him was the tone of the report, not just certain formulations. In addition, finance minister Sköld was sometimes irritated that Lange and Lemne as board members had approved texts which ran counter to the ministry's current policy (Kragh, 1987). Lundberg (1987b) presented his version of the incident at the Institute's 50th anniversary:

Yes, I have an extremely vivid memory of what happened. It came as such a shock that the chapter could not be approved. Lange and Lemne announced this rather curtly and then left the meeting. Karin Kock was in the chair as stand-in for Gjöres, who had approved the entire report in advance. I had with me from the Institute Krister Wickman, my co-author of the notorious chapter, and Lennart Fastbom. The latter no doubt remembers that the meeting was so highly charged that the table shook with the trembling knees of some of those present. After the meeting I phoned Sköld to say that as I no longer had the board's confidence,

I had no option but to resign. Some hours later he phoned back and told me he could not find anything worth remarking on in the chapter. After some rewording, the board approved the text.

During Bäckström's time the Riksbank Act was amended to increase the Bank's independence. Bäckström's successor, Lars Heikensten, as well as the present governor, Stefan Ingves, have a more professional and academic background. Besides their posts as director-general in the finance ministry, Heikensten was Handelsbank's senior economist before he became deputy governor of the Riksbank and Ingves came from the International Monetary Fund to succeed him as governor.

THE GOLDEN AGE

Bretton Woods and the gradual deregulation of international trade laid the foundation for a favourable and smooth economic development in the 1950s and '60s. In Sweden, post-war price increases had been comparatively moderate, though the public debate suggested otherwise. International price increases in 1950–1 in connection with the Korean war did contribute to some high inflation; in the next decade and a half, however, the level of inflation was modest even though growth was mostly strong and unemployment low.

The fixed exchange rate regime caused some trouble. As Keynes had pointed out, it exposed countries to fluctuations in international prices and opened the door to falling prices and deflation; he would have preferred floating rates targeted on price stability.

Central bank cooperation was extended in the 1960s. In 1961 the US Treasury Department initiated a number of bilateral agreements whereby central banks undertook to provide credit if a currency was being attacked. Such swap arrangements had existed on a much smaller scale since the 19th century. To provide the IMF with additional resources, in 1962 the Group of Ten³⁴ concluded general agreements to borrow. The G10 is still an important forum in which the Riksbank can collaborate with all the world's leading central banks.

³⁴ Canada, France, Germany, Italy, Japan, the United Kingdom and the United States (which together with Russia constitute the Group of Eight), together with Belgium, the Netherlands and Sweden; Switzerland joined the G10 in 1964, so since then it has had eleven members.



The National Institute of Economic Research was set up in 1937 but did not become an important institution until after the Second

World War. Caricatures of seminar participants by Nils Melander, March 1947.

The central banks also formed a gold-pool to reinforce the Bretton Woods system. A meeting in Basel in 1961 agreed to place £270 million in gold at the disposal of the Bank of England's market operations with the aim of stabilising the price of gold at the official rate of \$35 per ounce. The pool worked well for some years, though France left it in 1967. Sterling's devaluation that year led to increased demand for gold. From March 1968 onwards, the price of gold was set in the market (Pringle, 1995).

In Sweden it was the policy for low interest rates that caused problems. Low interest meant higher demand for loans, which added to inflationary pressure. In a review of monetary policy in 1955–67, Eklöf (1990a) notes that from 1950 the primary concern was internal balance; interaction with the rest of the world did not become a serious matter for the Riksbank until the late 1960s.

The argument for low interest rates was the relative sensitivity of housing construction to the price of credit; a low interest rate was therefore an effective way of supporting the provision of new housing. The discount rate was a blunter instrument for regulating the entire economy. This had been Myrdal's argument in 1944. Others were less certain. In 1950, finance minister Sköld tried to convince the prime minister, Tage Erlander, that interest rates must be eased. Erlander referred him to the economist Alf Johansson, director general of the National Housing Board and the government's representative on the Riksbank's board. Sköld took his advice and reported back that Johansson 'is a fanatical doctrinaire who is of the opinion that the discount rate is of no significance for the value of money'.

Åberg (2006) considers that this 'shows how far Alf had travelled from the economics he had previously taught year after year at the [Stockholm] School of Economics'. Alf Johansson was not alone among economists, however; Larsson (1998) cites an academic paper written by the future liberal leader Bertil Ohlin soon after the war: 'Talk of interest rate policy is scarcely modern.' Sköld fell into line; at the Economic Society's budget debate on 25 January 1951 he expressed scepticism about using the interest rate to stabilise the economy; its role should be confined to smoothing minor disturbances and shifting credit between different forms of lending (Kock, 1962).

Sweden's monetary policy dilemma was handled, as in many other West European countries, by controlling and rationing the supply of credit. The aim was to channel loans and capital to the economic sectors that were judged to be in greatest need.

The policy was inspired by the wartime controls; instruments were then refined and developed in the aftermath of the Korean war. In 1949 the Riksbank had been authorised to regulate the size of the commercial banks' cash reserves. Deputy governor Mats Lemne submitted a memorandum in August 1951 that underpinned the Riksbank's policy up to deregulation in the 1980s. The question he addressed was how to combine a restrictive policy with an unchanged discount rate. The new instruments that he proposed provided material for legislation on interest controls which the Riksdag approved in November 1951. The Act entitled the Riksbank to stipulate intervals for the highest and lowest bank interest rates. Moreover, all bond issues required a licence from the Riksbank, which meant that companies, housing institutions and local authorities had to queue up for what was called control of issues. The Riksbank also restricted the price of loans to industry and power plants to facilitate local authority bond issues. That autumn Lemne succeeded Bööf as governor of the Riksbank.

By the end of the year, the monetary policy situation had stabilised; 'Korean' inflation was over, the exchange reserves were satisfactory and the current account showed a surplus. In February 1952 the Riksbank started to regulate banks' cash reserves by means of voluntary agreements; the rather laborious legislation could still be used to crack the whip. The liquidity ratio was calculated as cash reserves in relation to the specified liabilities. As government securities and mortgage bonds were classified as liquid assets, the government and housing had a borrowing advantage over the corporate sector. Liquidity ratios, investment ratios and bond issue controls were 'instruments that were to be long-lived' (Eklöf, 1990a).

The earlier inflation continued to leave its mark on wage negotiations, with a 20 per cent wage increase in 1952. Early in 1953, Lemne expressed concern that this could impair Sweden's competitive position. In his opinion the exchange reserves were still 'vulnerable'; credit policy should focus on preventing a further drain. The government's budget deficit should not be financed by selling bonds to the Riksbank. He also questioned whether the

354 Riksbank ought to counter the currency outflow's tendency to raise credit market interest rates. This heralded a departure from the rigid low interest rate policy but that took time.

At the Riksbank's regular Monday meeting on 17 December 1953, the bank directors were asked whether they were prepared to prolong the voluntary agreement. Some days later, Lemne formally requested the Bankers Association to 'recommend that the members of the Association implement from the turn of 1953 and until further notice during 1954 the guidelines for credit and liquidity policy that have been drawn up in current agreements and to inform the Riksbank whether the banks are prepared to do this'.

The Association referred the question to its members. On 29 December, however, Marcus Wallenberg Jr bypassed the Association and informed the Riksbank that Stockholms Enskilda Bank (which had not been represented at the meeting) considered that 'a prolongation does not correspond to any need'. He saw this as a matter of principle rather than a factual dispute, which was correct at least as regards liquidity; Stockholms Enskilda Bank's ratio was above 50 per cent and the agreement stipulated only 33 per cent.

The bank's negative response attracted press comments on 6 January 1954. Wallenberg explained his position in person to finance minister Sköld and his under-secretary Lange; he also went to the Riksbank, where he met the board chairman Conrad Jonsson but not the governor. Social democrat and communist newspapers attacked big business for not shouldering its responsibility for the country's economy. They recommended tighter credit market controls. On the other hand, an editorial in *Dagens Nyheter* found Stockholms Enskilda Bank's response 'not the least remarkable'. With corporate borrowing on a downward path and a liquidity ratio of 54 per cent, it would 'be odd to make formal agreements about matters that for this bank are of no significance'. *Svenska Dagbladet* was less certain. A prolongation would have been of little importance for stabilisation policy, but it would have been welcome as a gesture of understanding. By cancelling the agreement without consulting the other banks, Stockholms Enskilda Bank had worsened relations; the Riksbank was now preparing to tighten the controls, which meant that every bank would suffer from Wallenberg's move.

The comments suggest that the banks were getting at each other. The

author of *Svenska Dagbladet's* editorial had consulted a Handelsbank director, Lars-Erik Thunholm, whose managing director Ernfrid Browaldh also chaired the Bankers Association. Browaldh resented Marcus Wallenberg's action, which side-stepped the Association. Thunholm's diary records: 'The atmosphere here [Handelsbank] is still very indignant. The whole thing is seen as an attack on Browaldh just as much as on the Riksbank.' Lemne was got at, too; besides declining to prolong the agreement, Stockholms Enskilda Bank had called the Riksbank's policy meaningless and mistaken.

The Riksbank withdrew its request on 8 January and asked the Bankers Association instead to recommend that its members adhere by the earlier agreement for 1953. At the Association's meeting some days later, all the members – including Enskilda Bank's representative – agreed to do so.

The background to Wallenberg's foray was that Enskilda Bank relied on a large deposit surplus from industry; in return, these customers relied on the bank to meet their requirements (Olsson, 1986). That would be difficult if the Riksbank regulated interest rates and credit stocks. Marcus Wallenberg feared that 'instead of being deposited in interest-bearing bank accounts, the surplus funds which many companies possess, at least temporarily, will be used to provide other companies with loans'. He was not far wrong.

As a result of this row, the Riksbank initiated an amendment to the emergency legislation on banks' cash reserves. Banks could now be forced to maintain a liquidity ratio of up to 50 per cent, twice as much as before. This threat did not have any immediate consequences.

In these and other ways, after the Second World War the commercial banks were co-opted into the implementation of economic policy. The government and the Riksbank forced the Bankers Association to discipline its members. 'The method of using trade associations as "semi-official" bodies for government regulations had been adopted for unemployment and agricultural policy in the 1930s and became systematic during the Second World War' (Olsson, 1986). When the matter was raised a fortnight later in the Riksdag's general political debate, Sköld's argument was: '[I]t must always be realised that if in our day, when everything is organised, certain sectors of the business community or social groups get together in organisations and take a joint, collective responsibility, those concerned must naturally take the consequences of this and stand as a collective in relation to other collectives, in this case the government.'

Per Åsbrink succeeded Lemne in spring 1955 and opened his 18 years as governor by raising the discount rate 1 percentage point. His era has been described as 'the renaissance of interest rate policy' (Kock, 1962).

The interest rate increase and liquidity requirement failed to check the boom. In talks in September 1955, the Riksbank therefore 'recommended' that the commercial banks reduce next month's 'other lending' (for everything except housing) to 99 per cent of the level in July. By the turn of the year, lending had been squeezed to a level that was 4 per cent lower than in June/July.

The banks were kept on a tight rein; the absolute ceiling on the volume of each commercial bank's advances was lowered from year to year. In particular, the Riksbank kept a close eye on the growth of credit to the car trade. Another instrument for directly influencing individual companies' investments was introduced in the form of a law on investment reserves, deposited free of tax in the Riksbank and withdrawable only at the government's discretion. Tighter depreciation provisions and higher corporate tax led to less internal financing. This hampered the corporate sector's development and renewal (Lindgren, 1994); companies concentrated on surviving and on rationalising existing operations.

The squeeze was criticised for being too focused on manufacturing and commerce; its opponents wanted a more flexible interest rate policy and fewer controls. When the Riksbank's annual report for 1956 was considered by the parliamentary committee, the non-socialist opposition tabled a reservation: the lending ceiling should be reserved for exceptional circumstances and used only briefly; issue controls should be dropped. The Riksbank was aware that its rationing of credit was problematic. However, the political majority preferred the lending ceiling to higher interest rates.

Trouble threatened in the spring of 1957; instead of a projected budget surplus of 500 million kronor, there was actually a deficit of 900 million. The Riksbank considered that such a deficit could not be financed without raising interest rates. It was obliged to support the market by buying new mortgage bonds and older government bonds. Bond rates moved up. In the summer the international currency market became more turbulent; the French franc was devalued and speculation in a revaluation of the German mark weakened the krona. When the Economic Society debated the draft



Per Åsbrink (1912–94),
Riksbank governor 1955–73.

358 budget for 1957/8, the new finance minister, Gunnar Sträng, admitted that fiscal policy was not sufficiently flexible; monetary policy was often a better alternative for short-term aims and sudden changes (Kock, 1962).

This was followed by Åsbrink's 'interest coup': the Riksbank raised the discount rate on 10 July 1957 by another full percentage point, from 4 to 5 per cent, without notifying the government in advance. In his memoirs, Ivar Rooth (1988), who had just stepped down as executive director of the IMF, relates what he knew had happened:

He [Åsbrink] had wanted a higher interest rate in the '40s and [now] he achieved it. He did so by getting the other three social democrat members of the governing board to come to his room one Thursday morning half-an-hour before the board meeting was due to begin. He then kept them there until 10 o'clock and they went to the meeting together. During the half-hour he had mentioned what he intended doing. He presented the proposal to raise the interest rate and had got the other party colleagues to promise to vote with him. He knew the conservatives and liberals were in favour, so his proposal was adopted.

In 1951 the social democrats had formed a coalition government with the agrarian party, where the 19th century emphasis on low interest rates was still alive. By 1957, when the agrarians added the words 'Centre Party' to their name, the coalition was faltering. Even so, Åsbrink had expected a rebuff if he consulted the government in advance.³⁵ With the support of the social democrats on the board, he could be certain of a majority. The members who were informed in advance were required by Åsbrink to promise they would not pass the information on to the government (Kock, 1962).

The coup gave rise to a lively debate. It was the only time the finance minister interrupted his annual holiday on Sweden's west coast and returned to Stockholm. One of his staff at the time³⁶ relates that when an alarmed

³⁵ 'There are invariably many considerate people who believe they know better than the party chairman how policy is to be conducted. If the Riksbank's leaders had come to me they would have found no need to make an effort to keep the agrarians in the government. Hedlund [leader of the agrarians] and I were in complete agreement that the coalition would be dissolved.' (Erlander, 1976)

³⁶ Carl Johan Åberg, personal communication 7 December 2006.

young official encountered Sträng in the ministry and wondered why he was there, the latter replied: 'They've had a nervous collapse at the Riksbank.' In the presence of witnesses Sträng had phoned Åsbrink and told him off: 'You cabbage counter, you could at least have phoned.'

Many social democrats called for the resignation of all their colleagues on the board, including Åsbrink. In the end it was only the chairman, Per Eckerberg, who tendered his resignation, at the government's request.

Erlander noted that the 10th of July was 'one of the darkest days in my political life'. Reflecting in his memoirs on how independent the Riksbank could actually be, he wrote:

I still find it unreasonable that the government was not informed. The government's fiscal policy and the Riksbank's credit policy are both instruments in the economic policy for which the government must bear sole responsibility. That does not mean that the Riksbank is to take orders from the government. A Riksbank governor is in an extremely strong position in a negotiation because he can always resign, which in a critical situation can be very troublesome for the government. The government does not go that far unnecessarily.

Professor Erik Lindahl, a leading Swedish economist in the mid-20th century, considered, on the other hand, that it was the Riksbank's duty to raise the discount rate even if this clashed with the wishes of the government and the Riksdag majority. As long as price stabilisation was the primary objective, the Bank must do what it found necessary to achieve this. Only an explicit Riksdag directive about the level of interest rates could relieve the Bank of its responsibility.

The new board chairman was Per Edvin Sköld, whom Gunnar Sträng had replaced as finance minister in 1955. Next year, when the bank committee scrutinised the board's actions, it established that consultation between the Riksbank and the government would precede important monetary policy decisions, of which interest rate adjustments was one. This was then a regular practice until the Riksbank Act was amended in 1999. Still, Åsbrink's discount rate increase remained in force, though in 1958 the centre party did table a motion calling for a return to the low interest policy. When a centre party representative on the governing board proposed a

360 discount rate cut, Åsbrink dismissed the idea with a reference to the balance of payments.

Compared with Åsbrink's first discount rate increase in 1955, the 1957 coup was a clearer departure from the policy of low interest rates (Englund, 1993). It was combined with an easing of controls – an end to the lending ceiling for commercial banks and less restriction of lending by savings banks and rural credit societies. Housing finance was an important consideration here; a higher discount rate made housing bonds more attractive and that enabled banks to dispose of earlier construction credits and make way for new housing projects.

When the economy slowed in autumn 1958, the Riksbank enlarged the frame for the banks' non-residential loans. This established the role of monetary policy as an active instrument for stabilisation. Policy was adjusted in an expansionary direction in such situations, while in upward phases it was made more restrictive by altering the discount rate, liquidity ratios, cash reserve requirements and lending ceilings, together with an exhortation to credit institutions to be generally restrained.

In a survey of the Riksbank's policy between 1945 and 1990, Jonung (1993) notes how circumstances changed at the turn of the 1950s. The European Monetary Agreement made West European economies more sensitive to interest rates from 1959 onwards. In Sweden, the government finances were reinforced by the reintroduction of turnover tax in 1960, after finance minister Sträng's indefatigable tour of the social democrats' labour communes. A new pension system entailed the build-up of public reserves to cope with fluctuations in pension disbursements caused by demographic developments. The accumulation of pension funds throughout the 1960s led to greatly increased public saving, which facilitated housing finance. If anything, the Pension Fund became too dominant in the bond market; in 1962 the Fund was already purchasing 38 per cent of all long-term bonds and 65 per cent of all industrial bonds. Eklöf (1990a) considers that this made it difficult for the Riksbank to withdraw from its regulatory role. On the whole, however, the Bank did become more market-oriented in the 1960s.

When economic activity started to boom in 1960, the Riksbank tried to check credit growth by raising the banks' liquidity ratios and the insurance companies' investment ratios. As the banks did not consider they were bound to conform, the Riksbank's board, after a fierce debate, introduced

a penal interest rate on bank borrowing from the Riksbank above a specified limit. This new, more market-related instrument soon led to a reduction of commercial bank borrowing from the Riksbank and the growth of credit slackened.

A slowdown early in 1962 was countered with a more expansionary policy. Liquidity ratios and the penal rate were lowered, followed by two discount rate cuts. More companies were permitted to issue bonds. The Riksbank also ceased to regulate prices in the secondary market for housing bonds, which in practice put an end to supportive purchases.

THE RIKSBANK AND HOUSING

When the business cycle turned upwards again in the summer of 1963, the Riksbank tightened its stance by raising the discount rate. In the autumn there was a conflict with the commercial banks because in the Riksbank's opinion they were not observing the liquidity ratios. After repeated warnings, some banks were banned from borrowing from the Riksbank as long as they failed to comply; they should borrow from other, more liquid banks.

By 1964–5 the economy was booming; residential construction was rising to a record annual rate of 100,000 dwelling units and unemployment was exceptionally low. Tighter credit controls in favour of housing hit banks as well as insurance companies. At a meeting with the commercial banks in May 1964, the Riksbank handed out lists of housing projects that had obtained building permits but were not financed; the banks were requested to put this right (Jonung, 1993).

One of the champions of housing construction was finance minister Sträng. Later, when Sträng was thanked for his services to the social democrats' executive committee, Olof Palme (1981) recalled 'almost the first time' he had seen him at close quarters:

In the '50s Tage Erlander was in the habit of assembling what was called the 'grumblers group' for uninhibited discussions of various matters. On one occasion the finance minister, Per-Edvin Sköld, was present and lectured sternly about the necessity of restraining expenditure, the importance of balancing the budget.

The withering salvo was followed by silence. In the end, someone I recognised as social and housing minister Gunnar

Sträng asked for permission to speak. His gaze pierced Per-Edvin Sköld as he declared: 'There are those who urge for a limitation of housebuilding. The devil take them if they do.'

Residential construction was not reduced.

In 1965–6, when housing production fell sharply for the first time in a decade, its political priority was manifest. The Riksbank had responded to the boom with two discount rate increases and more restrictive terms for its loans. These were general measures for the credit market as a whole, in keeping with the Bank's more market-oriented line. However, they also made it more difficult to transfer existing construction credits and get new credits approved. The restrictive line peaked in summer 1966 with a discount rate of 6 per cent and a 12 per cent penal rate. By autumn 1967 the discount rate had been cut twice to 5 per cent and the penal rate no longer applied to banks that complied with their liquidity ratio.

The slump in construction elicited a series of measures whereby credit policy was subordinated to housing policy. In October 1965 the banks undertook to provide credit for housing that qualified for state loans and the Riksbank guaranteed that housing institutions would be permitted to issue bonds to an equivalent value. In 1966 and 1967 the Riksdag began to set frameworks for state housing loans for a rolling three-year period; this was done to assist local government planning but it also had consequences for credit policy.

The housing shortage came to the fore in the run up to the local government elections in 1966. In a television interview, Tage Erlander was asked for his advice to young people who wanted a home of their own; when he replied that they should stand in line, the interviewer broadcast the number of years they would have to wait. The election was a setback for the social democrats and many people attributed this to the housing shortage.

In the winter of 1966/7 the government broadened the Riksbank's regular meetings with the banks; the chair was now taken by the finance minister, flanked by the Riksbank governor, the housing minister and some directors-general. Representatives from commercial banks, savings banks and the Post Office Savings Bank participated. The banks undertook to provide construction credits on a timely basis for housing programmes that had state loans. The agreement was much the same as before but the finance minister's presence gave it more weight.



Gunnar Sträng (1906–92), finance minister 1955–76 and then Riksbank board chairman, dominated Swedish economic policy in the early post-war decades.
Caricature by Martin Lamm.



In the run-up to local government elections in 1966, prime minister Tage Elander (left) was one of the first to endure 'grilling' by

television journalists, in this case on housing queues by 'the three Os', l. to r.: Gustav Olivecrona, Lars Orup and Åke Ortmark.

366 A consequence of the meeting was a new delegation for housing finance, with representatives from the finance and housing ministries, the national housing board, the labour market board and the Riksbank. Finance for housing construction was to be negotiated annually with the banks.

CREDIT CONTROLS AND THE CORPORATE SECTOR

How appropriate were the credit controls? Englund (1993) argues that the delegation for housing finance was successful in so far as the credit supply for housing went more or less smoothly; the programme for one million housing units was achieved, with a record of over 100,000 units a year in the period 1967–72; housing investment was then equivalent to 5.5 per cent of GDP, a level that was not reached again until 1990.

On the other hand, the policy meant that residential construction crowded out investment for other purposes. Lundberg (1953) questioned the niggardly treatment of early post-war investment in trade and Bergström (1969) wrote that 'By means of issue controls the Riksbank has at times excluded the private sector from the bond and debenture market. [...] This was particularly the case for industry in the restrictive period 1952–7.'

The controls were disadvantageous for new companies; tax rules allowed existing firms to fund investment internally on favourable terms. The 1950s and '60s are often seen as a successful period economically and, above all, for stabilisation policy. However, the credit controls may have contributed to the subsequent stagnation of manufacturing and lack of new establishments. Moreover, the cheap housing loans led to so much investment that the yield became negative when the public housing utilities in particular found it hard to attract tenants.

At the same time, effects of the controls were ameliorated by evasion. A 'grey finance market' began to expand in the 1950s. Farmers obtained a respite by delaying interest payments and amortisation, small entrepreneurs by means of trade credits. When banks' trust departments mediated loans between customers, an informal market grew up alongside the regulated flows.

In the 1960s the banks set up independent finance companies for their unregulated lending. In this and the following decade, Stockholms Enskilda Bank channelled some of its lending to Finansierings AB Vendor. At first, Vendor financed car purchases with credit against bills; quite soon the bank

367 was also using the company for innovative and unconventional practices such as factoring, leasing and credit cards. Vendor's loans were equivalent to half of Enskilda Bank's own lending. Credit was scrutinised in the same way as for the parent bank but evaded the Riksbank's controls.

The regulations also spurred financial creativity. In 1959–60 the Wallenberg group launched a major investment in a pulp factory at Nymölla in southern Sweden. A bond issue would require a Riksbank permit, so Nymölla jumped the queue: the general public was invited to subscribe to a 200 kronor unit, equally divided between one share and a loan certificate (Olsson, 1986). The idea came from Marcus Wallenberg; his brother Jacob, at that time chairman of Stockholms Enskilda Bank, would have preferred more equity capital and a separate debenture loan (Lindgren, 2007). Marc Wallenberg Jr, who had succeeded his father as managing director of the family bank in 1958, raised the matter with governor Åsbrink at the World Bank meeting in Washington at the end of September 1960; on the 30th, Marc cabled: 'Spoken Asbrink who has no reaction to finance loan. Boy.'

The Nymölla project was then announced on 4 October and a press conference to publicise the financial arrangements was scheduled for 6 October. Bank director Carl De Geer phoned Riksbank director Arne Callans and outlined the arrangement, whereupon Callans immediately concluded that the issue controls applied. De Geer was summoned to the Riksbank; Åsbrink was 'furious and unbalanced', claiming that Marc Wallenberg had only mentioned 50 million kronor in share capital and a later bond loan for 30 million. De Geer replied that the matter had reached a stage where it could not be stopped. Åsbrink said he had been duped and that what had happened would necessarily affect future relations between Stockholms Enskilda Bank and the Riksbank.

Åsbrink brought up the Nymölla incident at the next monthly meeting with the commercial banks on 12 October. The banks were obliged to agree that the issue controls were not to be evaded 'by means of a presupposition that certain debt instruments equivalent to bonds and debentures are not subject to the controls or by commercial bank participation in issues taking other forms than those which have been customary to date'. The Nymölla arrangement was not repeated.

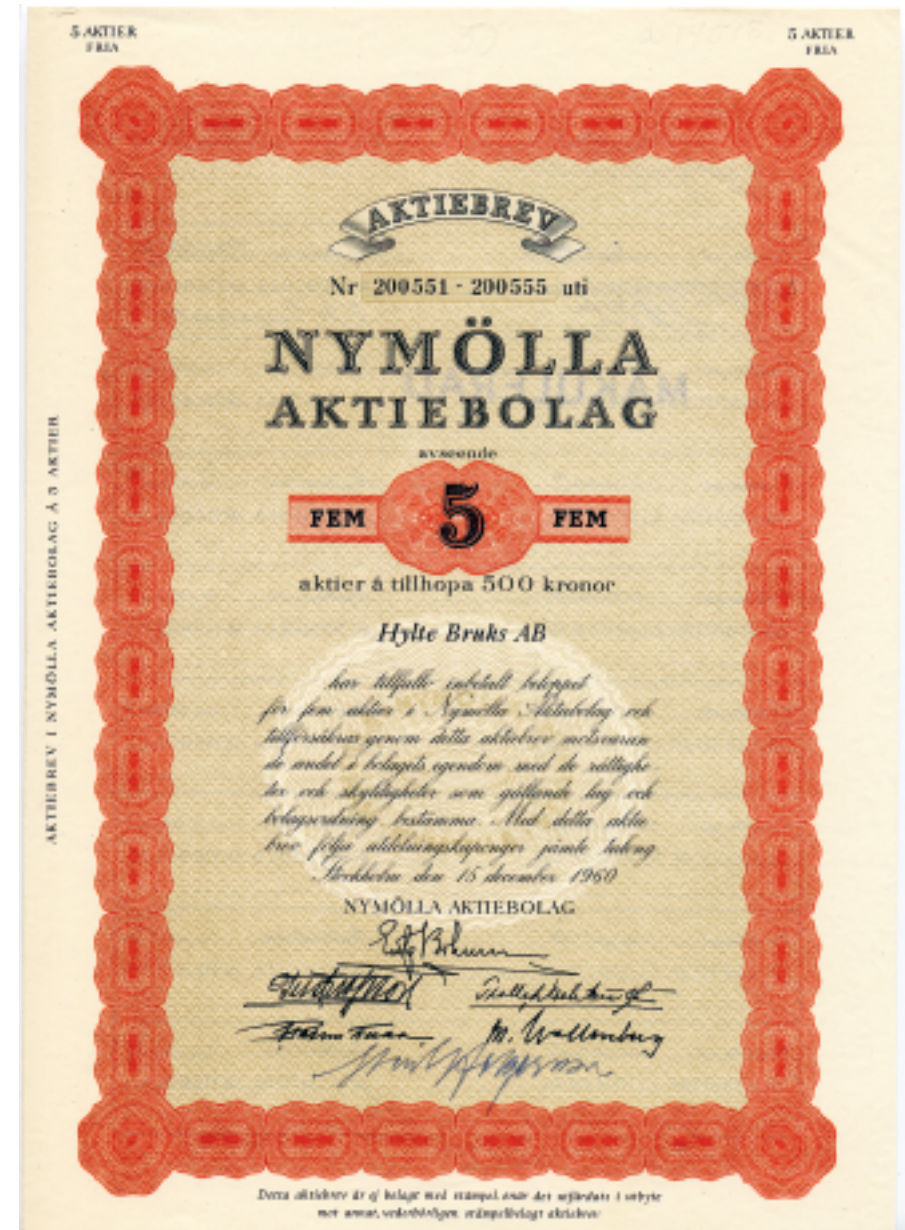
The purpose of exchange controls was to protect the Swedish economy from international capital movements. The controls were most restrictive, on trade as well as capital transactions, in connection with the currency crisis in 1947. In 1958 the krona became convertible for current transactions, partly as an effect of the European Payments Union; cross-border investment and capital transactions continued to be regulated, for individuals as well as companies. The nature and extent of the controls were reconsidered several times.

The most important inquiry was set up in 1960; two years later, its report (Ds Fi 1962:9) noted: 'Notwithstanding that foreign trade presupposes that payments are constantly mediated between Sweden and the rest of the world, the foreign exchange ordinance lacks any intimation that payments between inland and abroad are in fact indispensable transactions.' This led the committee to propose a number of simplifications.

The committee was also to analyse the consequences of abolishing most or all of the controls. In view of the ongoing negotiations for Sweden's association with the EEC, however, the committee found this impractical and simply requested Professor Börje Kragh to compose a memorandum on the matter. According to Wihlborg (1993), the result was used for decades to defend and motivate exchange controls.

Kragh (1962) saw the controls as a way of fulfilling economic policy objectives, in particular full employment. The main focus was on blocking short-term capital movements and building up adequate exchange reserves. Deregulation would admittedly be an advantage for the international division of labour and thereby enhance welfare, but it could also entail greater economic instability. Exchange reserves would have to be shielded from 'speculative' capital flows or made appreciably larger relative to trade. The analysis did not consider that the imbalances might be caused instead by economic distortions in Sweden, that dealing with these would be more meaningful than protective controls, and that seen from this angle the flows could be a useful indicator.

The exchange controls were another controversial issue in the Riksbank's relations with Stockholms Enskilda Bank. The United States had dominated capital exports in the 1950s, but the outflow was considered to undermine the balance of payments; in 1963 a US tax was imposed on



To fund the Nymölla paper mill in 1960, the Wallenberg Group evaded issue controls by using a novel combination of shares and loan certificates.

370 foreign bonds to equalise interest differentials between capital markets in America and elsewhere.

This shifted the focus to capital markets in Europe. In the late 1950s a group of European banks had formed international syndicates to underwrite bond loans, known as eurobonds. This business grew rapidly from 1963 to 1972 and was also utilised by subsidiaries of American banks (after 1963, parent banks in the United States were debarred from financing direct investment abroad). Some syndicates consisted of up to 200 banks and bankers from various countries. Stockholms Enskilda Bank got off to a flying start in the early 1960s and for a time was the leading Scandinavian bank in the eurobonds market (Olsson, 2000).

Marcus Wallenberg Jr was bent on transforming Stockholms Enskilda Bank into an international player. As the bank was not allowed to match the assistance which foreign banks provided in their home countries, he arranged credit with them instead. In the first half of the 1960s, around 17 per cent of the bank's assets were in foreign currency. Two amendments to the exchange controls threatened this strategy.

Exchange reserves had been depleted after sterling's devaluation in 1967; to replenish them, the Riksbank redefined the banks' statutory cash reserves: only half instead of all foreign currency assets could be included (the Wallenberg group referred to this as *Lex Enskilda*). The regulation was questioned in Stockholms Enskilda Bank's annual report for 1967: 'It can be noted that after the amendment, assets such as long bonds in their totality but assets in, for example, dollars only to half, are eligible as cash reserves; for the Riksbank as well as for the nation, however, dollars are undoubtedly a better cash reserve than long bonds.'

In 1969 the Riksbank then lowered the limit for Stockholms Enskilda Bank's exchange dealings from 471 million kronor to 200 million; Marcus Wallenberg stepped in and managed to settle for 250 million. According to Olsson (2000), these conflicts were a factor behind Wallenberg's decision in 1971 to merge with Skandinaviska Bank (Skandinaviska Kreditaktiebolag prior to 1939) and form Skandinaviska Enskilda Bank (known initially as SE-Bank, today as SEB) with the government's blessing.

The effectiveness of the exchange controls has been questioned. Interest movements abroad influenced the Swedish economy via cash flows for exports. Major exporters were able to postpone payments or bring them forward in order to benefit from interest differentials between countries.

371 Delaying payments tended to lower the exchange reserves and put upward pressure on interest rates. The interest differential between Sweden and the United States roughly matched the difference in the rates of inflation. In Britain, the level of interest rates and inflation was much the same as in Sweden. The real interest rate in Sweden was on a par with the international rates. Neither is it clear that the policy made interest rates less volatile (Englund, 1993). According to Eklöf (1990a), the exchange controls shielded Sweden from currency crises prior to 1967 but Wihlborg (1993) argues that this had more to do with the fixed exchange rate being stable and credible.

THE RIKSBANK'S DAILY ROUND

The era of regulation kept the Riksbank busy. Many of the controls had to be implemented case by case. The Bank became a major state bureaucracy for dealing with individual matters related to investment or cross-border transactions. In the 1960 annual report, for example, the exchange control board noted that the management of goldsmiths' waste had been transferred to the trading licence board.

In order to oversee and influence how the commercial banks handled the controls, their leaders were summoned to regular meetings with the Riksbank. The mood tended to be frosty (Thunholm, 2005):

It usually went like this: When we bank leaders had assembled in the boardroom, Åsbrink entered at full speed looking like death warmed up, shook hands with the Bankers Association's chairman, who sat next to him, ignored the others and started by going through the statistics. This was followed by the dressing-down the figures generally occasioned. Never a smile or a *bon mot* that could have lightened the mood. How he came to be like that beats me. Tore Browaldh [chairman of the Association] did try to make things friendlier by calling him 'Pelle' but he evidently disliked that.

The Riksbank was still managing a number of borrowing arrangements on behalf of the government. Young couples could apply to the Bank's provincial offices for a housing loan. The instalment credits from the late 19th

372 century were still on the Bank's books in the 1960s, as were the 'own-home' loans and other arrangements which the Bank had taken over from home ownership organisations and the provincial agricultural societies. Moreover, the Bank handled the accounts for forestry investment, forestry accounts, contracyclical investment funds, the credit fund for crafts and small industries and the loan fund for fishing equipment. The branch offices were responsible for the distribution of notes and coins, besides collecting worn-out notes for destruction. Sizeable repair work was meticulously reported to the bank committee. In 1965, for example, the boiler in Uppsala had been replaced for 10,000 kronor, the roof in Nyköping had been repaired and painted for 5,400 kronor and four 30-year-old letterpress machines in the printing works had been replaced by two new Heidelberg.

For the general public, the most relevant controls concerned foreign exchange. They stemmed from wartime legislation, adopted in 1939 and renewed annually. In 1959 this was superseded by a law that was available 'when this proves necessary to attain the objective that has been laid down for the Riksbank's monetary policy operations or otherwise out of consideration for the realm's foreign payment relationships'.

The Exchange Control Act authorised the government to issue foreign exchange ordinances, which were likewise formulated in general terms. The details were decided by the Riksbank. These regulations on implementation also specified the transactions that were permissible, subject to approval by the Riksbank's exchange control office and exchange control board. The board was able to adapt its practice to the business cycle without needing to alter the regulations.

Individuals as well as companies had to apply for a permit to either invest or borrow abroad. People who moved to another country could take just a limited amount with them. Complicated issues were handled by the exchange control board and the outcomes left their mark on the rules. In order to block loopholes, travel currency was restricted to a certain sum per person. In 1976 it was decided that notes with a higher denomination than 100 kronor were not to be taken out of the country; the following year the Swedish exchange banks were forbidden to repatriate larger notes. Currency holdings were checked at the border. All exchange transactions in foreign trade had to be arranged via the exchange banks, which were specially authorised and functioned as the government's overseer of exchange dealing.



Counting notes, counting coins, pistol practice; Photos of these and other tasks in the

Riksbank taken 1955 by Lennart Nilsson, later world-famous as a photographer.

The procedures were even questioned internally. In summer 1976, the head of the exchange control administration, Lennart Olofsson, wrote to deputy governor Hans Lundström about the discrepancy between the vaguely worded purpose of the controls and the detailed regulations. He pointed out that the business was in the hands of officials who lacked competence in monetary policy. Even so, in 1982 about a hundred employees in the foreign exchange department still had a work load of some 37,000 cases.

A large staff was needed to handle all the applications and supervise the rules. The numerous tasks in the Bank were recorded in 1955 by the photographer Lennart Nilsson. In the days before modern information technology, many people were involved in the flow of payments to and from the Riksbank. The staff peaked in 1980 at 1,111, of whom over half or 559 worked at offices in the provincial capitals. In addition, the Tumba Bruk paper mill had at least 400 employees.

Social developments occasionally showed up in the annual reports: 'The governing board has granted that as of 1964 until further notice all the Riksbank's offices are to be closed every Saturday during the months of April to September.' This was just as well – schools in Stockholm had been experimenting with free Saturdays since the previous autumn. To make up, the offices stayed open an extra hour on weekdays.

To commemorate the Riksbank's 300th anniversary in 1968, the Riksdag decided in 1964 to found the Bank of Sweden Tercentenary Fund for the promotion of scientific research connected with Sweden. The Fund has received additional contributions and is currently a major source of finance for research in the humanities and social sciences. Instead of a history of the Bank to mark the tercentenary, the Riksbank commissioned an economic history of Sweden (Samuelsson, 1968). When historians questioned governor Åsbrink about this, they were told: 'We don't want a chronicle; after all, you've got the Tercentenary Fund instead.'

The Riksbank also marked its tercentenary by instituting a prize in economic sciences in memory of Alfred Nobel. The prize was approved by the Nobel Foundation, the Royal Academy of Sciences agreed to designate the laureates and the Riksbank undertook to match the prize money for the Nobel awards. The first award was made in 1969. The Academy's work in connection with the prize has helped to give Swedish economic research a wider international network. The Nobel Foundation subsequently made it



The Riksbank's Tercentenary in 1968 was commemorated with a 10-kronor banknote (68×120 mm) and a Prize in Economic

Sciences in Memory of Alfred Nobel. The prize medal was designed by Gunvor Svensson Lundkvist; diam. 65 mm.

376 a matter of principle that no further prizes would be instituted.

Following thorough post-war reviews of Sweden's constitutional laws, a new Constitution was enacted in 1974. There had been a partial reform in 1968-9, when the electoral system was changed and the Riksdag ceased to consist of two chambers; the first election to the single chamber was held in autumn 1970. The buildings on Helgeandsholmen, which had previously housed the Riksbank as well as the Riksdag, had to be reconstructed to suit the needs of a single chamber. So when the Riksdag assembled at the beginning of 1971, it did so in temporary premises in Kulturhuset at Sergels Torg.

The reconstruction also meant that the Riksbank had to leave the building it had occupied since 1906. Instead it was assigned the present site at Brunkebergstorg. The governing board's annual report for 1964 had a notice that an open Nordic architectural competition would be held and the site would be the Fyrmörsaren block in Klara parish, Stockholm.

The commission to design the Riksbank's new premises went to the architect Peter Celsing. Construction started in 1970 and was completed in 1976. The building filled excavations left behind by demolition work next to what is now Sergels Torg. The Bank's vaults are in the depths of the Brunkeberg ridge.

THE 'IDIOTIC SQUEEZE'

The Bretton Woods system served as a trusty monetary policy anchor for economic development in the 1950s and '60s. Inflation was fairly low and fiscal policy was disciplined and balanced. However, the system was rather short-lived (Ahlström & Carlson, 2007). Convertibility was not restored in full until the late 1950s and the first signs of strain appeared in the early 1960s when France and other countries exchanged dollars for gold at the official rate, which was below gold's market price. Central banks could then make a profit by selling gold at the commercial rate. People in general did not have access to convertibility.

The US gold crisis was overcome but new tensions arose. A temporary solution to Britain's difficulties was provided by devaluation in 1967. The US economy caused more concern as inflation rose in the 1960s and the federal deficit grew, partly on account of ambitious welfare programmes but mainly due to the war in Southeast Asia. The dollar was the reserve currency



The Riksbank's current premises in Brunkebergstorg, architect Peter Celsing (1920-74), were built when the change from a bicameral parliament to a single chamber made it necessary to reconstruct the building on Helgeandsholmen.

378 in the Bretton Woods system, so some of the newly-printed notes found their way to the vaults of other central banks. The dollar surplus in the global economy threatened the system's stability. US reluctance to adjust the exchange rate made matters worse.

The system assumed that governments and central banks could control international capital flows, though leaks and loopholes could not be avoided. In the 1960s, Soviet banks provided accounts for dollar deposits and this gave rise to a capital market – the eurocurrency market – that did not have to observe the IMF countries' controls. Being outside the Bretton Woods system, eurocurrency accounts could offer better terms. Eurobanks were also open to borrowers to whom the regular system was closed. Oil-producing countries placed some of their surplus in eurocurrency accounts and the market expanded rapidly. There were no controls or limits and consequently no one who scrutinised the risks associated with eurocredits.

The higher level of inflation did not come solely from the United States. Many countries were investing in education and housing for the post-war baby boom. In an analysis of the rise and fall of international inflation, a group of American economists highlight the strong emphasis on employment; decision-makers were not prepared to implement the tight monetary policy that was needed to keep inflation under control. The Great Inflation, as they call it, started more or less simultaneously in the major economies in the late 1960s, when price increases accelerated and inflation became more variable (Cecchetti et al., 2007).

Events in November 1967 presaged the coming storms. Sterling had been under heavy pressure for some years on account of Britain's growing payments deficit. At a meeting with the newly-elected Harold Wilson at the end of 1964 to rescue sterling, the governor of the Bank of England, Lord Cromer, had demanded a complete realignment of economic and social policy; Wilson had threatened to call another election to assert the government's constitutional rights. Other countries provided support in the form of dollar loans. The labour government continued to give full employment precedence over economic balance. After a couple of arduous years, however, a 14 per cent devaluation of sterling was announced in November 1967. The uneventful years in the international currency market had come to an end.

Despite the Riksbank's insistence that Sweden would not follow suit, there was a large currency outflow. Denmark devalued by 7.9 per cent after

its central bank had persuaded the prime minister, Jens Otto Krag, not to go all the way with sterling (Hoffmeyer, 1993). Although the Swedish economy was still in a weak state, the Riksbank reversed its expansionary policy and raised the discount rate 1 percentage point, reintroduced the penal interest rate and cash reserve requirements and tightened the liquidity ratios. This was the first time the Bank produced a monetary policy package to deal with a currency crisis (Eklöf, 1990b). The market calmed down and after some months the Riksbank was able to resume a less restrictive line.³⁷

Concern about the dollar spread to Sweden (Wihlborg, 1993). The Riksbank's investments were questioned by Staffan Burenstam Linder at the board meeting on 14 March 1968: the greater part of the exchange reserves consisted of interest-bearing dollar assets – devaluation would reduce their value; on the other hand, dollars generated interest, gold did not. Governor Åsbrink considered it was up to the Riksbank 'not to cause trouble' that could weaken confidence in Bretton Woods; the United States had invested a lot of prestige in the price of gold and 'no one accepts a loss of competitive power relative to the United States'.

In 1968, student and worker unrest in France led to increased tension between the franc and the German mark. Swedish companies tried to avoid D-mark trade credits and deferred export payments from West Germany. International interest rates rose, led by the eurodollar rate. Sweden's exchange reserves had been declining relative to imports since the mid 1960s; early in 1969 the outflow became even larger.

The Riksbank put up a fight. Unlike the finance minister, who did not foresee any major improvement in domestic demand, the Bank judged that an upturn was on the way and would weaken the balance of trade. The most comprehensive monetary package to date was therefore launched at the end of February: the discount rate and the penal interest rate were both increased by one percentage point and the law from 1962 was invoked for liquidity ratios. Whereas the ratios had previously been a recommendation that gave banks some discretion, failure to comply now cost a bank 4 per cent of the deficiency.

This failed to check the currency drain. Despite a stronger economic upswing during the spring, the finance minister continued to reject fiscal

37 Describing monetary policy as 'less restrictive' often implies a lower interest rate but it can also stand for an easing of controls or an injection of liquidity.

380 restrictions. 'This difference of opinion meant [...] that the Riksbank felt it was solely responsible for a necessary tightening of economic policy and considered it was forced to conduct an extremely harsh policy of restraint' (Eklöf, 1990b). Another discount rate increase was accompanied by a ceiling on bank credit: lending for purposes other than housing construction was to be lowered in less than six months to the level at the beginning of the year, which in practice meant a 9 per cent reduction. Cash reserve requirements were reintroduced, borrowing from the Riksbank became much more costly and exchange controls were tightened. When borrowing abroad was suggested as an alternative to the squeeze, Åsbrink dismissed the idea: if companies were interested in cross-border investment, it was up to them to borrow abroad.

When Pompidou had succeeded De Gaulle, an 11 per cent devaluation of the French franc was announced in August. Repatriation of profits from speculation in the German mark's subsequent revaluation in October tended to strengthen Sweden's capital balance but the Riksbank did not relax its grip. This led to a heated encounter on 19 November between Åsbrink and Lars-Erik Thunholm, managing director of Skandinaviska Bank. Thunholm (2005) received a call from Åsbrink and went to the Riksbank:

When I entered Åsbrink's room, his colleague Eklöf was also present. 'It's best that I have a witness', said Åsbrink in his charming way. He was literally shaking with anger and continued the tirade he had begun on the phone, with the same lack of restraint.

I asked him in a friendly but firm tone to relax a little, choose somewhat more civilised words and tell me what it was all about. Only after a while did I learn that at that day's clearing we had exceeded our lending ceiling by 126 million kronor. This, said Åsbrink, had happened without any agreement with the Riksbank and he could not accept being treated in this nonchalant manner. He would charge us 1 per cent for this day's excess and then another 1 per cent for each day we exceeded.

When I pointed out that interest at 1 per cent for a day amounted to 365 per cent a year and wondered whether the element of usury in such a rate did not trouble him, he shouted: 'It isn't interest, it's a fine!'

When I had considered the matter in the next few days and talked with some sensible people, I decided to obtain an objective legal assessment to clarify whether a judicial process might convict the Riksbank of usury and exceeding its powers. The task went to Stig Jägersköld, professor of public law in Uppsala, whose opinion was ready in a matter of weeks. He concluded that we had every reason to sue the Riksbank and clearly had the law on our side.

I sent this opinion to Åsbrink as confidential information with friendly greetings, besides demanding repayment of the exorbitant sum the Riksbank had exacted and charged to our account. I received no answer to that either and Åsbrink never talked about it. There was, however, no need for further talk because the sum in question had soon been paid into our account.

The economic upswing peaked at the beginning of 1970. A growing current-account deficit was accompanied by a rapid increase in commercial bank lending. In order to prevent another large currency outflow, on 29 April Åsbrink launched a battery of measures that came to be known as the idiotic squeeze. It included a ceiling on bank loans that entailed a reduction by the end of the year, as well as a request that banks cut back approved but unutilised credit by at least 20 per cent. The latter measure was unprecedented: 'I well remember how shocked our customers were by the decree [...] that we were to cut back overdraft facilities by 20 per cent' (Browaldh, 1981).

Åberg (2006), a newcomer to the finance ministry at that time, considers that the government left it to the Riksbank to 'carry out the tightening of economic policy which in the run-up to the general election the government was reluctant to achieve with fiscal measures'. At a meeting with representatives of the Riksbank and the commercial and savings banks, the government expressed its full support for the credit squeeze and for Åsbrink.

When the economy slackened after the turn of 1970, both the current account and the currency flow became positive. The Riksbank changed to an expansionary stance by withdrawing the lending ceiling, liberalising the rules for its loans to banks and lowering the penal interest rate. This was followed by two discount rate cuts. The realignment was preceded by a series of negotiations whereby the commercial banks accepted a new form of credit

382 (industrial investment credit) in exchange for a more expansionary policy.

The 'idiotic squeeze' was heavily criticised at the time. Economists and the opposition held that the government should have primed the economy regardless of the budgetary consequences. The period came to be known as the 'lost years'. The government itself was split (Peterson, 2002):

[It] was divided into two camps on economic policy and how to combat unemployment. The older members supported the finance minister, the younger sided with [prime minister] Palme and so did the National Labour Market Board and its director-general Bertil Olsson [...]

Olof Palme became increasingly nervous and restless [...] The row with [finance minister] Gunnar Sträng made him want to resign. The letters to the speaker and the party board were written. But he gave in to the majority in the government who supported him, and soldiered on.

Palme's relationship with Sträng was not improved when, in early July 1971, the latter, together with interior minister Eric Holmqvist, decided to terminate a controversial inquiry into low incomes without first informing Palme. Lacking confidence in his finance minister, Palme built up his own decision-making base. He called in experts from the National Labour Market Board, the National Institute of Economic Research and the Riksbank without telling the responsible ministers. On 10 October 1971 the ministers most closely concerned were summoned to an emergency meeting on employment.

The party secretary explained that there was a lot of unrest in the party, an unusually strong concern about the party's employment policy. Gunnar Sträng countered by saying this was an exaggeration. He had not met any such unrest.

Olof Palme became angry and accused Sträng of deliberately turning a deaf ear.

Palme proposed an additional child allowance to add to purchasing power and thereby generate increased demand for Swedish products. Gunnar Sträng was against this. (Peterson, 2002.)



As prime minister in the early 1970s, Olof Palme (1927–86) took an active part in economic policy and clashed in some respects with his finance minister, Gunnar Sträng.

384 The opposition parties saw their chance. At a press conference in November 1971 they presented a joint package of economic measures, of which the main component was a 4 percentage point cut in value-added tax. Concern for full employment had become their issue.

In retrospect, the idiotic squeeze has been reappraised. Åberg argues that the package signalled an awareness that the conditions for a Keynesian policy had changed. The growing importance of foreign trade meant that economic policy needed to safeguard Swedish producers' competitive position.

BRIDGING THE INTERNATIONAL SLOWDOWN

In the run up to the general election in 1973, the consequences of the restrictive policy told against the government. Palme continued to acquire information and act on his own. Börje Kragh and Bengt Pettersson from the National Institute of Economic Research were asked for their assessment of the economic situation; Kragh would not say more than he had told Sträng. However, when Kragh had left the Institute, Palme called in Pettersson again without informing the new director; it turned out that Pettersson was highly critical of Sträng's policy recommendations.

Meanwhile, international conditions had changed. The Bretton Woods system had become increasingly precarious, President Nixon had suspended the exchange of dollars for gold in August 1971, and the Smithsonian Agreement had been ratified in December in an attempt to restore the system by devaluing the dollar against gold. The Swedish krona and the Italian lire were also devalued, while the German mark and the yen were revalued. National currencies would be allowed to fluctuate inside a tunnel of 2¼ per cent up or down against the dollar and by twice as much against other currencies.

In March 1972 the European Community countries set up their own system, known as 'the snake in the tunnel': exchange-rate fluctuations between their currencies would be restricted to half the width of the Smithsonian tunnel. Britain, Denmark and Norway joined the snake at an early stage; Sweden waited until the beginning of 1973.

A 10 per cent devaluation of the dollar against gold on 13 February 1973 sealed the fate of the Bretton Woods system. Acting on Åsbrink's advice, the Riksbank's governing board decided on a joint 5 per cent devaluation with Finland against the snake currencies. Eklöf (1990b) sees the decision as the product of 'a simple mercantile view'. The commercial

argument was that forest industries would otherwise suffer a loss on dollar contracts. One month later the dollar had become too weak for its new parity and the Riksbank's board faced a choice between a free float and participation in the currency snake; the latter won without further discussion. The system of fixed exchange rates based on the dollar was abandoned in March and the dollar floated against other currencies. 385

International economic activity had turned upwards during 1972 but in autumn 1973 the Organisation of Petroleum Exporting Countries (OPEC) embargoed oil shipments to certain western countries as a reaction to their support for Israel in the October war that year. In the period 1972–4, crude oil prices quadrupled. This shock did not actually bring Swedish economic growth to a halt. There was a currency drain but the higher oil prices pulled up prices for other commodities and products based on them. This favoured large segments of Sweden's exports, with greatly increased profits in 1973–4.

The new situation also affected wage formation. In the 1950s and '60s, centralised wage agreements between blue-collar unions (LO) and the Employers' Confederation (SAF) had helped to moderate wage increases; with fixed exchange rates, the wage increases export producers could pay without a loss of competitiveness were determined by productivity and inflation. These relationships were formally recognised towards the end of the 1960s in the EFO model, named after the senior economists at TCO (Confederation of Professional Employees), SAF and LO – Gösta Edgren, Karl-Olof Faxén and Clas-Erik Odhner.

With higher inflation and no Bretton Woods system, however, conditions changed. There was growing pressure for large wage increases and the government meddled in matters that were the responsibility of labour market organisations. Direct tax cuts and increased social contributions were used to hold wages back. In 1974 and 1975 the government succeeded in persuading the liberals, and later the centre party, to support such measures, in what were known as Haga agreements, but the trade unions still refused a commitment to restraint. Instead, rising wage costs contributed to an appreciable weakening of Sweden's competitive position. Later in the 1970s, attempts were made to restore competitiveness via devaluations but that simply freed the negotiating parties from responsibility; given floating or flexible exchange rates, wage increases in excess of the EFO model could be offset by devaluing the currency.

In the longer run, higher oil prices did affect economic activity. When Western Europe experienced the first proper post-war economic recession in 1974–5, the Swedish government chose a different path. ‘The new Riksbank governor, Krister Wickman, was one of the first to formulate ideas about bridging [the recession]’ (Eklöf, 1990b).

This was partly connected with the political situation. The new unicameral Riksdag had 350 members and the 1973 election was a dead heat, with 175 seats for each bloc. In the period 1973–6 controversial matters were decided by drawing lots; in the 1975/6 session, 39 draws went the government’s way and 40 the opposition’s (Bergh, 2007). This made fiscal policy rather feeble.

Interviewed by Jonung (1993), Wickman said that the hung Riksdag had given him greater freedom: ‘From the Riksbank’s and my point of view it had the advantage that [finance minister] Sträng never obstructed an activation of Bank policy. Because it was, after all, the Riksbank’s policy that could be implemented, despite the parliamentary deadlock.’ The finance minister’s insights were another matter: ‘He never grasped monetary policy, much less foreign exchange policy. And he could only discuss monetary policy as a way of managing a rationing system.’

The 1973 election was fought in terms of the ‘lost years’. Neither bloc dared advocate a restrictive policy. The government proposed some stimulatory measures in October, before the oil crisis. When the draft budget did not include additional stimuli, the opposition was up in arms. Some weeks later the government retreated; child allowances and pensions would be increased and a temporary reduction of value-added tax was agreed with the liberals and the centre party. The bridging policy’s principle component was a 20 per cent subsidy for stock production so that labour could be retained until the economy recovered. When the international recession dragged on, however, the support had to be wound up prematurely.

Similar strains were experienced elsewhere. The German reaction was very different, more like Sweden’s idiotic squeeze. Without Bretton Woods and with floating exchange rates, the Bundesbank was able to repel external inflation. In 1972 the German money supply had grown by 13–16 per cent and the rate of inflation at the beginning of 1973 was 7 per cent. Following the introduction of a highly restrictive monetary stance in March 1973, in a matter of months the Bundesbank had checked both the increase in the money supply and inflation.



Krister Wickman (1924–93), Riksbank governor 1973–6, was one of the first to

advocate an economic policy aimed at bridging the international recession.

388 The Bundesbank acted to contain price increases associated with the oil price shock; its monetary policy remained considerably more restrictive than that of most other central banks until well into 1974. In that year West German inflation stopped at 7 per cent compared with 13 per cent in France, 16 per cent in Britain, 19 per cent in Italy and 23 per cent in Japan. On the other hand, German economic growth and employment fell sharply.

Things went differently in Sweden. In the quarter-century since 1950, domestic saving had matched investment and this had been accompanied by external balance. The bridging policy entailed growing budget and external deficits. The OECD exhorted its members to recycle petrodollars and not be unduly restrictive; Sweden was one of the countries that took this advice most seriously. The Riksbank played its part by encouraging financing abroad so that domestic borrowing would not lead to higher interest rates in Sweden.

In spring 1975 the Riksbank used the lending ceiling to restrain consumption. Politicians and business representatives pressed the Bank to ease its stance. The discount rate was cut and the lending ceiling was removed in August, followed later by lower cash requirements. The Riksbank wanted to use liquidity ratios to steer the commercial banks. With backing from the liberals and the centre party, the Riksdag issued detailed instructions for the Riksbank to increase its lending to small industries, agriculture and related enterprises. The expansionary monetary policy lasted until the summer of 1976.

Sweden's current account continued to deteriorate. Tensions in the currency snake pushed up interest rates abroad; the Riksbank wanted to raise the discount rate but finance minister Sträng would not agree. When the Riksdag went into its summer recess, however, the Bank was able to add 0.5 of a percentage point to the discount rate on 3 June and the penal interest rate was raised 2 percentage points in August. The Riksbank's statistics showed that the growth of bank lending had considerably exceeded what had been allowed for at the beginning of the year; governor Wickman expressed disappointment that the banks had exploited the transition to more market-oriented instruments.

In October, when the government had lost the general election, the Riksbank raised the discount rate by as much as 2 percentage points. Wickman also wanted to reintroduce the ceiling on bank lending. As the non-socialist government was still being formed, Wickman informed caretaker

389 finance minister Sträng of his intentions. Sträng was indignant and arranged for deputy governor Essen Lindahl to have the matter shelved; Wickman, however, was supported by the board's non-socialist members. Shortly after these measures, the German mark was revalued against the other currencies in the snake; this entailed a 3 per cent fall in the value of the krona, which temporarily eased pressure on the exchange rate.

ROCKETING GOVERNMENT DEBT

The imbalances which had appeared under the social democrat government became more pronounced while the non-socialist parties were in power from 1976 to 1982. Besides generating larger budget deficits and increased government debt, the expansionary fiscal policy fuelled inflation, which led to higher wage demands. Although wage costs in Sweden rose considerably faster than elsewhere, attempts to tighten the fiscal stance were rather lame.

The new government's economic policy reflected uncertainty about how to handle the unfamiliar situation. Government borrowing was now arranged abroad, which eased the upward pressure on interest rates and to that extent was in line with earlier policy. However, it also meant that the budget deficit's negative consequences took longer to materialise. When the social democrats on the governing board, led by Gunnar Sträng, criticised the foreign loans, the government side replied that the first moves had been made by the previous regime – while currency was flowing out of the country after the first oil price shock, governor Krister Wickman had met the Shah of Iran at a skiing resort; Sweden might need a borrowing facility to cope with an acute currency crisis.

For the first time, the change of government involved the appointment of a new Riksbank governor. It was not what Wickman wanted: 'It is well known – at least among Krister's acquaintances – that he would have liked to continue as governor' (Åberg, 2006). It was Olof Palme who made Wickman's departure inevitable by not nominating him as a social democrat representative on the governing board. The non-socialist parties were not prepared to relinquish any of their seats and the Riksbank Act stipulated that the governor was to be a member of the board, so Wickman had to leave. The new government approached a number of potential candidates and the post was finally accepted by Carl-Henrik Nordlander.

In 1977 Nordlander warned the government about continued budget

390 deficits and financing them with foreign loans; he preferred a tight fiscal policy and/or deficit financing in the domestic market. He stressed that in order to restore external balance, price and wage increases in Sweden would have to be below the average abroad. Nevertheless, his governorship saw increased external borrowing and rapidly growing budget deficits. Efforts were made to encourage corporate borrowing abroad, just as the social democrats had done in 1974–5, but companies were reluctant – the exchange risk was seen to outweigh the interest differential.

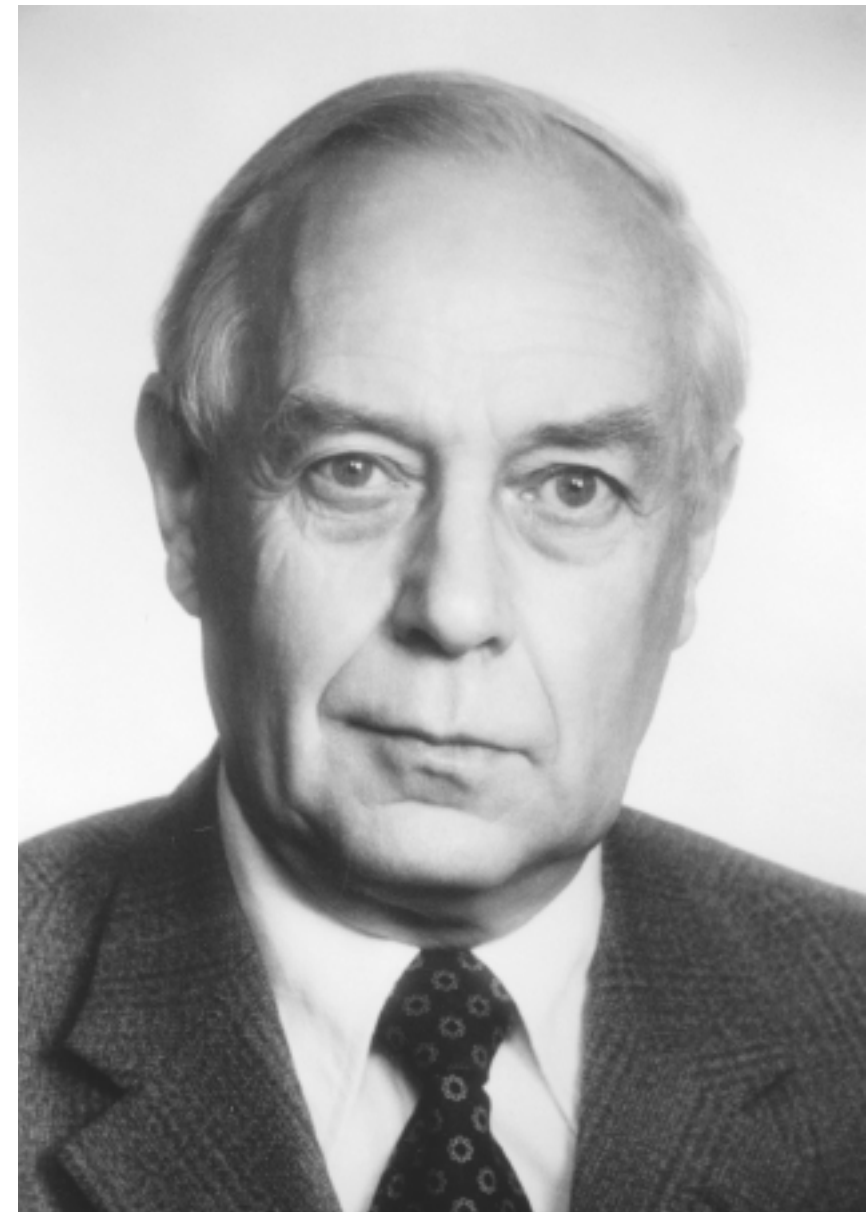
In April 1977 Sweden initiated a meeting of the currency snake's member states in Brussels; external imbalance was cited as a reason for a 6 per cent devaluation of the krona against the German mark. When Sweden left the snake in August there was another devaluation, by 10 per cent; the krona was tied instead to a basket of 15 currencies, weighted for their shares in Sweden's foreign trade, except that the dollar's weighting was doubled.³⁸ The board's discussion shows that governor Nordlander would have preferred to go even further but made do with 10 per cent in view of reactions abroad.

The new exchange rate policy was criticised by Sträng and the board's other social democrats; without the link to the German mark via the snake, there was less need of a strong policy to combat inflation. Their reservation was that price increases as a result of the devaluation would unsettle the labour market. A tight fiscal policy would be better, with 'price controls'.

The Keynesian approach continued to dominate even after the attempt to bridge the international recession. Three senior professors of economics, Erik Lundberg, Bertil Ohlin and Assar Lindbeck, submitted a nine-page memorandum, 'Motives for a more expansionary economic policy', to the prime minister in August 1978. As a quick stimulus to economic activity, they advocated a cut in value-added tax and played down the risks for the budget deficit and inflation. According to the contemporary under-secretaries Lars Wohlin and Sten Westerberg, the memorandum made things difficult for those in the government offices who wanted a tight economic policy (Jonung, 1999). An improvement in the balance of trade gave the krona some relief in 1978 but the government deficit was still growing.

The memorandum's assessment did not go unchallenged – a more

³⁸ The weight of the dollar was doubled to allow for the exports to countries other than the United States that were also priced in dollars.



Carl Henrik Nordlander (1909–2003), appointed Riksbank governor in 1976 when the change of government obliged Krister Wickman to resign.

392 pessimistic view of the possibility of dealing with economic strains was gaining ground. 'Experience from the 1970s clearly shows that economic policy is ultimately incapable of mastering employment problems that stem from extreme increases in wages and costs' (Calmfors, 1979).

The Riksbank aimed to counter the budget deficit's consequences for liquidity and to channel government borrowing away from the banking system. A series of cuts quickly lowered the discount rate from 8 to 6.5 per cent, while bond rates were held at around 10 per cent. This was intended to attract investors as a way of financing the deficit and absorbing liquidity. Borrowing abroad in 1978 stopped at a couple of billion kronor.

In December 1978, the foundation was laid for the European monetary system (EMS), based on fixed bilateral exchange rates and joint support. The system, introduced in March the following year, was not restricted to EC countries, but Sweden (along with Norway and Britain) decided to stick to its currency basket.

Lars Wohlin succeeded Nordlander as governor in November 1979. He had been under-secretary in the ministry for economic affairs and continued to exert a strong influence on economic policy. At the turn of the year, a more market-oriented monetary policy was signalled by allowing banks to issue certificates that did not require a Riksbank permit; the unregulated interest rate largely followed the cost of bank borrowing from the Riksbank.

The Riksbank's next problem arose when the current account deteriorated and the budget deficit continued to grow. International interest rates were still rising; in order to check the currency drain, the discount rate and cash requirements were both increased. Monetary policy alternated between regulation and market conformity. The Riksbank was becoming more aware that with broader, more open markets, controls were less effective; politicians feared the consequences of acting otherwise.

In March 1980, while public sector wage negotiations were in progress, the Riksbank wanted to raise the discount rate but was prevented from doing so and resorted instead to controls: the insurance companies' investment quotas were tightened and credit controls were extended to include the 'fringe' finance companies.

When speculation in a devaluation of the krona led to an acute currency crisis in January 1981, the discount rate was increased to what was then an unprecedented 12 per cent and the penal interest rate to 17 per cent. Cash



As Riksbank governor 1979-82, Lars Wohlin (b. 1933) continued to exert a strong influence on the government's economic policy.

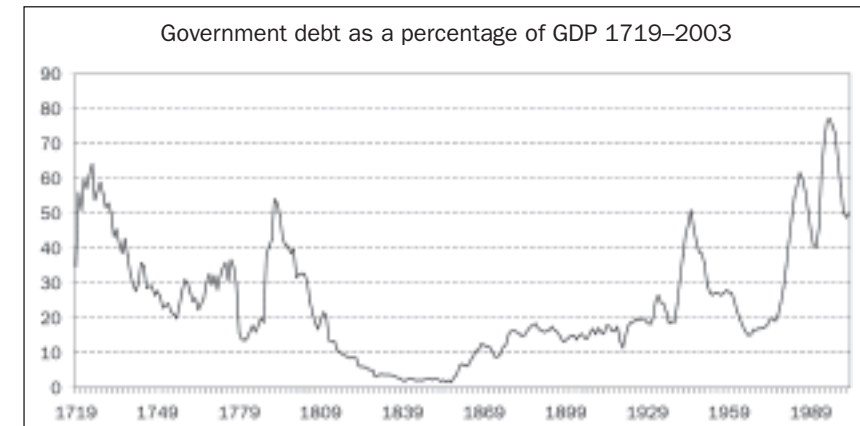
394 ratios were also increased and now applied to cooperative and savings banks as well as to commercial banks. A lending ceiling was imposed on finance companies as well as banks. The speculation subsided and the currency outflow ceased but interest rates remained high. In his presentation of the package to the governing board, Wohlin expressed regrets about fiscal policy.

Shortly afterwards the Riksbank considered the possibility of abolishing the statutory interest controls; nothing came of this because of fears that, as a result of the budget deficit, free interest-setting would result in higher rates. A tax agreement between the social democrats, the centre party and the liberals on 24 April 1981 (known as ‘the wonderful night’) had restricted tax relief for debt interest expenditure but households were still considered to be less interest-sensitive than companies; higher interest rates would therefore have a greater impact on demand for industrial credit than on consumption.

Wohlin worked instead for a 10 per cent devaluation; by September he had managed to persuade the government. The case he made to the governing board was that public expenditure had been allowed to grow too fast in 1979 and 1980. The labour-market and industrial support from 1977–8 had underpinned obsolete structures and should have been terminated earlier. Neither had the government done anything to increase the supply of labour and other resources, which meant that shortages soon put a stop to every economic upswing. A further blow to Sweden’s competitive position had come from the dollar’s doubled weight in the currency basket – the stronger dollar had entailed a 10 per cent appreciation of the krona against the EMS currencies.

Some party political considerations may have contributed to the 1981 devaluation (Lindvall, 2006):

Lars Wohlin, Riksbank governor at the time, says ‘It was fairly clear, judging from their [the social democrats’] rhetoric, that sights were set on a large devaluation. The risk that these ideas would affect confidence in the krona was an argument for not postponing the decision to devalue.’ Sten Westerberg, under-secretary at the ministry of economic affairs, is more explicit, ‘The purpose of the [1981] devaluation was twofold. One was to reset the level of costs and thereby improve the situation before the election. The other was to deprive the socialists of the possibility of starting their term with a large devaluation.’



In earlier times, the national debt grew in connection with Sweden’s or other countries’ wars; in the late 1970s, an increase occurred in peacetime and raised the level higher than ever before.

396 The Riksbank followed up the devaluation by lowering the level of domestic interest rates (industrial investment was at a post-war low) and continued to raise the commercial banks' liquidity ratios so that government bonds could be issued to finance the budget deficit, which was still growing. Banks had to buy bonds in order to comply with the liquidity ratios and this limited their supply of business credits.

In the period with a non-socialist government, controls were tightened and some loopholes closed. In the latter years, however, the Riksbank used more market-oriented instruments. Treasury bills became one of monetary policy's principal instruments in the 1980s. They were launched in July 1982 as a new form for government borrowing outside the banking system. The major companies' investment divisions had surplus liquidity which the bills would absorb.

Market speculation in yet another devaluation began in the summer of 1982, prior to the general election at the end of September. The budget deficit was now equivalent to 14 per cent of GDP. Restrictive measures were called for; to check the currency outflow, the Riksbank again raised the penal interest rate to 17 per cent.