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A Financial System under Pressure: The Case of Sweden 1930-45

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Abstract

The Swedish financial market changed radically during the Second World War. The introduction of a special currency control left the Swedish commercial banks cut off from its traditional trade channels and financial markets. As a consequence, the market structure changed – not least with regard to bank deposits, advances and assets.

These changes called for new institutional efforts, i.e. the central bank had to assume an increasingly important role on the Swedish financial market. This development marked a major step towards a larger governmental control over the country's financial market.

The demand for capital traditionally utilized by industry and especially construction was limited during the Second World War. Thus lending from both commercial and savings banks stagnated, while deposits continued to grow. Banks, insurance companies and other financial intermediaries on the Swedish financial market instead became financiers of the growing Swedish national debt.

The Swedish economy was dependent on German foreign trade during the Second World War. The clearing arrangement between the two countries was originally established by a Swedish initiative in order to force Germany to settle their large debt payments with Sweden. Measured in prices, trade volumes and capital flows, there is little evidence that Germany, as a great power, took advantage of its position in the Swedish-German economic exchange. Instead Sweden in several ways could direct the outcome of the clearing arrangement.

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Introduction

According to Forsyth & Notermans, the crises of the early 1930s were an international watershed between two incompatible macroeconomic and political systems. The collapse of the gold standard and the Liquidity Crisis initiated the transition. First, the turmoil that emerged from the crisis set off a growing mistrust in the financial sector; second, the policy makers set new objectives. By abandoning the gold standard, a new set of regulating tools were required to be able to stabilize domestic prices and secure balance of payments. While the gold standard system was facilitated by mechanisms as free capital movements and financial openness for domestic price level stability, the new system called for constraints and controls to supervise and maintain market stability. This was the initial motive behind the new financial regulatory regime.¹

Even though the regulatory institutions expanded during the 1930s, they aimed at controlling rather than intervening. In so far Sweden experienced a political-cultural change during the pre-war years. The major step towards a macroeconomic shift was taken by the introduction of the war economies. All economic activity was put in the hands of extreme protectionist governments and authorities. Financial regulations became key regulations for the emergency policies. The perhaps most important single regulation, however, was the law that prohibited foreign capital movements. The initial purpose of this regulation was to ensure means of payments to finance imports and meet increasing expenditures for armaments and military needs, but also to finance public relief work and rapidly expanding administrative costs. However, macroeconomic stability and innovative monetary policies, such as the aim for full employment and stable prices (inflation targeting), proved efficient. Thus, these policy changes became the definite shift from the policies of the gold standard system to an era of interventionist economic policy.²

Empirical examples from the neutral Mediterranean countries show that this regulation obviously had a decisive effect on the market structure.

¹ The macroeconomic changes have been accurately outlined in Mundell (1960), Sjögren (1991) and Forsyth & Notermans (1997).

² Berg & Jonung (1998).

Whereas capital was accumulated, the investment opportunities diminished. Solvent banks and intermediaries utilized their capital to expand horizontally by merging. Thus, one important feature of the market structure of the Mediterranean countries was that business was concentrated to fewer, but larger, competitors.³ Theoretically this affects market efficiency negatively.⁴ However, there were obvious gains from these policies as well. A significant part of the capital was absorbed by the domestic industries. According to Tortella and Pons, this became the entrance capital for both the industrial take-off and the monetary and financial interventionist policies displayed in the expansionary budget policies during the post-war decades.⁵

Various examples from the literature indicate that Sweden showed several similarities to the Mediterranean countries. For instance, like the Mediterranean countries and Switzerland, Sweden was a small neutral state, whose main objective was to stay out of the war; similarly, the Swedish government introduced emergency laws, which were facilitated by an emergency administration to supervise and monitor the centrally planned economy in accordance to the political guidelines.⁶ Sweden likewise adopted a foreign capital movement regulation to ensure that capital remained in the country, which subsequently led to a rapid increase in capital reserves. Sweden, too, retained the wartime financial policies during the post-war decades. However, there were also significant differences. The most important is that Sweden already was an industrialized economy⁷, while the Swedish financial and banking sector probably was more developed than the Portuguese and Spanish.⁸

Did banking business change? In this paper the development of Sweden's domestic financial system during the Second World War is analyzed, in particular the credit market and the development of the commercial banks. Attention is particularly paid to whether the interaction between financial intermediaries, and intermediaries vis-à-vis the government, changed. Was the war in fact a watershed in the development of Sweden's financial system or a continuum of the economical and political regime of the inter-war period?

³ Pons (1999) and Tortella (2001).

⁴ According to the theory of imperfect competition and the monopoly theory outlined in Krugman & Obstfeld (2000), pp. 122-130.

⁵ Pons (1999) and Tortella (2001).

⁶ Friberg (1973), pp. 356-357.

⁷ Schön (2000), pp. 220-226; in figures pp. 227-240.

⁸ This assumption draws on Tortella and Pons, who claim that these sectors in Spain and Portugal were not very sophisticated during the war. Pons (1999), Tortella (2001).

Sweden's domestic financial system during the interwar period

Commercial banks were heavily involved in different types of speculation in the Swedish economy during the First World War. Through lending against shares as securities and both direct and indirect purchase of shares, they underpinned speculation on the stock exchange, resulting in heavily overvalued prices on shares.⁹ The largest commercial banks were also involved in the restructuring of Swedish industry.

The financing of mergers and of new machinery and equipment resulted in structural changes in the economy. However, through these activities commercial banking was exposed to heavy risks, which resulted in large losses during the deflationary crisis in the early 1920s. Several commercial banks had to reconstruct their business, and in order to avoid the collapse of some banks, the government, together with the strongest commercial banks, established a special organisation – *AB Kreditkassan* – that could act as a lender of last resort. This meant an increased governmental activity within the banking sector, which was a deviation from previous policy, where bank legislation was the most important feature of governmental policy. This was not a new feature of the Swedish financial system. During the crisis of the 1870s, commercial banks and the government (via the National Debt Office) raised credits in order to fund industrial complexes that were lacking in liquidity.¹⁰

In the late 1910s and early 1920s, the Social Democratic Party increased its political power, and after the party congress in 1920 a new program supporting the nationalization of trade and industry was adopted. After a successful election in September 1921, the Social Democrats formed a minority government. Thus, the government's position was not very strong, and, due to the parliamentary situation, it was impossible to implement more radical changes of ownership in the Swedish economy.

The two largest Swedish commercial banks – Svenska Handelsbanken and Skandinaviska Banken – both experienced heavy losses in the beginning of the 1920s and were in need of additional capital to avoid liquidation. These crises coincided with a political discussion about forming an

⁹ Larsson (1991), pp. 84-91, Östlind (1945), pp. 257-298.

¹⁰ Boksjö (1994), pp. 13-17.

independent publicly owned commercial bank that could compete with the privately controlled banks. It is therefore not surprising that a proposal was put forward to the board of directors of both banks to accept 50 per cent state ownership of the banks in exchange for capital guarantees. However, as the banks managed to recruit capital from private interests, it became possible for both banks to reject these proposals.¹¹

During the interwar period, the official banking policy was in other respects more or less pragmatic. Legislation for the commercial banks was changed in order to prevent the same type of speculation that had occurred during the First World War. Thus, the commercial banks' right to acquire shares in bank-affiliated investment companies was abolished in 1921. By that time, however, the banks had already taken over shares owned by their investment companies, and therefore the legislation did not have much effect on the connections between banks and industry. On the contrary, the crisis for commercial banking in the beginning of the 1920s saw the establishment of a bank-controlled economy when the three largest banks became the major owners of a large part of Swedish industry. One estimate shows that around 20 per cent of the total industrial work force in 1924 was employed in companies controlled by these three commercial banks.¹²

In March 1932 commercial banking was hit by another crisis, connected with the suicide of the Swedish industrial magnate Ivar Kreuger. Up till then Sweden's economy had performed quite well, in spite of the international depression. With the death of Kreuger, however, his international industrial empire collapsed, leaving a state of confusion in the commercial banks' lending, as well as in Sweden's balance of payments. By the time of the Kreuger crash, about 20 per cent of total advances from Swedish commercial banks had been given to the Kreuger group. This heavy commitment was mostly related to the second largest commercial bank, Skandinaviska Banken, which contributed about half of these credits.¹³

Already during 1931 commercial banks and the Bank of Sweden (*Riksbanken*) began to act to save the Kreuger empire. The poor liquidity of the Kreuger concern made it impossible to pay off loans coming due. Both the government and the national bank regarded the continued existence of the Kreuger concern as a question of central importance. The three largest banks – Svenska Handelsbanken, Skandinaviska Banken and Stockholms Enskilda Bank – were therefore recommended to admit further credits to

¹¹ Hildebrand (1971), p. 163. Söderlund (1978), pp. 392-398.

¹² These banking-groups increased their holdings in Swedish industry during the following decades, and in 1979 approximately 40 per cent of the industrial work force was employed in bank-controlled companies. Lindgren (1990), p. 27. Östlind (1945), pp. 595-599.

¹³ Lindgren et al. (1988), pp. 439-441. Söderlund (1978), pp. 487-491.

Kreuger. However, the Wallenberg-dominated Stockholms Enskilda Bank refused to take part in this rescue action because of the risks connected with bad securities.¹⁴ After the crash, this refusal made Stockholms Enskilda Bank appear to be more far-seeing than its competitors, which probably strengthened the Wallenbergs both as financiers and industrial owners.

Skandinaviska Banken, however, experienced large losses on its loans to the Kreuger empire, and once again it was necessary for the government to support a commercial bank. This was criticised, especially by the left wing parties, and the Minister of Finance, Ernst Wigforss, had to explain in a special pamphlet why a Social Democratic government supported a private bank hit by a crisis.¹⁵

Not very surprisingly, after the Kreuger crash, the right of commercial banks to acquire shares was totally abolished. Furthermore the banks were supposed to sell their shares in industrial and other companies within five years, provided this could be done without losses. For some banks this meant that the shares were not sold until well into the 1950s.

Of course, the regulations and decrees emanated from the distrust of the stability of the financial market and the reliability of the financial actors. The idea behind this institutional change was to reduce the risks connected with owing and trading with shares, as well as to reduce the commercial banks' control over industry. This, however, proved to be a difficult task. Only one of the four largest commercial banks – Göteborgs Bank – dissolved its connections with the industry. The other three banks circumvented the regulation by selling their shares to affiliated companies or their own pension funds and thus managed to retain control over their industrial companies.¹⁶

Commercial banks played a decisive role in the development of Sweden's economy during the late 19th and early 20th centuries. The years of inflation during the First World War even strengthened this development. The crises in the early 1920s and 1930s, however, reduced the role of commercial banks. Even though they managed to maintain their ownership and control over several of the largest industrial companies, banking legislation reduced the possibilities to have a direct control over these companies and to extend the banks' interests in Swedish industry. A period of active restructuring in Swedish industry was replaced by a period of administrating capital. At the same time, the growing solvency in the industrial companies reduced their need for long-term financing by the banks.

¹⁴ Lindgren et al. (1988), pp. 439-444. Söderlund (1978), pp. 475-483. Ironically, the typically cautious Wallenbergs considered the measures taken as hazardous, and retrospectively, from the Wallenberg perspective, this rescue action may be viewed as a converse joint adverse selection basis.

¹⁵ Wigforss (1932).

¹⁶ Olsson (1997), pp. 133-135. Larsson (1998), pp. 98-101. Carlsson (1997), pp. 91-93.

These changes in the interwar economy in general, and for the commercial banks in particular, affected the development of the financial sector as a whole. During the late 19th century and the first two decades of the 20th century, savings banks continuously lost market shares to commercial banks. The situation changed, however, with the bank crisis in the 1920s. In contrast to the commercial banks, the savings banks were not allowed to participate in speculation and heavy lending to industry. Instead savings banks invested in government bonds, which in the 1920s gave a comparatively high rate of interest. This made savings banks more attractive for both smaller companies and private savers.

Thus, the position of the savings banks strengthened vis-à-vis the commercial banks. In the 1930s competition between commercial and savings banks increased. Higher volumes of savings and a stagnating demand for capital on the part of both private persons and industry made credit cheaper. Interest rates fell, and in the middle of the 1930s the official discount rate was fixed at three per cent. As late as 1938, it was also possible to issue a 20-year industrial bond loan at three per cent. The fall in the interest rate did not only affect banks. Insurance companies were hit by this development as well. In the contracts of the insurance companies, customers, savers in life insurance, were guaranteed an interest rate of four per cent per year. Under the circumstances, this promise was impossible to fulfil, and, with the consent of the Insurance Inspection Board, interest rates were reduced.¹⁷

Industrial financing underwent considerable changes during the interwar period. After the liquidity squeeze in the 1920s, the need for capital was reduced. Although there were strong fluctuations on the stock market towards the end of the 1920s and early 1930s, the stock exchange was not used in the same active way as during the First World War.

The amortizations on loans and increased self-financing among industrial companies also reduced the use of the Swedish bond market, especially during 1924-26 and 1932-36. However, the comparatively strong liquidity of the Swedish capital market during the 1920s and early 1930s attracted foreign bond issuers, and several foreign bond loans were directly aimed for the Swedish market, while Swedish investors also acted as buyers of bonds in the international market.¹⁸

Governmental policy regarding the Swedish financial market during the interwar period was basically pragmatic, irrespective of the political colour of the government. As an effect of the crises, however, the commercial banks' space to manoeuvre was restricted, and public control over com-

¹⁷ Larsson (1998), pp. 81-82. Kock (1961), pp. 154-173.

¹⁸ Lindgren et al. (1988), pp. 186-189.

mercial banks was strengthened. However, the question of a nationalisation of the banks was never really of current interest.¹⁹

New regulations of the financial market

The outbreak of the Second World War did not cause any immediate and/or radical changes in the regulation of the financial market. Instead both banking and industry were organized to support the overall aim to maintain foreign trade at an acceptable level and to guarantee both civilian and military needs.

The experiences from the First World War played an important role already during the interwar period in organising the Swedish economy. In 1928 the government appointed a special commission to evaluate the national system for economic defence (*Rikskommissionen för ekonomisk försvarsberedskap*). This commission especially scrutinized the economic disproportions during the First World War in order to give the government and parliament the possibilities to handle a new war situation more effectively. These measures included public control of all foreign trade, international payments and national consumption.²⁰

This meant that the Swedish administration was better prepared for a war in 1939 than in 1914. Through special legislation, the parliament gave the Swedish government an extensive right to ban exports, control imports, control building activities, introduce price controls and ration consumer goods. Thus, decisions regarding investments, production, pricing and sales moved to a considerable degree from business management to special government organizations for industry, trade, fuel and price controls. In particular the governmental control of foreign trade had a large impact on the activities of commercial banks.

In order to secure access to capital for the national food supply and Swedish defence, the government formed a special national credit council to discuss questions of priority. This council was led by the Swedish minister of finance and included politicians as well as the head of the Swedish central bank and representatives from the financial sector, among them Jacob Wallenberg from Stockholms Enskilda Bank.²¹

¹⁹ While the nationalization of banking was never brought up for discussion, the Social Democrat Albert Hermansson proposed in the Swedish parliament in 1934 that the private insurance companies should be nationalized. However, this proposition was rejected by the parliament. See Grip (1987), pp. 31-36.

²⁰ Carlsson (1997), pp. 109-111.

²¹ "Statlig kreditnämnd, kommunal lånepolitik och räntebärande skattekonton" (1939), p. 442.

However, the activity of this credit council was not that extensive. After a short period of restraint in the credit market from the autumn of 1939 to the early summer of 1940, there was no longer any need for restrictions on the Swedish credit market. Until the end of the war there was no lack of capital in the Swedish market; on the contrary, increased liquidity in the national economy during the latter half of the war threatened Sweden's economic stability. This was to a large extent an effect of a desire on the part of the Swedish banks to – without special regulations – support the overall aims of the government. The credit council never really started to work; instead it was dissolved after a short period.²² Governmental control was thus far more detailed for industry and trade than for domestic banking. On the other hand, banking activities on the international market were exposed to a detailed control.

Of great economic importance, as well as a matter of principle, was the introduction of a special currency regulation to control international transactions in currencies and securities. This special regulation was introduced already during the spring of 1939, but to begin with was not so strict. At the beginning of the war, regulation was instead based on informal agreements – to restrict the Swedish banks' international trade with currencies – between the central bank and the commercial banks. However, in February 1940 a full regulation of currencies was introduced, meaning a prohibition in principle for Swedish citizens and companies to carry out foreign payments and transactions with Swedish and foreign securities. Payments could only be handled after dispensation from the Swedish Exchange Control Office. Thus, with a dispensation, it was still possible for the general public to acquire foreign currencies. Such transactions, however, had to be handled by one of commercial banks that had been given the right to trade with foreign currencies. These restrictions introduced a new tradition in Swedish law, motivated by the extraordinary situation during the war. Despite this, the currency regulation was not repealed until 1989.

The aim of this regulation was to stop all capital movements – both inflow and outflow – that could be harmful for the Swedish economy. The purpose was not to use the currency regulation for import control. However, as national consumption deteriorated, especially from April 1940 as Sweden was cut off from trade with the Allies, the need for a stricter import regulation increased, albeit only for a limited period. As imports fell and exports continued to be strong, the use of currency regulation to ration imports became unimportant. The currency regulation was instead used to economize the use of limited foreign currencies. Until October 1944 Swedish foreign payments were of primary interest, but as it became clear that the war was coming to an end, it became more important to control

²² Carlsson (1997), p. 111.

also foreign payments to Sweden. There were also political motives behind this, since the Germans balanced their bilateral payments with gold transfers that could be looted gold. The foreign policy also included a ban on the import of crude gold.²³ Together with clearing and other arrangements for foreign trade, the currency regulation had a strong impact on the commercial banks' foreign activities. While their role in foreign economic relations was diminished, the importance of the Swedish central bank grew larger.²⁴

Besides its ordinary activities in the international market, as being responsible for the reserve in foreign currencies and gold, the central bank also had to:

- Transfer currencies according to international payment agreements.
- Handle or give commercial credits connected with international trade.
- Transfer foreign payments between Swedish commercial banks and their foreign connections.²⁵

From a practical point of view, the Second World War did not seem to introduce any new important changes in the legislation regarding commercial banks. Planning was much more rigorous for industry and trade than for banking. During the war, there was really no need for an extended control of banking. Restrictions on industry and trade were enough to facilitate the government policy. But the introduction of these planning arrangements foreboded major changes in the Swedish banking policy during the years directly after the war.

The war period had shown that it was possible to guide economic development and private enterprises with a combination of regulation and cooperation. For the Social Democrats, it was obvious that the state had an important role to play in the national economy after the war. In a program for economic development after the war, which was presented in 1944 by the

²³ There was a growing negative attitude among representatives for the Swedish Ministry for Foreign Affairs against trade with German gold during 1944. The Allies suspected that it could be looted gold and warned Sweden as well as other countries from trading with gold from Germany. However, neither in Swedish legislation nor in practise was there any support for not accepting gold as a means of payment. See Hedberg (2003), p. 231. Kock (1962), pp. 242-249. Sveriges riksbank (1997), pp. 12-14. *SFS 1944:693-94*.

²⁴ Thus the changes in legislation for commercial banks were of minor importance during the Second World War. Compared to this, any changes in the regulation of insurance companies seemed extensive. These changes were often motivated by higher risks in insurance for both persons and objects. Larsson (2002), pp. 177-180.

²⁵ Kock (1962), p. 249.

Swedish labour movement, both extensive planning and nationalisation of different areas of business were discussed.

The socialization plans were formally presented publicly in the so-called “*arbetarrörelsens efterkrigsprogram*” (the labour movement’s post-war program).²⁶ However, the plan was severely criticized in the parliament and in particular in the media. The impression made by the critique and the forthcoming general election of 1948 forced the Social Democrats to retreat to a more modest rhetorical approach.²⁷

Thus, not much of this program materialized immediately, but it was definitely a step in accordance to the macroeconomic changes described by for instance Forsyth & Notermans (1997) and an indication of the more radical policies that characterised the period after the Second World War. Instead the guidelines and control over industry and trade motivated by the war were gradually withdrawn. For the financial sector, however, the official control was strengthened towards the end of the 1940s and early 50s. Through an extensive control of the financial sector, it was possible to support political ideas and make sure that cheap money was available for sectors that were given priority.

In the 1950s, under the guidance of the Swedish central bank, several new restrictions were introduced for commercial banks, as well as other actors on the financial market. Thus interest rates could only fluctuate within limitations decided by the central bank. The issuing of new bonds had to be approved by the central bank, which resulted in high volumes of bonds for housing, but nearly none for industrial companies. Lending from commercial as well as savings banks was also directed to specific areas of the economy, reducing credit to private persons as well as to industry. Together with other measures, this resulted in a financial market with limited competition controlled by a political oligarchy well into the 1980s.²⁸

Even though these regulations were introduced in the 1950s, the origin of a controlled economy had been established during the Second World War. For the Swedish financial market, the war definitely was a watershed between the more liberal inter-war period and the planned and controlled post-war era.

²⁶ Arbetarrörelsens efterkrigsprogram: de 27 punkterna med motivering (1944).

²⁷ The political “arena” was flooded with pamphlets that polemized against the socialization arguments. One typical example was edited by the liberal Folkpartiet (1948). Lewin (1970) has presented the rhetoric and the political chain of events carefully. The program and the “new” macroeconomic policy are accurately analyzed in Stråth (1998).

²⁸ Kock (1962), pp. 385-412. Larsson (1998), pp. 144-148.

Governmental policy and priorities

In December 1939 a coalition government took office. By assembling representatives from the four largest political parties, the war-time policies gained parliamentary support. This was considered a prerequisite to provide political unity and the ability to act vigorously.²⁹ The political power was centralized to the government (from the parliament), and a centrally planned economy was introduced to direct the economy in accordance to the plans. Technically, or rather judicially, the transition to war policies was effected by the introduction of the emergency laws and the emergency administration, which was commissioned to control and facilitate the overall objectives. By equipping the government with the right to impose regulations and restrictions, such as rationing, licenses, quotas, export and import bans, as well as extensive fiscal policies, the area of responsibility (and control) ranged over the whole society.³⁰

However, even though the political representation from the four largest parties enhanced the capacity to act vigorously, the political objectives and the wish for national unity still required participation from business. Fortunately, already during the spring of 1939 – thus before the outbreak of the war – an initiative had been taken for a meeting in which politicians as well as representatives from business and finance were summoned, in order to formalize and facilitate further co-operation. Several business organizations as the Swedish Bankers' Association (*Svenska Bankföreningen*), the Federation of Swedish Industries (*Svenska Industriförbundet*) and the Swedish Employers' Confederation (*SAF*) were formally appointed and accredited to government services. However, this initiative was not a result of the increasing tensions in Europe, but rather a product of the “Swedish model” that developed during the 1930s, although in a clearly extended version.³¹

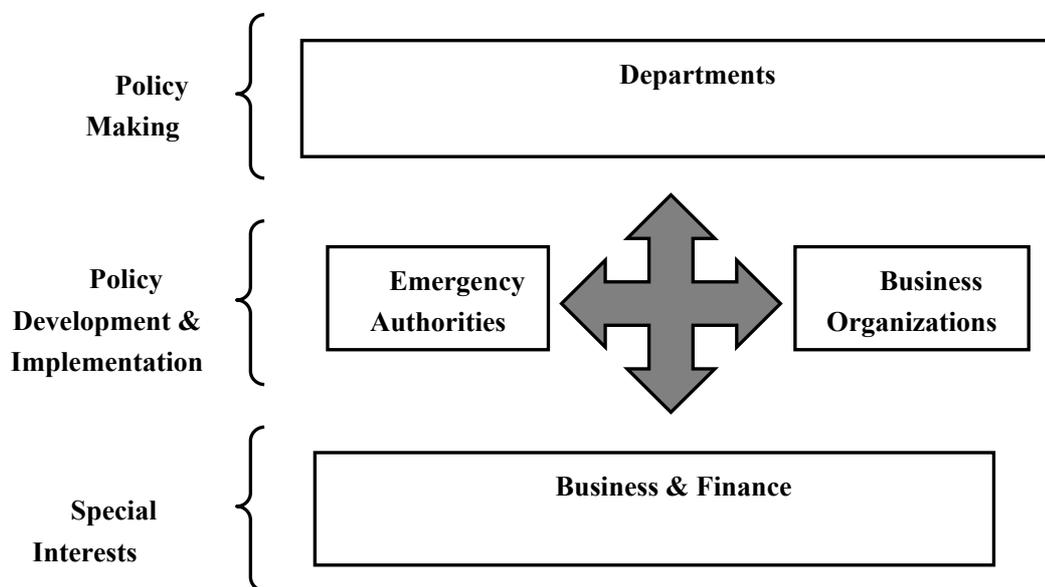
²⁹ The prerequisites, the chain of events and the objectives of the Swedish government have been carefully analyzed by Wilhelm Carlgren. See in particular Ch 1, Carlgren (1973). See also Molin (1986), pp. 11-14.

³⁰ Friberg (1973), p. 12 and Ch. 5. See also Ekman (1986), pp. 51-52 and Carlgren (1973), pp. 74-78.

³¹ The Swedish model is contextually presented in Magnusson (2002), pp. 445-449. This model has also been termed “relationship capitalism”, which refers to a political culture where policy making is conducted through personal contacts and networks, rather than

During the war, the public administration and the political power were organized as illustrated in figure 1 below. Even though the governmental departments and the emergency authorities were formally in charge of and responsible for the wartime policymaking, the business organizations possessed valuable capabilities and skills required by the policymakers. As is displayed in the boxes at the top and the bottom, the government (the departments and the executing and supervising authorities) and the business representatives interacted politically both directly and indirectly via executives: the emergency authorities and the business organisations. The right and left boxes in figure 1 represent the interaction between the emergency authorities and the business organisations, which in turn were the governmental subdivisions of the government (the departments) and Swedish business and finance. As mentioned above, the latter were already organized. But during the war, new organizations were formed in order to facilitate the centrally planned economy. Thus, business and government depended on each other. Despite the fact that the Swedish society in general experienced a transition to a centralized and politicized economy, the business organizations still exerted influence.³² In all probability, the Swedish wartime model enhanced the efficiency of the wartime organization, as well as the post-war development of the Swedish model.

Figure 1. The Swedish model/Swedish relationship capitalism



through transparent “arm’s length” contracts. Rajan & Zingales (2003), Ch. 11. The wartime economic organization is briefly discussed in Hedberg (2003), pp. 134.

³² Hedberg (2003), pp. 52-53, 132-134.

The wartime organization had both advantages and disadvantages. The advantages were of course that the Swedish government was provided with business knowledge – which it lacked to a great extent. During the war the business representatives were heavily involved in negotiations on international trade and finance (see below).

As mentioned above, the wartime policies were based on the experiences from the First World War. Basically, the plan was to keep the country out of the war and to provide for price stability and sufficient supplies, as well as to allocate raw materials and consumers goods. However, armaments and protectionism led to a rising scarcity of raw materials and staple commodities. Consequently, the international markets experienced a rapid rate of inflation in combination with large capital movements. Therefore, since imports required solvency, one of the most important objectives was to encourage useful imports and safeguard for large cash reserves.³³

The development of the Swedish monetary policy was of major importance for banking and the Swedish capital market during the Second World War. During the 1930s the cheap money policy had been introduced and combined with a limitation of the demand for capital, by fixing both the official discount rate and interest rates on bond loans (on around three per cent), during the whole decade.

However, with the outbreak of the war, interest rates gradually increased. The most immediate reaction to the new international situation was of course in short term lending, where interest rates rose from 3.5 per cent in the middle of September 1939 to 4.5 per cent three months later (table 1). The official discount and interest rates on 1st class bonds also increased during late 1939 and early 1940.

After the first eight months of the war, new economic problems emerged. With rising interest rates and an uncertain political situation, the interest for

Table 1. *Selected interest rates 1935-1945, in per cent.*

	Official discount	1 st class bonds	3 months loans against shares
1 April 1935	2.5	2.5	3.5
22 September 1939	-	-	4.0
15 December 1939	3.0	3.0	4.5
17 May 1940	3.5	3.5	5.0
19 May 1941	3.0	-	-
1 June 1941	-	3.0	4.5
9 February 1945	2.5	2,5	4.0

Source: Bank of Sweden. Yearbook 1947.

³³ Jonung (1989), p. 43. *SFS 1939:349, 625, 838, 851, 726, 956*. Åmark (1941), pp. 179-181. Kock (1962), p. 119.

investments fell sharply. During the first six months of the war, the number of building licences was only about 10 per cent of what it had been a year earlier. The production of new dwellings also fell sharply, from 45 000 apartments in 1939 to just over 20 000 in 1940. Increased interest rates, as well as problems in obtaining long-term loans, were blamed for this reduction. But also the uncertain situation on the Swedish real estate market after the German invasion of Denmark and Norway played an important role. In order to counteract this situation, the parliament in 1941 introduced new legislation where the state guaranteed the introduction of bond loans from mortgage institutes and also subsidized interest rates for loans to housing. The aim of this policy was to make it more profitable for entrepreneurs to construct new dwellings, but to avoid increasing rents a special rent control was introduced at the same time. Whether or not this policy had any effect is, however, uncertain. As these new regulations were introduced, the situation on the Swedish credit market eased, and both mortgage institutes and banks showed an increasing interest in lending to the building sector. Towards the end of the war the production reached the size of that of 1938/39.³⁴

The long-term interest rates fell from June 1941, but were not back on the pre-war level until early 1945. Throughout the war short-term lending continued to be slightly higher priced than before – compared to long-term lending.

The importance of low interest rates was also emphasized by the Swedish parliament, through the Banking Committee, during the spring of 1941. A cheap money policy would not only encourage building activities, but also the development of industrial and agriculture production. The Banking Committee's wish to lower the general level of interest rates was not supported by the central bank. Instead the stabilization of the cost of living was given priority, and in November 1942 both a price and a wage freeze were introduced.³⁵

After the rapid inflation during the first half of the war, both living costs and wholesale prices showed a considerable stability from 1942. This development was supported also by a more stable development for prices on both imported and exported goods (table 2 below). Thus the anticipated war inflation did not cause any severe problems.

The outbreak of the war meant an extra strain on public finances. The state budget was under-balanced both as an effect of military expenditure and the build up of the national food supply. There are two main methods to

³⁴ Kock (1962), pp. 285-302 and Hildebrand (1971), pp. 356-357.

³⁵ *Parliamentary publications* (Riksdagstryck) Bankoutskottets utlåtande över riksbankens och riksgäldskontorets styrelse och förvaltning. 4 March 1941. Kock (1962), pp. 238-240.

Table 2. *Price index, cost-of-living, wholesale and foreign trade. August 1939=100.*

	Cost-of-living index	General wholesale price index	Imported goods price index	Exported goods price index
1939	100	100	100	100
1940	114	132	165	130
1941	129	155	215	139
1942	139	170	248	167
1943	141	177	266	181
1944	140	177	266	182
1945	140	175	253	180

Source: Åmark (1952), p 1072.

finance war economies: taxation and borrowing. (A third option may be looting.) During the war, warring as well as neutral states adopted the first method by raising as much capital as possible from various forms of taxation. However, the expenditures still seemed to increase faster than the revenues from the fiscal system. Thus, taxation was complemented with borrowing. Like extensive taxation, this marked a new feature of the Swedish fiscal policies. During the 1930s public borrowing operations were motivated by the exchange of old bond loans with high interest rates for cheaper loans. However, with the new war situation public borrowing reached unknown levels. During the war, the public debt increased by more than 8 000 million crowns, which could be compared with 1 000 million crowns during the First World War (table 3 below).³⁶ Especially the years 1940-1943 resulted in heavy expense surpluses in the national budget.

To balance public finance it was desired that personal savings finance the under-balanced budgets, and in order to attract sufficient capital, a so-called defence loan was introduced in 1940. This was followed in 1941 and 1942 by two other similar large loans. These bonds were introduced with a 4 per cent interest rate and at lower denomination than ordinary loans. The introduction

Table 3. *Sweden's official national debt, in million SEK. Current prices.*

Year	Million SEK	Year	Million SEK
1920	1497	1942	6926
1930	1800	1943	8731
1939	2634	1944	9774
1940	3625	1945	10953
1941	5170		

Source: The National Debt Office (Riksgäldskontoret). Yearbook 1947.

³⁶ Kock (1962), pp. 274-275.

was also preceded by extensive governmental marketing in the media, as well as by channelling information via Swedish business organizations. It is, however, a myth that these bonds were eagerly embraced by private persons, who preferred to deposit in commercial or savings banks. Instead banks and insurance companies became the largest buyers of these public bonds.³⁷

Besides these special defence loans, the National Debt Office also introduced several more traditional bond loans. No Swedish bonds were sold on the international market during the war; instead investors on the Swedish credit market purchased more than two thirds of the bonds. The reduced production of housing also helped create room for an increased public borrowing.

The introduction of these large bond loans on the Swedish market also helped solve the problem with over-liquidity in the banking sector from 1941. A large inflow of capital in the banking system could otherwise have resulted in investment problems among the financial actors or an increased inflation.³⁸

The expanded public borrowing was also used for the purchase of foreign currencies. According to the application of the currency regulation, the inflow of foreign currencies was to be taken over by the central bank. The imbalance between the inflow of capital and use of these foreign currencies, however, resulted in a continuous increase of foreign exchange. A large part of this capital came from cargo incomes from the part of the Swedish merchant navy that still was working on the international freight market.

As a result of these incomes, the reserves in foreign, convertible currencies (especially gold) increased dramatically (table 4 below). Thus, a part of the increased national debt was compensated by the growth of the national reserves. On an international level, Sweden was a large holder of gold by the end of the war, which proved to be of practical importance when the international trade increased during the latter half of the 1940s.

³⁷ Nygren (1979), pp. 122-123.

³⁸ Increased deposits during the war were, however, a problem for the banks. Since more than 40 per cent were short-term deposits, however, the interest rate was fairly low. Another way of limiting the cost for the bank was to reduce the interest rate for higher deposits. From 1942 the largest interest rates were given to deposits of up to 300 000 SEK. See Hildebrand (1971), pp. 358-359.

Table 4. *Sweden's net foreign exchange and gold at market value, in million SEK. Current prices.*

	Net foreign exchange Exchange	Gold, market Value	Total
1939	543	1405	1948
1940	588	756	1345
1941	814	783	1597
1942	592	1256	1848
1943	588	1514	2101
1944	579	1830	2410
1945	678	2000	2678

Source: The Bank of Sweden. Yearbook 1947.

Financial intermediaries on the Swedish war market

The situation for Swedish banking changed considerably during the Second World War. Both housing and industrial financing stagnated or fell, and the demand for capital from private persons was not very strong either. Thus, it is not surprising that bonds became more important in both the commercial and the savings banks' portfolios. This was more or less a continuation of the policy conducted in the 1930s. For commercial banks, however, the 1930s and 40s also was a period of consolidation after the previous crises.

In 1939 and 1940, the commercial banks' advances exceeded the deposits. From 1941 onwards, however, deposits exceeded the advances (table 5). Especially during the last three years of the war, this surplus was quite extensive, leaving plenty of capital for the purchase of bonds.

The savings banks experienced a deposit surplus both in the 1930s and during the war. However, the sum of this capital increased gradually and in 1945 was as high as 2500 million SEK or nearly 50 per cent of total deposits.

Already during the 1930s, the businesses of savings banks and commercial banks gradually had become more similar. Restrictions on the savings banks' activities were seen as obsolete, especially among representatives from these banks. The relative standstill on the Swedish credit market, however, did not promote any institutional changes. It was not until the end of the war that changes really began for the credit market.

Already in the middle of the 1930s, Swedish insurance companies began to reevaluate their business in case of a war in Europe. The insurance risks would under such circumstances change considerably, for life insurance as well as for fire, maritime and casualty insurance. From the capital market

Table 5. *Total deposits and advances in the Swedish banking sector, in million SEK. Current prices.*

	Commercial banks		Savings banks	
	Deposits	Advances	Deposits	Advances
1935	3650	3878	3351	2701
1939	4526	4608	3679	3217
1940	4300	4730	3596	3172
1941	4583	4340	3808	3197
1942	5037	4249	4137	3297
1943	5511	4533	4611	3480
1944	6077	4915	5106	3757
1945	6729	5408	5606	4130

Source: The Bank of Sweden. Yearbook 1940, 1947

perspective, the altered situation for life insurance was of greatest importance. The outbreak of the war resulted in new regulations for insurance compensation due to acts of war, but also in additional premium payments.³⁹

The new market situation also resulted in increased co-operation between the insurance companies, to establish joint conditions for life insurance taken during the war period. The collaboration between companies also developed in other business areas, especially concerning the regulation of special risks. Thus, compared to commercial banks, there was a need for special regulative measures in the insurance sector due to acts of war. The state not only supported, but also took the initiative in developing, joint solutions for insurance problems. This policy was largely motivated by the protection of the insurance companies' long-term solidity in an uncertain situation.⁴⁰ The tradition of co-operation and cartel-agreements that already before the war had characterized the Swedish insurance sector was therefore strengthened. This development was also supported by the insulated national character of the Swedish insurance branch. It is true that foreign insurance companies – in contrast to foreign banks – were allowed on the Swedish market, but since the late 19th century they had played a minor role.

The insurance companies' net premium incomes increased in general during the war period. However, there were some exceptions. Premium incomes from car insurances fell sharply directly after the outbreak of the war (see table 6, other insurances). This was an effect of the difficulties to obtain petrol. Gradually vehicles were converted with producer-gas units, but still many cars were not in use and therefore not insured.

The net premium incomes from maritime insurances also stagnated and fell towards the end of the war. This was an effect of large damages on the

³⁹ *SFS 1940:851*. Framtiden livförsäkringsaktiebolag (1972), pp. 166-167.

⁴⁰ *SFS 1940:540*. Larsson (1991), pp. 56-58.

Table 6. *Premium income and total assets in life insurance and non-life insurance in Sweden, in million SEK. Current prices.*

	Net premium incomes					Total assets
	Life	Fire	Maritime	Casualty	Other	Private insurance
1935	189	60	17	13	41	3302
1939	226	63	34	17	52	3951
1940	229	67	35	17	41	4133
1941	244	80	30	17	43	4433
1942	280	87	36	21	47	4718
1943	314	97	33	23	53	5086
1944	339	99	28	24	58	5427
1945	395	101	24	29	66	5847

Note: Casualty insurance only includes private insurance, not insurance in the National Social Insurance Board.

Sources: Source: The Bank of Sweden. Yearbook 1947; Historical Statistics of Sweden (Historisk statistik för Sverige).

ships, but also a consequence of the reduced size of the Swedish merchant navy 1941/42.

Premium incomes from the largest two insurance branches – life and fire insurance – grew steadily during the war. In both cases, this was partly an effect of compensation for higher risk, but in the case of life insurances there was also a growing interest on the market.

With increased total assets, the insurance companies came to play an important role for the introduction of government bonds. Due to a restrictive legislation, life insurance companies had very few alternatives besides bonds in their selection of portfolio investments.

The war did not only result in structural changes in lending and investments for banks and insurance companies. The war also had a strong impact on the Stockholm stock exchange. During the autumn of 1939, there was a widespread fear that a war would result in a panic-stricken sale of shares on the stock exchange. Similar situations had occurred at the outbreak of the First World War and in the beginning of the deflation crisis in 1920. At the outbreak of the First World War, the commercial banks and the central bank had together established a special company that was to facilitate borrowing with Swedish bonds and shares as collateral.⁴¹

Compared to the situation in 1914, companies on the stock market were well-consolidated in 1939, and speculations were fairly unusual. However, the protection against stock exchange panics was not recognized. The larg-

⁴¹ Carlsson (1997), pp. 120-121.

est commercial banks and a number of large industrial companies therefore decided to once again launch a special lending company that by supporting purchases could counteract falling prices on the stock market. This company was not used to any great extent; on the contrary, it only intervened a couple of times during the winter of 1939/40 and was not used at all after April 1940. However, the mere existence of the organization could very well have had a stabilizing effect on the market.⁴²

This does not imply that share prices were stable. In fact there was a sharp drop in prices 1940 (table 7), but already in 1942 the share-index exceeded the 1937 level and the increase continued up till 1945.

Thus, share prices were not hit too hard by the outbreak of the war, especially compared to the public interest for trading with shares. The turnover at the stock exchange dropped with as much as 75 per cent between 1937 and 1940. It is rather surprising that the prices did not fall more the 23 per cent under these circumstances. Obviously, shareholders in general had much confidence on their companies' ability to survive the war. There might also have been expectations of an inflation that would raise the prices, as had happened during the First World War.

The low turnover on the stock exchange indicates that it was more or less a closed market. Only a few companies were introduced during the war, and the issue of new shares was uncommon. Thus the stock exchange did not function as a dynamic market for companies in need of capital.

Table 7. *Turnover of shares at the Stockholm Stock Exchange in million SEK, current prices and share-index (1937=100).*

	Turnover	Share-index
1937	510	100
1938	334	96
1939	266	94
1940	129	77
1941	211	90
1942	245	108
1943	243	108
1944	281	117
1945	464	132

Source: Historical Statistics of Sweden (Historisk statistik för Sverige); Statistical Yearbook of Sweden (Statistisk Årsbok) 1947

⁴² Carlsson (1997), pp. 121-122.

Swedish international finance during the war

The modern Swedish financial sector emerged from the industrial enterprises of the early 1830s and depended to large extent on foreign investments, in particular British capital.⁴³ Even though Sweden was regarded a small-scale economy, Swedish actors like Stockholms Enskilda Bank, Skandinaviska banken and Ivar Kreuger became relative strong actors on the international financial markets. During the interwar period, Swedish bankers also took active part in international co-operation, for instance within the framework of the League of Nations and the management of the Bank for International Settlements (BIS). BIS was established May 1930 when electors were elected by 28 bank representatives (about a week before the Austrian Credit-Anstalt crash). The overall aim was to enhance cooperation and coordination between the central banks in order to pursue monetary and financial stability. In practice, a lot of attention was paid to supervising and monitoring the German financial payments to foreign debtors.⁴⁴

Traditionally Sweden had extensive contacts with Great Britain, but financial and trading relations with other countries were also of great importance. When the trade blockade was introduced immediately after the outbreak of the war, it became difficult or even impossible to maintain several of these contacts.

The Swedish commercial banks' lending on the international market was thus reduced with the outbreak of the war. The banks' foreign assets in 1944 were only about 20 per cent of the 1939 level (table 8). However, foreign advances – both to banks and other customers – were not cut off directly with the beginning of the war. Lending was of a considerable size in both 1939 and 1940, but was reduced sharply in 1941. The major part of these advances was short-term and could therefore be recalled with short notice. The ease with which these credits could be withdrawn can perhaps explain why lending was not reduced until 1941.

⁴³ Gårdlund (1947), pp. 160.

⁴⁴ A detailed description is given by Dulles (1932), Ch. 1 and pp. 509-517. See also Jacobsson (1929) and Costigliola (1972)

Table 8. *Commercial banks foreign assets 1935-1945, in million SEK. Current prices.*

	1	2	3	4	5	6
1935	126	113	95	78	413	77
1939	85	91	146	47	369	44
1940	81	58	115	14	268	51
1941	51	24	27	6	108	-119
1942	49	22	22	6	98	-134
1943	48	14	26	4	91	-138
1944	29	13	30	7	78	-169
1945	18	13	58	27	116	-173

1) Commercial bank advances to foreign customers other than banks and bankers

2) Foreign bonds

3) Advances to foreign banks and bankers

4) Foreign bills

5) Total assets

6) Commercial banks' net position in relation to foreign contacts

Source: Source: The Bank of Sweden. Yearbook 1940, 1947

These years also marked a change in the commercial banks' overall financial contacts with foreign customers. The banks' holdings of both foreign bonds and bills decreased considerably in 1941. All these changes taken together indicate a considerable change in the commercial banks' foreign activities. Up to 1940, the net position of the commercial banks' foreign activities was positive. From 1941 until 1945, however, the debts exceeded the assets by more than 100 million SEK. These figures include all the foreign relations of the commercial banks, and it is not possible from available sources to separate the Allied relations from those with the Axis countries. Considering the risks connected to the international war situation, indebtedness was definitely preferable to lending.

During the interwar period, credits were in common use. The Great Depression and the Liquidity Crisis contributed to the developing of export credit guarantees, in order to overcome the risks and insecurities that restrained international commerce. But after the outbreak of the war, not even guarantees were sufficient to overcome the risks, i.e. credits in international commerce become rather unusual.⁴⁵ Nonetheless, Sweden granted several foreign trade credits in order to maintain the Swedish trade volume.

At the outbreak of the war, the Swedish trade bureaucracy searched for alternative markets, and one of the most eye-catching potential market was the Soviet Union's, even though the Swedish-Soviet trade was historically quite modest. During the 1920s and the 30s, the Swedish-Soviet trade rep-

⁴⁵ Hedberg (2003), pp. 183-184.

resented a share of 4-9 per cent of the Swedish trade turnover. But the Soviet Union possessed rich supplies of goods that were expected to become scarce in Sweden, and on this basis Swedish-Soviet trade negotiations commenced. However, due to the outbreak of the Finnish-Soviet war in November 1939, the negotiations were without results. The Swedish government supported Finland in the conflict, and therefore expanded commercial exchange with the Soviet Union was out of the question. Moreover, during the end of the 1930s the Soviet Union's industrial capacity, in combination with its political expansion westward, was considered a threat to Sweden.⁴⁶

Nonetheless, despite the fact that the Swedish government considered the Soviet Union a potential political threat, new Swedish-Soviet trade negotiations commenced in the spring of 1940. The motive for this diplomatic turnaround was, of course, the Swedish trade losses that followed from the Skagerrak blockade. Initially, the Soviet negotiators made optimistic export and import commitments, which appeared to offer a vital input to the Swedish economy. However, during with the negotiations, the Soviet negotiators made gradual withdrawals from these commitments. The agreement, which was signed in September 1940, was a real disappointment from a Swedish perspective. Firstly, there was no agreement on the import of strategic goods (such as coal and coke, textiles, chemicals) necessary for Sweden. Secondly, the agreement was exceptionally complicated, since it required participation from other countries to be realised. The Soviet export commitments amounted to a value of 70 million SEK (about 17 million USD), while the Soviet Union was granted a credit of 100 million SEK (24 million USD) in order to finance the import of Swedish ball bearings, steel, machines et cetera.⁴⁷

Probably, the Swedish-Soviet agreement had a deterrent effect. Towards the end of the war, Sweden started to play a more important role as an international lender. One important type of credit was used in 1944/45 and contained advances against a low interest rate (one per cent) to countries that had been occupied by Germany. These credits were used for the crea-

⁴⁶ See Carlgren (1973), pp. 17, 25 but in particular Ch. 3. The transition to war communism and "The Great Leap Forward" is discussed in for instance Nove (1989). The Swedish deliberations on the exchange with the Soviet Union is expressed in Hägglöf (1958), Ch. 9.

⁴⁷ Hägglöf (1958), pp. 154-166. During the 1970s the agreement was published by the Swedish Ministry for Foreign Affairs (UD). Böök (1976). However, the agreement was negotiated and concluded as one event of many. As mentioned in a note above, Carlgren's thorough study complements the official publication. Carlgren (1973).

tion of police forces and to help refugees and were given to Norway, Denmark and the Netherlands.⁴⁸

Another type of credit was used for the rebuilding of the national economies in the same countries and in Finland. These credits were granted to make it possible to import Swedish goods both before and after the acts of war had ended. The use of these credits was decided only upon the basis of each country's needs and could thus include both the purchase and storage of goods. These loans ran at an interest rate of 3.5 per cent and did not have any regulated repayment terms.⁴⁹

Sweden also granted traditional commercial credits as a part of ordinary trade agreements. These credits were constructed in different ways depending on the trading partner's ability to deliver goods. This made it also possible for countries with destroyed production output facilities to trade with Sweden. Besides these credits, also advances with special state guarantees were used. These were of the same type as had existed before the war.

Credits during 1944/45 were mostly given to Sweden's neighbouring countries, and especially to Norway, which during these two years received, or was promised, credits of 540 million SEK. During the same period, Denmark was granted credits of 230 million and Finland 150 million SEK. Finland, however, was also given priority during the earlier years of the war, and Sweden's state credits to Finland amounted to nearly 420 million SEK.⁵⁰

These state credits were often related to bilateral trade agreements and thus included special risks that hardly could be handled by commercial banks, industry or trade. The construction of bilateral agreements in the 1930s and during the war period thus forced aside commercial banking, but in a long-term perspective a reconstruction of a new, more liberal international trade was the aim of the Swedish government. The active state credit policy was only a transitory state and would be followed by an increased role for private initiatives.⁵¹

Financial relations with Germany

Despite the Swedish financial orientation towards the British market, the financial relations with Germany dominated the 1930s and the war years. There were several reasons for this. The main reason was London's finan-

⁴⁸ Hammarskjöld (1945). *Supplement till Svenska Handelsbankens Index*, November 1946.

⁴⁹ Hammarskjöld (1945).

⁵⁰ Credits to the Netherlands, Belgium, France, Italy, Poland and Czechoslovakia totalled at nearly 300 million SEK during 1944/45. See Hammarskjöld (1945).

⁵¹ Hammarskjöld (1945).

cial withdrawal during the interwar years. During the mid 1920s, the British government introduced an exchange control that regulated (more precisely banned) foreign investments. After the First World War, the international demand for British capital clearly exceeded the supply, which threatened the monetary stability. The high finance in City called this regulation a self-assumed “*embargo*”.⁵²

From the perspective of international business, an important long-term consequence of the embargo was that the British market lost in credibility. Further, eventually the difficulties to maintain the pound rate eventually deterred its credibility.⁵³

The German market appeared as a prosperous alternative to the unpredictable British market. During the 1920s, international recovery programmes were launched to bring growth and stability to the German economy. The programmes were financed by joint or private capital ventures directed towards Germany. During the 1920s, at least 259 million USD were channelled to the German market. Eventually these claims came due.

The Swedish-German financial exchange during the war was settled bilaterally. German suspensions of payments on financial claims during the Liquidity Crisis and the Great Depression were resolved in a continuous bilateral clearing exchange agreement. The bilateral agreements became one of the most common features of the interwar period. During the war the bilateral exchange clearing offered convenient forms for exchange control. The basic principle of the bilateral exchange was to fund repayments on financial liabilities with a recurrent German bilateral trade surplus.⁵⁴ In 1934 the financial claims totalled 1 billion SEK (or 259 millions USD). Compared to Germany’s total debt, this was an exceedingly small sum (in 1931 Germany foreign debt amounted to about a nominal sum of 24 billions RM). To the Swede’s, however, it was a large sum.⁵⁵ The total annual repayment to the Swedish creditors amounted to about 30 million SEK.

⁵² The end of the embargo (1925), pp. 739-740.

⁵³ Analytically this is an excellent example of increasing political risk. According to Thunell, political risks originate from either regime changes or political instability. With regard to the embargo, the problem that emerged may be analyzed in terms of a causal connection between risks, aversion to risks and unpredictable market discontinuities that followed from British policymaking. Thunell (1977), pp. 4-12. “Ottawa – en dubbelbesvikelse” (1932). Recently Kobrak and Wüstenhagen have attended to the managing of political risks in the Third Reich and attempts by German companies to protect their assets. As the war drew nearer, the strategies of the companies and the policy makers and the bureaucracy diverged. The companies adopted cloaking methods in order to reduce risks. Kobrak (2006).

⁵⁴ NA. UD. H 90 Ct, Vol. 2185. Report from the Swedish Embassy in Berlin. 1 July 1933.

⁵⁵ This sum may be compared to the active turnover volume from the Swedish-German trade which totalled at 435 millions SEK (113 millions USD) in 1934).

Table 9 below displays German repayments on Swedish financial claims in 1934, 1941 and 1944. In the main, the Swedish claims fell into two categories: government loans and private claims. These were about equally large claims (nominally). The largest single claim, though, was the Kreuger loan.⁵⁶ Technically, this was a private claim, but since it was a long-term loan with low interest rates, its terms and conditions were equal to the government loans, but since the Germans entered the 1930s highly indebted, their ability to pay was quite limited. As is shown below, this loan became a highly controversial question in German-Swedish negotiations throughout the 1930s. However, after successful negotiations from the Swedish side, the Kreuger loan eventually gained government loan status and rank. Moreover, in 1935, 1936 and in 1940 the Germans repurchased (nominally) 405 million USD Kreuger bonds to reduce liabilities for payments.

The Swedish holders considered the deal beneficial, but the Germans benefited as well: in return the Kreuger bond interest rate was reduced from 4½ to 4 per cent.⁵⁷ The other two government loans, the Dawes and the Young loan, emanated from the international economic recovery programmes of the 1920s that aimed to stabilize the German economy. During the war these three government loans amounted to 357-370 million SEK. German

Table 9. *Swedish certified government bond claims on Germany 1934, 1941 and 1944. Million SEK and USD in parenthesis. Current prices.*

		1934	1941	1944
Government loans	Dawes claim	42 (11)	39 (9)	35 (8)
	Young claim	117 (31)	107 (26)	97 (23)
	Krueger claim	399 (106)	208 (50)	210 (50)
	Austrian claims* ¹)	-	16 (4)	15 (4)
Total		558 (149)	370 (88)	357 (85)

Note *¹= Clearing item from 1938

Source: 1941: NA (National Archives – Riksarkivet), CLB (*The Clearing Board – Clearingnämndens arkiv* –) FIIb 17, vol. 488. List of old Swedish claims in Germany. 26 November 1941. 1944: RBA (Riksbankens arkiv) F5 A:48. Swedish claims in Germany the 10th of January 1944.

⁵⁶ The Kreuger loan amounted to 125 million dollars and was granted by the Swedish Match Co. (the parent company of the Kreuger Group). In exchange the company was granted a monopoly on the German match market. In January 1930, at the Haag conference when the participants in the Young plan met, the Kreuger loan was linked to the Young plan. In the opinion of the Kreuger Group, this agreement equated the Kreuger loan with the Dawes and the Young loan. NA. UD. H 90 Ct, Vol. 2183. Memo to Ministry for Foreign Affairs. 19 June 1933.

⁵⁷ Wittmann (1978), pp. 69.

government loan repayments were undertaken with without friction, in accordance with the bilateral exchange clearing agreement.

While the government loans were homogenous (long-term government bonds with a low interest rate), the private claims differed in sizes, terms and values, and more importantly, they were in the hands of various private claim holders and single intermediaries such as banks, while the government loans were held by other governments.⁵⁸ The latter were rather easily settled, while the private claims were frequently renegotiated. Even though there were various forms of private claims, they generally were short-term, high interest claims. The Germans did not recognize these claims willingly. The German shortage of cash that followed from the runs and capital flight in the wake of the Liquidity Crisis left the German monetary reserves almost depleted.⁵⁹

Since private claims generally were cashed in convertible currencies, they strained the reserves. This was clearly reflected in the German monetary policies, as well as in default of payments. During the war most private claims were stable in value. However, the total value of the private claims increased by about 50 million SEK. Bonds, stocks and shares were the largest items within the private claims category.

Besides the international financial ventures, a significant part of the Swedish export industries made large-scale direct investments in Germany. In 1937/1938 at least 104 millions SEK emanated from Swedish shares in subsidiary companies.⁶⁰ One typical example was the world's leading producer of ball bearings, *Svenska Kullagerfabriken* (SKF), which had made large investments in the 1920s in the subsidiary company *Vereinigte Kugellagerfabriken* (VKF) to expand its business in Germany. The German economic policies a decade later made the company board reconsider its activity in Germany. VKF was indeed profitable, but increased taxation, duties, state control and German nationalism cut the subsidiary company off from the parent company in Sweden. These events made the German market appear risky. It would have been rational to terminate these assets, but in the case of large stock liquidations or transfers, German law stipulated considerate interest write downs. Thus, it was more profitable to keep

⁵⁸ NA. UD (Ministry for Foreign Affairs). H 90 Ct, Vol. 2183. PM. 19 June 1933. Report from the Swedish negotiators to the Ministry for Foreign Affairs. 22 June 1933. Guillebaud (1939), pp. 24, 28-29 and 76-77.

⁵⁹ The dramatic course of events has been pedagogically described and analyzed by James (1985), Ch. 5 and Guillebaud (1939), pp. 20-23. The rapid depletion left a heavy imprint in the historical statistics as well: in 1931 the Reichsbank's reserves totalled at about 2.8 billion RM. In December 1934, though, only 7 per cent of the reserves remained. *Statistisches Jahrbuch für das Deutsche Reich 1936* (Gold und Deckungsdevisen. Reichsbank und Privatnotenbanken).

⁶⁰ Hedberg (2003), p. 112.

the shares and the influence over the subsidiary companies, than to take losses from the sales.⁶¹

Instead of terminating these assets, the Swedish holdings of stocks and shares increased (see table 10). In 1934 these holdings amounted to 135 millions SEK, to be compared with those in 1944 which totalled at 224 millions SEK. However, this was not only a result of Swedish parent companies trying to protect their subsidiary companies or the value of their assets. It was also a consequence of a German openness towards new means of payment, due to its lack of capital reserves. The stock exchange index began to fall in 1940, and in 1944 the German stock exchange had practically ceased to function. Since stock price fluctuations were prohibited, it was impossible to profit from the stock exchange. Ironically, the demand for bonds, stocks and shares, holdings et cetera increased during the war.⁶² When the stock exchange was stationary, it was better to make use of stocks and shares as means of payments than to go through the complicated German bureaucratic process to transfer money to a partner.⁶³

Table 10. *Swedish certified private claims on Germany 1941 and 1944. Million SEK and USD in parenthesis. Current prices.*

		1934	1941	1944
Private claims	Bonds	252 (67)	78 (19)	77 (18)
	Stocks and share	135 (36)	147 (35)	224 (53)
	Real estate	35 (9)	38 (9)	37 (9)
	Mortgages	15 (4)	17 (4)	17 (4)
	Bank deposits	16 (4)	13 (3)	14 (3)
	Other deposits	41 (11)	34 (8)	31 (7)
	Funding bonds*)	26 (7)	25 (6)	3 (1)
Total		520 (139)	352 (84)	403 (96)

Note *) = Funding bonds from 1936

Source: 1941: NA, CLB FIIIb 17, vol. 488. List of old Swedish claims in Germany. 26 November 1941. 1944: RBA F5 A:48. Swedish claims in Germany the 10th of January 1944.

⁶¹ Karlsson et al. (1998), pp. 9-11. Steckzén (1957), pp. 523-524. Theoretically, the German economic policies of both the Weimar regime but in particular the Nazi regime are a perfect case of political risk, that is the risks and uncertainties that emerges on a market from policymaking. See for instance Thunell (1977). For a diametrically different interpretation of the changes in price, see Frey & Kucher (2000) who derive the changes to major historical events, like the Japanese attack on Pearl Harbour, the German setback at Stalingrad etc. The causal relation, though, is somewhat vague and no particular attention is paid to German policymaking or market conditions.

⁶² "Bank- och börsrestriktioner i Tyskland" (1943). Bank for International Settlements (1943), Yields of Shares and Government Bonds, in percentage, p. 286.

⁶³ Hedberg (2003), p. 228.

Conclusions

The Swedish economy came to a turning point at the outbreak of the Second World War. In some respects the war was a watershed and an introduction to new developments, but in other respects it did not cause any long-term changes. This development has been the main question of this study.

The war economy, with its strong connections with Germany, meant an intermission in the traditionally extensive trade relations to Great Britain. However, this lasted only for a limited period, and, as in other countries, increased trade with the United States characterized the early post-war era. In this longer perspective, Sweden also broke the traditional role of being an exporter of raw materials and semi-manufactured goods and became an exporter of machinery and equipment, thus becoming an important competitor to Germany.

In its foreign trade Sweden was obviously dependent on Germany during the war. However, this dependence was mutual, meaning that Germany needed those export products Sweden could offer, especially iron ore. Sweden was, therefore, treated with care by the German bureaucracy. The Swedish trade negotiators also deliberately used their positions and the trade regulations to create a flexible system that Sweden could benefit from. Despite this, the clearing trade system was to the advantage of both Sweden and Germany.

The Swedish-German clearing arrangement was originally established through a Swedish initiative. The aim was to use the clearing situation to force Germany to settle its large debt payments to both the Swedish state and private lenders. In this respect the clearing arrangements functioned quite well, despite some conflicts between Swedish and German interests. Looking from a trade as well as a debt payments perspective, there is little evidence that Germany took advantage of its position as a great power; instead, Sweden could affect the outcome of the clearing arrangement in several ways.

Changes in the Swedish foreign trade obviously changed the role of the commercial banks. Instead of handling international transactions as in the 1920s, the clearing trade meant that an increasing part of Sweden's international financial transactions were handled by the central bank. This be-

came even more obvious during the war when the currency regulation put every international transaction under its control.

During the war, the demand for capital for investments in industry and dwellings was also reduced. Thus, lending from both commercial and savings bank stagnated, while deposits continued to increase. As a consequence, actors on the Swedish financial market increased their role as financiers of the growing Swedish national debt. In this respect the war was a period of change for Swedish banking. In the latter half of the 1940s and beginning of the 50s, the banks' role as financiers was acquiesced to investments given priority by the state, and the policy became more institutionalized. While the development during the war period was based on business necessity, that of the post-war era was built on legislation and other regulations, which forced the banks to act according to state priorities. Even though this policy was established after the war, it originated from the control policy developed during the war economy. In this respect, the Second World War really was a watershed between a more liberal tradition and a more planning-oriented regime.

It is obvious that the war brought about changes that may have been of great significance for the future Swedish economy. These changes may well indeed have marked the beginning of a transition, rather than being a consequence of the conditions of the war. Thus, the changes outlined above have not been analyzed with either the depth or breadth they require. A reasonable concluding observation must be that this essay opens up for further analyses of the wartime as well as the post-war financial market and institutional structure, as well as these markets importance to the post-war economic growth.

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