Lessons Learned: Bo Lundgren

Maryann Haggerty

Follow this and additional works at: https://elischolar.library.yale.edu/journal-of-financial-crises

Part of the Economic History Commons, Economic Policy Commons, Finance and Financial Management Commons, Policy Design, Analysis, and Evaluation Commons, Policy History, Theory, and Methods Commons, Public Administration Commons, Public Affairs Commons, Public Economics Commons, and the Public Policy Commons

Recommended Citation
Available at: https://elischolar.library.yale.edu/journal-of-financial-crises/vol6/iss2/7

This Lessons Learned is brought to you for free and open access by the Journal of Financial Crises and EliScholar – A Digital Platform for Scholarly Publishing at Yale. For more information, please contact journalfinancialcrises@yale.edu.
READERS TAKE NOTICE:
As of April 2024, the YPFS Resource Library's site domain has changed to https://elischolar.library.yale.edu/ypfs-financial-crisis-resource-library/.

Please be aware that upon clicking any of the URL references to the former Resource Library domains, either https://ypfs.som.yale.edu or https://ypfsresourcelibrary.blob.core.windows.net/, in the "References/Key Program Documents" section of a case study, readers will encounter a "page not found" error.

Readers can still retrieve a given resource cited within this case study on the new site by searching here for the title cited.
Bo Lundgren was Sweden’s cabinet minister for fiscal and financial affairs from 1991 to 1994, making him a key leader in managing the nation’s severe financial crisis during those years. Lundgren had a decades-long political career as a member of the Swedish Parliament from 1975 to 2004, was leader of the Moderate Party (1999–2003), and vice president of the European People’s Party in the European Union. He also served from 2004 to 2013 as director general of the Swedish National Debt Office, the country’s central financial agency. Drawing on his experiences in the Swedish crisis, Lundgren has shared his views with US and Irish government panels examining the 2007–09 Global Financial Crisis and the European debt crisis that followed. He has also written a book about the Swedish crisis. This summary is based on a Lessons Learned interview held in May 2022; the full transcript may be found here.

Trying to understand the parameters of the crisis will be very useful in shaping the appropriate response. Looking to past crises can help.

The extent of the banking problem wasn’t clear when Lundgren’s Moderate Party took the helm of the government as the lead in a four-party coalition in 1991. “You don’t always understand when you are in the face of it where you had a bubble and it’s bursting,” he said. “When we took office in October 1991, it was very difficult to see to what extent we had problems.”

The extent of the situation soon became clearer. One large, troubled bank, Nordbanken, was already 80% government owned. Första SparBanken (or First Savings Bank), the nation’s seventh-largest bank, was also facing losses. Sweden had no deposit insurance at the time, and banks, including Första SparBanken, had a lot of foreign funding, Lundgren recalled. The government handled the two banks on an ad hoc basis but soon realized a bigger problem might be afoot that would require more government intervention. He explained:

So we started to try to learn from crises that had occurred before, from the savings and loan crisis in the US and also from the crisis in the ’30s, to try to see, how does a financial crisis play out? What will happen in the economy? And we understood after a couple of months that this would be a huge crisis, and we would have to sooner or later apply a huge package.

But we started, in the first half of 1992, we handled the banks case by case. Both Nordbanken, which was somewhat easier, since we owned the bank, and then the First Savings Bank, were handled separately. And then we started to have more banks hit, and there was lot of uncertainty in the Swedish macroeconomic situation. But still, we managed until September 1992, when we were forced to make a huge comprehensive package to address the situation.
In the midst of a crisis, the most important thing is to do what it takes to restore confidence in the banks and financial system.

In the spring of 1992, Lundgren was part of the government group—along with the central bank, and in consultation with leaders of other political parties—that began to pull together the bank rescue package. By then, he said, “we understood that all banks would be hit one way or the other.” That would lead to a loss of confidence in the financial system. “You lose confidence,” he said, “then the really bad things do happen.”

By late September 1992, spreads in financial markets were very wide, Lundgren said. It was obvious participants didn’t trust bond markets. The rescue package he and others had been working on called for guarantees for all bank creditors and depositors, but not for shareholders or holders of perpetual bonds. The government would provide capital, and in return take a corresponding stake in the bank. Bank boards would be ousted and leadership overhauled.

The package was necessary to restore confidence in the system, Lundgren said:

The most important thing to do is to try to get confidence back. You have to have the central bank in the country that is hit by this take corrective action. You have to have the central bank going out with liquidity, so the liquidity doesn’t dry out in the markets. That’s what you need to do. But you also have to have from the political side, from government, you have to have measures that increase confidence. For us, it was the blanket guarantee.

Interventions create great expectations and panic can occur when these expectations are not adhered to or when policymakers change course.

For Lundgren, concrete moves to support confidence are key to stabilizing a crisis. And that’s a lesson he thinks applies across time and different crises: “Sometime in the development of the crisis, there is probably shaky confidence. . . . You have to do it, and at least then you can manage the situation.” When authorities don’t act, he cautioned, the results can be catastrophic:

For instance, if I get to the modern times, when [US Treasury Secretary] Hank Paulson let Lehman fall without anything to handle the situation, that created a huge uncertainty in the world economy. Not only in the US economy. The world trade lost, and they could see in Sweden—Volvo . . . lost almost 90% of their orders, just as a result of the uncertainty and the fright that spread across the world. Because if you have solved, like we did, the First Savings Bank and also Nordbanken, and we had some problems with a bank called Gota Bank, if you have these problems and you solve them, people get the implicit understanding that you are going to handle the situation. And you had the same expectation with Bear Stearns and so on, that was handled by the Fed [Federal Reserve Bank]. . . .
As long as the individual problems were solved by the Fed taking over, or government going in one way or the other, as long as you had that situation, then there was no problem in the economy, not a huge problem. But then suddenly Lehman Brothers.

Lundgren recalled that the impact of Lehman in Sweden compelled the government to act swiftly to restore confidence and support its markets:

And we felt it in Sweden three days after that. In our markets, nobody wanted to buy housing bonds in Sweden. So [the government] had to go in. Everyone wanted government paper. We had to issue extra T-bills, and then we used the money we got from the extra T-bills to buy housing bonds in order to keep that market going as well.

**Being hard on banks that cause their own problems and require government support not only protects the taxpayers but also addresses moral hazard.**

The Swedish government required an ownership stake in banks that received capital, Lundgren pointed out, along with other measures that bankers saw as heavy-handed. Some stakes were reflective of significant support. Lundgren believes that such measures are necessary to protect taxpayers, manage moral hazard, and handle the risk of the behavior being repeated:

You had to be tough on banks. First of all, when we gave support in one way or another to a bank, we had to kick the board from their positions. You have to change leadership within the bank. You have to show that you are serious. And also, we formed the package so that we could regain as much as possible of the outlay we made in order to handle the bank situation. So if you go to 1996, when the guarantee was lifted after a new Parliament decision, soon after that, we got back all the money that we had invested in the banks. They even had to pay the consultant fees that we had.

So, by being tough on the banks, straightforward and tough, changing their leadership and telling the management, as a representative of the people, that if someone has made themselves and the country problems, they had to go. That was a thing.

It helps also when it comes to the moral hazard question as well. Because obviously if a banker knows that the government is going to come in and help you, then they can take more risks than you otherwise would’ve done. But in Sweden, if you took more risks, you could really lose everything.

In this respect, Lundgren disagreed with the US response in 2009. He would have recommended that the government take more control over companies that received large investments. But he remembered President Barack Obama distinguishing the Swedish solution—“Well, the Swedish way of nationalizing the banks, that’s not for us Americans”—and acknowledged that every country is different.

Still, Lundgren doesn’t believe that the government needs to nationalize companies in all situations, and he advised the government not to take equity in designing the response to
the COVID-19 pandemic, when businesses across Sweden received extensive government aid, as in other nations. He explained:

They asked me what to do. They said, “If the Swedish corporations have problems now, since they couldn’t sell as much as beforehand, and you lose markets and so on. If government goes in and helps the companies, should we get part ownership in the companies?”

And I said, “No, no, no. It’s one thing when some banks mismanaged themselves and need government support, then you could say that. But if 200,000 medium- or small-sized companies need help in Sweden for a short period, that’s a crisis, it’s a Swedish crisis. Then you shouldn’t have any ownership and you cannot manage the ownership anyway.”

**Austerity measures can create more problems than they solve and should not always be the automatic solution for fiscal policy.**

Often, when a nation faces a financial system crisis, the response is fiscal austerity, especially cutting government expenditures. This is the solution international authorities have pushed on a number of governments over the years—for instance, in the Latin American debt crisis of the 1980s and the eurozone debt crisis of the 2010s. In Lundgren’s view, this is not always the right answer.

During the Swedish crisis, the governor of the central bank was concerned about the budget deficit. His suggestion was to “save, save, save. We have to have more austerity, more austerity,” Lundgren recalled. Lundgren, who was then finance minister, disagreed:

But as I said, we had a cost problem. And we had a situation where the public, the household sector, was starting to pay off their loans from the ’80s, when we had a negative savings ratio. And it is obvious, that if you have an increase, a huge increase in the private savings ratio, then you have a downturn and a decrease in the public savings ratio. So you have a deficit. And if you go in too hard with austerity measures early in that process, you only add to the problem.

So, I was very critical of when they forced, for instance, Spain, to take very huge austerity measures [during the eurozone debt crisis]. Spain had some problems that were very similar to the ones we had in the beginning of the ’90s. And I criticized my former aide, who was minister of finance, Anders Borg, for supporting the European Union stance and the German stance on this—that if you have a deficit, you have to close it by austerity.

The only way that we solved that problem in Sweden was through increased growth, to make growth incentives better in the economy. Because when you look back, when we closed our budget deficit, it was mainly due to growth. It was not mainly due to the austerity measures. And we have a very good budget situation now.
Dated: July 2024

YPFS Lessons Learned No: 2022-08