YPFS Lessons Learned Oral History Project: An Interview with Bo Lundgren

Bo Lundgren
Maryann Haggerty

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Lessons Learned Oral History Project Interview

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Introduction:

The Yale Program on Financial Stability (YPFS) interviewed Bo Lundgren regarding his tenure as Sweden’s cabinet minister for fiscal and financial affairs from 1991–94, making him a key leader in managing the nation’s severe financial crisis during those years.² Banking deregulation in the mid-1980s fueled commercial and residential real estate bubbles. The bubbles popped beginning in 1990; the nation’s biggest banks took big losses; and the economy overall faltered. In 1991, the government provided support to two of the troubled banks, but by 1992, troubles were worsening, and a systemic crisis was apparent. Numerous measures were taken to stabilize the system. They are generally regarded as successful. 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. He has also written a book about the Swedish crisis.

Lundgren has had a decades-long political career. He was a member of the Swedish Parliament from 1975 to 2004. For several years he was economic spokesman for the Moderate Party. He was the party’s leader 1999-2003. Between 2002 and 2004 he was vice president of the European Peoples Party in the European Union. He served from 2004–13 as director general of the Swedish National Debt Office, the country’s central financial agency. Currently he serves on several private and public boards.

This transcript of a Zoom interview has been edited for accuracy and clarity.

Transcript

YPFS: Today we’re going to run through some of the measures Sweden took in confronting its financial crisis, discuss lessons those measures can teach,

¹The opinions expressed during this interview are those of Mr. Lundgren and not those of the institutions with which he is or was affiliated.
²A stylized summary of the key observations and insights gleaned from this interview with Mr. Lundgren is available here in the Yale Program on Financial Stability's Journal of Financial Crises.
especially lessons that can help others in the public sphere as they think about, prepare for, or confront other financial system crises.

Thanks so much for taking part in this interview. We're going to be repeating some things you have said in the past, but I'm hoping we can concentrate here on lessons learned that might be useful to those in the future. So, let's dive right in.

Just start by describing the financial system situation in Sweden, leading up to that crisis. I know we're going back to a lot of years, but this is something that you have talked rather extensively about.

Lundgren: During the '70s, Sweden had a very bad economic development. The Social Democratic government that took office in 1982 wanted to solve all problems by a huge devaluation of the Swedish currency, 16% against other currencies. Which meant, of course, that if you don't take care doing such a devaluation, you have the cost advantage directly, but you also have the risk of inflation when you have all imported goods going up in price and so on.

What we got was of course, a good situation for industry, but we got overheating in the economy, wages and salaries went up. During this inflationary pressure we had, during all the '80s, the central bank decided to abolish a lot of the credit regulation we had. Which meant that before the deregulation, banks could only increase their outstanding loan portfolio by 2%. After deregulation, they were free to do whatever, but they had no experience of a nonregulated environment. So, what happened after this so-called November Revolution in 1985 was that you started to get households borrowing a lot of money because interest was also deductible at the rate of 50%. So, you didn't feel the cost of the interest you had to pay on loans. Households took loans on their houses to buy new kitchens, to buy a new car, buy a boat or whatever.

And you also have the people that are speculating, starting to buy real estate, houses and commercial real estate. We got into what is a very, very good example of a real estate bubble. And of course, every bubble always bursts sooner or later. And this happened in Sweden in 1990. It started with some financial corporations outside of the real banking system and then it spread. People in the household sector started to save, to repay because the deductibility of interest went down. You could only deduct to a value of 30% from 1991 and onwards. And people started saving to be able to manage their situation. From a deficit in private savings until 1991, you had a very fast shift in the household sector to a positive savings ratio; 20% of GDP was the shift. Which meant, of course, that you had a huge fall in public revenue, because if you don't consume, you don't get the VAT. If you don't work, you don't get the payroll tax etc., etc.
That's one part of the crisis we had. The other part was the speculators. Because obviously when they cannot borrow anymore, when they have to repay the levels they borrowed, they cannot do it. Then you get real estates that are overvalued, they're going down in value. So, we had commercial real estate going down in the big cities by 50%. And as the bubble burst, the banks got a lot of losses. One of the banks, the most hit rather large bank, lost 37% of its loan portfolio, 37%. On average, it was almost one-fifth, dependent on which bank it was. So, it was really a bad situation. But you don't always understand when you are in the face of it where you had a bubble and it's bursting. When we took office in October 1991, it was very difficult to see to what extent we had problems.

We knew that one bank that was 80% government owned, Nordbanken, had problems. And then we had a lot and still have a lot of savings banks. My first problem was with what is translated into English as the First Savings Bank, Första SparBanken in Sweden.

It was the seventh-largest bank in Sweden at that time, but still rather small, if you compare it to Nordbanken and SEB, Swedbank and others that still function. So, at first, we didn't know how huge the crisis would be, but we knew that we had a situation with no deposit insurance, we had a lot of foreign funding in the Swedish banks, not least in this First Savings Bank, Första SparBanken. So, after analyzing the situation, we found that we couldn't let the First Savings Bank go bankrupt, with losses for creditors. Because that would, of course, create a loss of confidence in the Swedish public, but also in the foreign financiers we had at that time.

So, we had to make a deal, which we did. We made some guarantees and since several banks were starting to form a huge savings bank, the First Savings Bank was put in there with some government guarantees. And that was the only bank we lost some money on in the long run during the crisis.

Then after that we had Nordbanken, and we saw that the credit losses increased over time. 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 a 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. Long answer, but still.
YPFS: No, no, you took us through. There are points that you brought up I would like to let you expand on. One is you said you looked at some of the lessons from past crises, what did you look at? How did you think through those challenges? What was useful from the past? What could be useful to others going forward from your experience?

Lundgren: I was myself particularly interested in the banking crisis in the US in the early 1930s. And when [President Herbert] Hoover didn't really understand how to solve the problem, which was interesting in a way, because it was ultimately solved in the US from a proposal by Ogden Mills, who was the Secretary of the Treasury to Hoover. It was his proposal that [President Franklin D.] Roosevelt later used. They closed down all banks in the US for a week, and then reopened the ones that they could go through and see that they were sound, and people could trust the banks. That was one way of solving it. This is of course more difficult to do in a more sophisticated economy, as both the US and Sweden were in the 1990s. So, we couldn't do that. But when we started to handle the situation more comprehensively, we used the classification of banks that Ogden Mills proposed to Roosevelt in 1933, where we classified the banks into three classes. So, everything comes back, you could say.

But what happened in Sweden then was that we understood that we just were in the beginning of a crisis. We saw credit losses increasing, we could see people started to save more and more because of the uncertainty. We got a huge deficit in public finances. We had a situation where the banks would need some kind of support. And, as I said, we had no deposit insurance. We had to play it by ear in this case. And Urban Backstrom—who was my assistant minister, my second man, before Stefan Ingves [Backstrom would become governor of the central bank in 1994]—Urban, myself, and Stefan [undersecretary and head of the financial markets department at the Ministry of Finance], we tried to learn as much as possible. In the spring of 1992, we started to prepare a package. Because by that time we understood that all banks would be hit one way or the other. Some more and some perhaps less. But if we lost confidence in the market—and that's what happens in a financial crisis, you lose confidence—then the really bad things do happen.

For instance, if I get to the modern times, when [US Treasury Secretary] Hank Paulson let Lehman fall without anything to handle the situation, which 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, they 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.

But then when you come to a situation where trust leaves the market, then you have to take real action. In the end of September, we had the spreads in the financial markets go very wide. And we saw that people didn’t trust the bond market at all. So, we needed to do something. And we had prepared since May of that year, 1992, we had prepared a package which started out with a guarantee for all creditors to the Swedish banks. Not to the shareholders and not perpetuals. It is the shareholders who should always pay first—that’s a necessity. And then the government could go in.

And we were very clear that if we had to help a bank, not only by a guarantee, but to go in with capital, we would have the same stake in the company as the amount of capital we put into the bank, which was a rather tough package. We also discussed whether we should have a limit on the guarantee, but we decided that you cannot have a limit. If we had set a limit for Sweden, it would’ve been say, a hundred billion Swedish crowns, and we needed to go back to Parliament and say, "You have to give us another 20, another 30." Then you get more uncertainty. So, we decided that you have to have a non-specified amount. You have to have Parliament give you the right to do as much as you need to do to handle the situation.

YPFS: How do you build political consensus for such a dramatic package?

Lundgren: First of all, our government was four parties in coalition, and we worked quite well together. We had one populist party, which was two guys, one was in the record business. And one who was a businessman, quite good businessman as well. They were like Laurel and Hardy or something like that together; one was tall, and one was short. Well, anyway, they tried to be the real populist party. They gave us a problem because with them, we had a majority. We couldn't trust a majority that really was on the foundation of having them to vote with us. So, we needed the Social Democratic opposition. They were the biggest party at that time, still are. Even if they’re much smaller now.

From the First Savings Bank problem and from Nordbanken problems, already when we took office in October '91, I regularly informed the Social Democrats and their economic spokesman at that time, Allan Larsson. I informed him what was happening, and I asked for support. And of course, Alan is a Social Democrat but he's also an honorable man, so he understood that they had responsibility for what had happened beforehand and led us into the financial crisis. If they could accept the solutions we put forward, they felt that they had to support us. So, when we presented the way, we saved First Savings, by putting them into the larger savings bank corporation, which today is Swedbank, they accepted that. And of course, they were the ones who had run
Nordbanken when it got all the problems and made the bad loans, so they had a responsibility, they felt.

But it was very vital for me to have this personal contact with Alan, and we are still friends by the way. And when he worked at the European Commission, he helped bring to my hometown, the university town in Sweden of Lund, the European Spallation Source (ESS), a multi-disciplinary research facility which is one of the best in the world. But in a small country, we know each other, even if we are different parties. So, they understood, and we had the Social Democrats with us all the time. And the night before we issued the package with the comprehensive guarantee, we had a meeting with Alan and his aides as well and went through all the package so they could accept it as well.

YPFS: And how about the broader public?

Lundgren: They hated banks, of course. It’s very easy to hate banks. And you have had the same experience several times in the US. 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 the end, 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 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.

I remember Peter Wallenberg. Are you familiar with the Wallenberg family? They are quite big in Swedish industry and have been over the years as well. Peter Wallenberg, who was the master of the Wallenberg family, he was also the master of SEB, the biggest business bank in Sweden. Which was their crown jewel, so to say. I met him in, I think it was in 1992 in the autumn. And he asked me,"Do you really want to nationalize SEB?"

I replied, "If you need government money, if the bank had been run in a way that you need government money to survive, then of course, yes, we would do that. But that’s a rescue operation. That’s not nationalized for its own sake."
This helped in a way, because they managed to find foreign and domestic investors so that they didn't need money from the government. But they wanted soft money from the beginning. But since we didn't give them soft money, they tried to solve it on their own and they did really. A couple of other banks did also. If I would’ve been Hank Paulson, I would have a nationalized Citigroup.

YPFS: How do you make that decision? I'm trying to think about, what would have happened if they nationalized Citi? We're talking now about how you assess individual institutions.

Lundgren: Citibank, if it had been treated like other Swedish banks, when they needed money, and the government needed to give them money, to inject capital, then of course the government should have the same influence. That's why we said— for every Swedish krona we put into a bank, we want the same influence and the same stake in the bank. And if that means the majority, so be it. What they did, talking about moral hazard... If you go in and let, for instance, Citigroup and other banks have capital injections without taking influence... I was sitting for a CNBC interview in Washington when I heard about the [TARP]³ program and I was really amazed when it was approved by Congress later on because that you should buy toxic assets from the banks, that's a really crazy idea. The Irish did that as well. If you buy toxic assets, if you have a balance sheet, you cannot buy it at full value. Okay? So, if you buy it at say 70% or 60%, there's still a hole.

The only way of handling the situation, if there is a problem with capital in the banks, is that you have to inject capital. And if you inject government capital, which is the people's capital (obviously I wouldn't do that if it's not necessary), but on the other hand, if you do it, then obviously you should have what belongs to you. So that's why in the US, in the handling of the banking crisis, by [New York Federal Reserve Bank President Timothy] Geithner and Hank Paulson, they left out that part, which is actually necessary in the long run to let banks understand that the moral hazard problem is there not to use, but to be afraid of really.

YPFS: At least they eventually did not buy the toxic assets, even if that was the original pitch.

Lundgren: I remember that, in February 2009 it must have been, Obama was on one of the programs in the US. We saw it here in Sweden as well, saying, "Well, the

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³ The Troubled Assets Relief Program [TARP] was a $700 billion rescue package passed by Congress that became law on October 3, 2008, which originally proposed to buy toxic assets (mostly real estate-related) from troubled banks and financial institutions. The Treasury Department later changed direction to inject capital into troubled banks and financial institutions, amongst uses.
Swedish way of nationalizing the banks, that's not for us Americans." Well, anyway. We differ that way.

YPFS: Now, still in Sweden here, let's look at some of your strategies with the individual banks when you went into the proposal, so you calculated the loan losses, nonperforming loans. Can you talk about how you assess the strategies for supporting individual banks when you came to calculating the loan losses and the nonperforming loans? That is current value, vs. writing losses off gradually, etc.

Lundgren: We used current value, because if you want to have credibility of your valuation of the situation of the banks, both for the public, but especially for the financial markets, you have to accept that the market value you have at the present time is the one that you should use when you do the valuation of the loans and also what's the size of the losses later on.

I had a discussion with my colleague in the ministry of finance who was responsible for the budget, because obviously she felt, "Is that necessary?" Because doing that meant that the holes in the balance sheets of the banks were larger than if we had tried to project a future value. But on the other hand, who knows what the future value should be? I firmly believe what we did was saying that "We are using the value that you have on the collateral for the loans as it is today, and we have no discussion what would happen sooner or later." Which of course, since we did that valuation, we got the money back more quickly, because obviously the real estate prices went up. Not very quickly, but in a few years, we had a better situation. So, it made it easier for the banks to repay the loans they had.

YPFS: Let's talk about control of your currency. Obviously, you were in a non-euro environment at that time and now. As opposed to when the next round of crises come up with European currency: Greece was not able to devalue, even though they debated it. Can you just talk a little about one national currency versus currency union and how that affected your thinking?

Lundgren: We didn't devalue. Sweden had a history during the '70s after the oil crisis which the then government tried to handle by fiscal support that made us lose competitiveness over the years in the '70s. We had several devaluations. And these devaluations made both my party and the Social Democratic Party, finally, in the end of the 1980s, understand that we cannot do any more active devaluations. So, in our government, we had the support of the Social Democrats to try to save the fixed exchange rate at almost any cost, in order to show the world that we didn't want to use the devaluation tool to solve a crisis once again.
But when the market forces are too extreme, it's very difficult to do. So, in November 1992, we had to let the currency go and some call it a floating currency. We had a sinking currency, to be honest.

Together with the Social Democrats, we made several packages, besides the package that was the bank guarantee and so on, what came with that. Besides that, we had two agreements on budget measures. What I proposed myself together with Urban Backstrom, my vice minister, in April in '92, since we had a cost problem. Besides the problem of the financial bubble, there was the real estate bubble. Besides that, we also had a cost crisis since they hadn't managed the situation after that huge devaluation in 1982. So, we had probably 15% disadvantage cost-wise when it came to competitiveness with other nations, in Europe mainly.

So, in the first package the government made by itself, I would've liked to have lowering ... what you call an internal devaluation. Which is lowering the payroll taxes and financing that at least partly with perhaps increasing indirect taxes like the VAT and so on. Because then you increase tax on consumption but you lower labor costs. You could say when we made the package with the Social Democrats, in September before we made this bank support package, in the second of these packages we had ... and that eased the pressure on the Swedish currency for a while at least. Then we had a small 5% reduction in payroll taxes and with other taxes that financed it, so to say. So, I think one of the mistakes we made was really not to try to handle the cost crisis as well, because that was what made George Soros and others speculate on the Swedish currency. It wasn't stable. So, finally they succeeded in that part.

Also, there was another ... we had a problem and that was that the then-governor of the central bank, Bengt Dennis. He always said, "I just want to put them to ease. I'm not going to. Okay." He said that what we had was ... since the budget deficit rose and rose, his suggestion was we had to save, save, save. We have to more austerity, more austerity. 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.

So, you have to be very careful when you have to apply them [austerity measures], but you can apply them with a time lag. We decided, for instance, on cutting the ... we had subsidies for building houses, rental houses. Very huge subsidies that were not feasible in the long run. So, what we did was we had a five-year period when we [implemented] them part by part, so not everything at once. I'm very much against, when you come to a crisis like the one, they had in Europe and the one that we had in Sweden, that you go in too tough with the austerity measures. I think Geithner was better in that respect when it comes to the latest US crisis.

YPFS: Can you talk about any longer-term changes that may have resulted from the crisis and the actions taken to confront fiscal tax policy and regulatory policy?

Lundgren: When we were in government, I was also responsible for taxes. We did some tax reforms that meant that the double taxation on the retained earnings and dividends was abolished. It was reintroduced some years later by our successors. But on the other hand, you could say that the measures we took regarding taxes and some other things when it comes to industrial policy and so on, before we went into the crisis in 1990, there was almost two thirds of people in the business sector said we had a bad business climate. That was in 1990. Two thirds said we had a bad business climate. And then we hadn't come into the crisis. In 1993, when we had governed for two years and handled the crisis, which is a difficult thing to do because people tend to think that, "Well, we should have someone who has more luck with economy than these ones have."

But anyway, in 1993, two thirds of the people in business, in the midst of the crisis, said that conditions for business were improved and were working. We had good conditions in Sweden for business. So, I would say that some of the measures we took helped get growth going again in the economy. Some tax measures and some other measures as well. For instance, we had a state-owned telecom company, but we privatized the telecommunications sector in Sweden, which has been very successful over the years since then. And we also opened up for other companies in that sector. Which meant that Sweden has been over the years, with Ericsson and others, very successful when it comes to telecom altogether. And also, with respect to IT companies.

So, we did deregulate, we did lower taxes, and we did create a better business environment. But also, during this time, we decided with the Social Democrats
on a budget reform. Because we still had the deficit problems with entitlements that go up with prices and so on. You have the same situation in the US, I think. We decided that we should have no entitlements. We should have only benefits, that, for instance, if you have some benefit that's 100, it will be 100 until Parliament decides otherwise. So, you have to have a positive decision to increase it and not an indexed benefit. That was one of the changes.

We also decided that the budget the government proposes has to be very longsighted, and we also changed the way the budget is passed in Parliament. Because in the Parliament, there is a risk that a lot of different interests add together, as they do in your budget process as well. And you get a more expensive decision as a result of that. We put the framework first, and then you cannot add on anything that's costly if you don’t take something else out of the budget. Because you have a ceiling. You cannot go over that ceiling. So, we did a budget reform.

We also had a pension reform. We had an unsustainable pension situation in Sweden that had to be changed. And that was also something that we had a consensus over with the Social Democrats. So today it’s a black box. Everyone who works in Sweden, the employer pays 18.5% of the salary or wages into the public pension system. And what comes out in pension is what's in the box, so to speak. The pensions do not increase automatically, the public pensions. There are private pensions, but that’s another thing. Today we have a very, very robust public pension system, which means that we have acceptance for increasing pension ages. The normal pension age in Sweden was 65 years.

**YPFS:** 65 years.

**Lundgren:** So now it’s 67 and is going on up to 69, hopefully in a year or so, to have a full pension. People understand that, and they also understand that the more people work, the more money gets into the pension system, and the more money comes out of the pension system. Today, there is a debate on that. Because it’s tempting for every politician to try to give promises of increased pensions.

So, we did some reforms that help the public finances and today I think our debt is 35-37% of GDP or something like that.

**YPFS:** Are there banking or financial system regulatory changes stemming from your crisis?

**Lundgren:** The banking system in Sweden is sound. We had some problems in 2008-2009. Some of the Swedish banks were exposed to the Baltics. And the Baltics had huge problems as you know, Latvia and Estonia and so on. I was running my second banking crisis, since I was head of the debt office, which is also responsible for bank resolution in Sweden. I had to follow that all the time. But I can say that we had one bank, Swedbank, that had a credibility problem. Not
a solvency problem, but they had a credibility problem for different reasons. But all the banks have managed to get out of the problems they had, and we have a very strong banking system today, if that's the question.

YPFS: Can you capsulize the lessons from that crisis, things you wish you had known, and that perhaps you would like other people to know.

Lundgren: Lessons from the crisis in the beginning of the '90s? Well, I think I put it down on paper, as you know, when I went to the US Congressional Oversight Panel in 2009, I think it was. I always used to say, when I speak about this, the best way to handle a banking crisis is trying to avoid it by having macroprudential policies and so on. But if you have a crisis, most financial crises have the same origins in a way. Assets that have been appreciated beyond the long-term values. Sometimes it’s commercial real estate. Sometimes, like in the US crisis, it’s subprime loans and you have the housing situation and so on. But when you come into that kind of crisis, what happens sooner or later is that you have credibility problems. People start to lose confidence.

And 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.

There might be other things. Obviously, the Roosevelt-Ogden Mills solution in 1933, by closing all the banks, and then only reopen the ones that were found to be solid. Obviously, that increases confidence because it was guaranteed by Roosevelt that, "These banks, you can put your money in they are safe. No problem for you." It’s a very difficult thing to do it in the modern economy.

But I think these kinds of guarantees are necessary one way or another. And you can see that from the US situation in 2008 that 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 and...

I was in New York the Wednesday before that weekend and spoke about this. And I met the public relations officer of Lehman who was rather pale, I would say, at the luncheon we had.

But I never thought... When I came back to Sweden and understood that they had let Lehman go without any safety net whatsoever—then I was really

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astonished. And we felt it in Sweden three days after that. In our markets, nobody wanted to buy housing bonds in Sweden. So, we 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. The mistakes were made by Hank Paulson at that time were obviously something that also hit Sweden, Britain and others. And Britain had their own problems with Northern Rock and so on as well. Sometime in the development of the crisis, there is probably shaky confidence. And then [the government has] to go in. You have to do it, and at least then you can manage the situation.

YPFS: You had jumped ahead of me a little. I was going to ask you lessons from the Swedish perspective on the 2007–09 crisis, but you sort of got there. So, similarly, were there lessons from the Swedish experience in ’90s and in the global financial crisis that should have been relevant to the European debt crisis in ’09-’10?

Lundgren: I had a lot of contact with people from London because they had obviously a banking crisis that was rather huge. One piece of advice, since we are partners, you could say, with the Conservative Party, was that I tried to get them to understand, that even if they were not in the government, they should try to make a consensus handling of the situation in Britain. And sooner or later, not because of me, but they understood themselves that they had to do something to be seen as working together to some extent at least, they managed that situation rather well, even if there were some problems from the beginning.

My main criticism when it comes to the handling of the crisis, is what’s happened, as I said earlier, with the austerity measures. It was too harsh on Spain and perhaps on Italy as well. Greece is a chapter of its own. I was even asked to be an advisor to Greece in 2010, and I said, ”No, thank you. It’s too difficult to do that.” Because they should never have been allowed to go into the euro community, obviously.

The lesson everyone learned of course, was if you have a common currency, then you have to have a fiscal policy that’s working in order to handle the situation. If you have an overheated economy, and you let go on the financial policy, then the fiscal policy, that’s disastrous, as we’ve seen in Spain and also mainly Greece.

But the only thing that could be handled at that time was, if you have a situation like in Spain, which is my main example here, if they have a situation where they had a real estate bubble, they also had a situation where people started borrowing because they had inflation that was very high and not competitive with their being part of the euro community.
When you come to the situation where everything goes bust, then you have to be careful. Because as I said, if you do austerity very harsh in the beginning, it only drags you down even deeper. Because when the household sector starts repaying their owed debt, and they also see that their benefits in social programs are getting down, et cetera, they are even more afraid, and they start saving even more. So, you have to handle the situation, very, very cautiously. You have to be very careful in the way you apply the austerity measures and do it over a prolonged time, rather than do it very quickly.

YPFS: Let’s move further along in time, closer to today. You’re no longer in government. How’s the Swedish economy faring in the wake of the pandemic and the related crisis?

Lundgren: It worked quite well, you could say. I was to some extent a consultant to the ministry of finance, because 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." So that helped to some extent that even Stefan Ingves, the governor of the central bank, said the same thing to them.

What happened was that we had a good budget situation, when suddenly the economy went down. As a company, you could apply for support to keep people employed, but not working for a while. We have a system that we call PEM. It’s a system in our labor law where you can do that. But normally you have to take the cost yourself. But this time, the government went in with huge support so the companies could keep the labor force and they had lower income. They still were able to consume. It did cost a lot to the Swedish GDP. I think that they used, say, 6% of GDP or something like that in public expenditure to help companies and individuals during the crisis to keep up consumption and to keep the companies' workforces available for them as well. And when [COVID subsided], they could start up right away.

That happened also in 2009 in the Swedish economy, because then one of the labor unions accepted that kind of solution, that their employees could work three days instead of five days. And they accepted that a somewhat lower payroll. And then they got subsidies for that as well. So, we tried that at a smaller scale in 2009, but now it was on a huge scale for a couple of years. Small companies that had problems paying taxes, because the markets disappeared, they got credit and didn't have to pay the VAT until later. So, I
think we managed, economically speaking, the pandemic quite well. We have
a very huge growth capacity in the Swedish economy, both industry and the
service sector, so it's hardly noticeable. As I said, 6%, 7% of GDP in extra
expenditure. And still we have the same public debt now that we had before
the pandemic.

YPFS: I want you to talk a little more about the differences in thinking about a
crisis that comes from the financial sector, as opposed to one that is the
response to outside shock, such as COVID, such as the war in Ukraine.
How do policymakers think differently?

Lundgren: First of all, if a bank has made bad decisions themselves, which threatens the
financial market and the economy in Sweden, then of course government has
to do something about it, but the one who makes the mistakes has to pay. But
if you have a pandemic, if it's like Trump says it's a China virus or whatever,
well, it's difficult to say that someone is responsible, they should pay
everything globally, obviously. So, then that's a catastrophe like nuclear. Well,
not nuclear because that's like Fukushima, there was someone responsible for
that. But still, like also Ukraine. It's difficult to get Putin to pay for what's
happening to the European economy per se. Then the government has to do it,
like an ordinary catastrophe.

YPFS: As we wrap up, I'd like to ask, would you like to add anything on topics
we have not touched on, particularly, if there were lessons that you
would like to pass along? That you learned, so others don't have to?

Lundgren: No, I don't think so. My conclusion is in the document that you got also from
[the US Congressional Oversight Panel] as are the conclusions I draw from the
years in government during the '90s. As I said, to a large extent, it's a question
of confidence, and to choose the right tools.

I remember also when I was in Ireland, the then minister of finance in Ireland
was a bit angry at me because when I was questioned by the Parliament
committee, I said that I don't like the idea of buying toxic assets, which they
were doing as well. And as I said, I think it was Neel Kashkari, who outlined
the new package from the beginning, before it became capital injections. And
he said, "We're going to buy toxic assets." And I was very amazed.

What you have to understand is, as a politician, confidence is everything. But
you also you shouldn't be afraid to be very hard. My party used to be affiliated
in a way with the Republican Party. I even was invited to dinner with the last
Bush administration in the White House. So, we are pro-business; but pro-
business doesn't mean that we accept everything businesses do. That's why I
could say to Peter Wallenberg when he asked me, "Would you really
nationalize SEB the bank?" "No, but if I have to, well, then so be it."
And that's what I felt with Hank Paulson, and to some extent, Obama when he said this, "That's the Swedish way of doing it." Perhaps, but you have to be hard because that's how you handle the risk of seeing the same thing repeated once again. If you don't really feel something, it's not the same. All the board members of the banks that we had to dismiss from their positions, obviously they understand that something happened that they shouldn't have done.