

Banking in Sweden (*)

Judged by the size of her population which just exceeds 7 million Sweden is a small country. But her economic influence in Europe and the rest of the world is far greater than this figure would imply. Since 1850 she has undergone an extensive process of industrialisation and development which has raised her standard of living to a level exceeded only by that of the United States. She has not only exploited her natural resources of wood, pulp and iron but has developed the production of a wide range of manufactured goods. Her foreign trade is extensive and she is an important customer of the United Kingdom, Western Germany and the United States. Since most of her economic expansion has been financed internally, it follows that she must have developed an organised monetary and financial system for the mobilisation of savings and their transmission to industrial borrowers.

It is the object of this paper to review this system. Such a review by an English observer may be of special interest because in recent years Swedish monetary institutions, like their English counterparts, have been forced to adapt themselves to an environment which has been increasingly influenced by the growth of the public sector and the extent of governmental intervention.

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At the apex of the system is the Riksbank, the central bank, which is actually the oldest bank of its kind in the world. It was founded in 1657 and endowed with note-issuing powers. In its early years it engaged mainly in ordinary banking business and did not finally emerge as a fully-fledged central bank until 1897.

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The structure of Swedish commercial banking is more complex than in England, for there is a heterogeneous group of institutions which do « banking business » in that they assume a liquidity risk in accepting deposits from the public which they in turn lend to creditworthy borrowers. The institutions whose activities most closely resemble those of the English commercial banks are the « affärsbanken ». Altogether there are sixteen in number of which the five largest are nation-wide banks. They hold about 45 per cent of the total published banking resources, the remainder being spread over the Savings Banks, the Post Office Savings Bank, the Postal Cheque System, and the Agricultural Credit Associations which are part of the strong Swedish co-operative movement (See Table I).

TABLE I
TOTAL DEPOSITS OF CREDIT INSTITUTIONS IN MARCH 1956

	Mill. kr.	%age
Commercial Banks	12,830	43
Savings Banks	10,919	37
P.O. Savings Bank	3,268	11
Postal Cheque System	1,715	6
Agricultural Credit Institutions	837	3
<i>Total</i>	29,569	100

The « Big Five » among the « affärsbanken » are, in descending order of size, the Svenska Handelsbank, the Skandinaviska Bank, the Stockholms Enskilda Bank, the Sveriges Kreditbank and the Göteborgs Bank; they control 80 per cent of the total assets of the « affärsbanken ». Of these the first two are much larger than the others, for they have respectively 300 and 250 branches and together hold over 50 per cent of the assets. The Stockholms Enskilda Bank is a private bank, which is controlled by the wealthy heirs of Herr Wallenberg, the founder. Although it is nationwide in the sense that its interests have ramifications throughout the country, it has branches only in Stockholm and its hinterland and in many ways is more accurately described in English terms as a merchant bank.

The Sveriges Kreditbank, which has over 60 branches, mostly in the south of Sweden, is an interesting example of a State commercial bank. In 1945 a Banking Committee of the Risksdag was

established to consider the expediency of establishing one or more commercial banks controlled by the public authorities. In its report this Committee rejected many of the criticisms of the private banking system but considered that there were certain practical and psychological reasons in favour of an appreciably expanded and more effective State participation in the commercial banking business. Of these the most important was to provide some means whereby the State would be able, if necessary, to counteract the « monopolistic tendencies » of private banking as revealed by their agreement on rates. Thus the Sveriges Kreditbank was established in 1950 by the amalgamation of the Jordbrukarbanken and Göteborgs Handelsbanken in which the State already had considerable interests. Although it was not intended that it should have any special privileges vis-a-vis the other private banks, it was understood that all State Departments and Institutions should transfer their banking business to the new bank. For example, the large balances of the State Tobacco, Wine and Grain Monopolies were withdrawn from the Svenska Handelsbanken and deposited with it. Also many trade unions and local authorities transferred their balances.

Since its establishment it has grown rapidly and has displaced the Göteborgs Bank as the fourth largest commercial bank. Judged by ordinary commercial standards it has been very successful. (See Table II). But the wisdom of initiating such an experiment in these years of inflationary strain may be doubted. However this particular issue will be considered later.

TABLE II

Bank	Total assets June 1951 m. kr.	Total assets June 1953 m. kr.	Increase in assets col. 3 - col. 2 m. kr.	% age increase	Total assets June 1955 m. kr.	Increase in assets col. 6 - col. 3 m. kr.	% age increase
I	2	3	4	5	6	7	8
Svenska Handelsbanken . . .	3,254	3,681	+ 427	13.2%	4,278	+ 597	16.3%
Skandinaviska Banken . . .	2,930	4,546	+ 610	20.8%	3,944	+ 398	11.2%
Stockholms Enskilda Banken	1,170	1,312	+ 142	12.1%	1,705	+ 393	30.3%
Göteborgs Banken	1,064	1,060	— 4	—	1,232	+ 172	16.0%
Sveriges Kreditbanken . . .	793	1,009	+ 216	26.4%	1,360	+ 351	34.6%
<i>Total</i>	9,211	10,608	+ 1397	15.2%	12,569	+ 1911	18.0%

The eleven remaining « affärsbanken », of which eight are regional and three local, are much smaller institutions but are not without importance in their respective areas (1). The three largest, the Skanska Banken, the Wermlands Enskilda Bank and the Sundsvalls Enskilda Bank, which have assets of approximately 500 million kronor each, more than hold their own with their larger competitors in their own particular regions. They maintain offices in Stockholm and transact a certain amount of foreign business. In the scope of their operations and the character of their assets they have more in common with the many small savings banks than with the larger « affärsbanken » (2), for a big proportion of their funds is invested in mortgages. They have no counterpart in England but may be compared with the Swiss Cantonal banks. The Skanska Banken, which does business in the extreme south of Sweden, is exceptional in so far as it has developed an extensive business by financing small traders with commercial bills of exchange.

Of the three local banks one is an unusual institution of particular interest. It is the Sparbankernas Bank which was established in 1942 (through an agreement between the major savings banks) to act as a central bank for the large number of savings banks. Its constitution was based on a similar institution in Finland. The savings banks are the sole shareholders and deposit their cash reserves there either on current account on which they receive interest at $1\frac{3}{4}$ per cent or on deposit account with interest at 3 per cent. They are able to raise loans from this source whenever they are in need of funds. Thus the Sparbankernas Bank performs the very useful function of mobilising surplus funds from one region for the use of another. In an agricultural country in which the seasonal pattern of payments and receipts varies considerably — for example between the north with its reindeer and forest industries, and the south with its fat cattle and grain — this increases the flexibility of the credit system and evens out the flow of money between different sectors of the economy. The Sparbankernas Bank also acts as a clearing-house for the Interbank Service whereby any depositor in a savings bank may deposit or

(1) A proposal to establish a Trade Union Bank to administer trade union funds has recently been rejected by a committee of the Social Democratic Party and the Council of Trade Unions.

(2) Henceforth the affärsbanken will be referred to as « commercial banks ».

withdraw money by presenting his passbook at any other Swedish savings bank.

The commercial banks are subject to strong competition from the savings banks in attracting deposits from the public. Over a long period the proportion of deposits entrusted to the commercial banks has been declining. More recently the independent savings banks have been losing some ground to the Post Office Savings Bank. The savings banks have developed alongside the commercial banks and have played an important part in collecting the savings of the population. But the structure of the savings banking system is very different from that of the commercial banks. Essentially it is a unit banking system for there are over 450 separate institutions most of which are very small and serve only a limited geographical area. They differ also from the commercial banks in that they are non-profit making institutions, have no shareholders and are compelled by law to reserve one-third of the places on their governing bodies for the nominees of state and municipal bodies. They are not active in banking of the English type, for their business is concerned with collecting small savings on the one side and lending mainly on mortgage on the other side of the balance sheet. Prior to the Savings Banks Act of 1956 their competition with the commercial banks was limited in so far as they were only allowed to accept sums of less than 50,000 kr. on deposit account. However the new Act has intensified this competition for not only are the savings banks now permitted to accept sums up to 100,000 kr. on deposit account but also are able to accept cheque accounts. There is no limit on the size of individual cheque accounts, but the aggregate cheque accounts of any individual savings bank may not exceed 15 per cent of that bank's deposits on savings account. The savings banks have an advantage in attracting deposits because they offer a slightly higher rate than the commercial banks ($4\frac{1}{4}$ per cent instead of $3\frac{3}{4}$ per cent). The total amount of money deposited with them is to-day slightly more than 10,000 million kronor and the number of accounts is 5,700,000. They pursue an active and dynamic policy in promoting thrift and are always ready to adapt their facilities for saving to meet the needs of different groups. As a result they have great prestige in their respective areas.

Another institution which has grown very rapidly and competes strongly with the commercial and savings bank is the Post Office Savings Bank. As in Britain it has the great advantage of con-

venience for money may be withdrawn from or deposited at any of the 4,321 branches of the Swedish Post Office. Until recent years it offered the same rate of interest on deposits as the Savings Bank; but since April 19th, 1955, this has been slightly lower and at the moment is $3\frac{3}{4}$ per cent compared with $4\frac{1}{4}$ per cent..

Lastly, there are the Agricultural Credit Associations which, although quantitatively of minor importance, have greatly extended their activities in recent years so that they are now serious competitors of the commercial and savings banks in the specialised field of agricultural credit. Organised on a cooperative basis they accept deposits, both on current and deposit accounts, and supply credit to farmers through loans, overdrafts and the discounting of bills.

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The twin functions of purveying the supply of money and keeping the national accounts are not so extensively performed by the banking system as in the United Kingdom. This difference in banking practice is a reflection of the difference in the national habits of making day-to-day payments. In Sweden there is a much more extensive use of notes and coin than is usual in the United Kingdom. It is customary for factories, businesses and even banks to pay salaries and wages from the managing director downward in notes. Consequently they are used for all normal retail payments so that the average Swede is much more accustomed than his English counterpart to carrying considerable sums of money on his person. This widespread use of notes is reflected in a much higher ratio of notes to national income than in the United Kingdom. Even with this difference in national habits, the banks would play a greater part in handling transactions were it not for the existence of a most efficient « Postgiro » system which is organised as a department of the Swedish Post Office and enables payments between different people to be made efficiently and quickly. Some idea of its relative importance in the Swedish monetary system may be gained when it is realised that at the end of 1955 it accounted for deposits of 2,113 million kronor as compared with the commercial banks' 2,031 million kronor in cheque accounts (3). Almost all businesses, public authorities,

(3) Total commercial bank deposits amounted to 12,455 million kronor.

hotels and many private individuals have accounts with the Post-giro (4). As a state institution its lending activities differ from those of an ordinary bank. 50% of its assets are invested in Government bonds and bills, 30% in loans to local authorities and the remainder in real estate. An idea of its relative importance as a means of payment may be judged to some extent by the result of an enquiry undertaken by the Swedish Banks' Association during the week January 21st to January 27th, 1945. This showed that of the total *amount* of all payments made during the week 27 per cent were made in cash, 38 per cent through commercial bank accounts, 28 per cent through the accounts of the post giro and 7 per cent by other means. The apparent importance of payments through the commercial banks is misleading in so far as it can be explained by the *large average* size of the sums paid in this way. The payments made through the post giro consist of a larger number of small amounts. If we compare the *number* of payments transacted through the different financial institutions, the result of the inquiry conclusively shows that payments through the post giro predominated. During the period they accounted for 1,248,708 of the payments made, compared with 202,368 through the commercial banks' cheque accounts. The Swedish commercial bankers are very conscious of the postal cheque system's importance in limiting their own scope and have belatedly responded to the challenge by the introduction of the bank customer's transfer service whereby an account-holder may transfer funds free of charge from his current account to another customer's account either in the same bank or another commercial bank.

This widespread use of notes and postal cheques means that the average individual has recourse to the commercial banks solely for the purpose of depositing his savings. Only businesses, institutions and a few wealthy individuals keep current accounts with them. Consequently current accounts are much less important than deposit or savings accounts and comprise less than 20 per cent of the total. The deposit account is a generic term which embraces a surprising variety of species. Firstly, there is the short-term account from which withdrawals may be made after the necessary 14 days' notice. Secondly, there are three types of time deposit which earn different rates of interest according to the

(4) For a fuller account see *The Bankers' Magazine*, September 1956.

length of notice required before withdrawal which is 2 months, 4 months and 6 months respectively. The accounts which are subject to 6 months notice cannot exceed 50,000 kr for each individual. Thirdly, there is the savings account. Deposits on savings account are restricted by law to a maximum of 15,000 kr but withdrawals are allowed on demand up to a maximum of 2,000 kr per week. Their ownership is widely diffused throughout the population and, despite the right to withdraw at 7 days' notice, the rate of turnover is very low. The banks expect them to be left untouched for long periods and used for non-recurring forms of expenditure such as the education of children and the needs of old age. Finally, there are the « premium savings » accounts which were introduced in Sweden in April 1955. These were sponsored by the Government as an anti-inflationary device. Every individual was allowed to deposit up to 1000 kr in each of the years 1955 and 1956 and, provided that he leaves these amounts untouched up to the end of 1960, the Government will pay a non-recurrent premium of 20 per cent over and above the ordinary

TABLE III

SOME DATA CONCERNING THE SWEDISH COMMERCIAL BANKS, END OF 1955

Name and group of Swedish Commercial Banks	Num- ber of Offices (1)	Num- ber of Emp- loyees (1)	Capital & Reser- ves			Total Assets
			Depo- sits	(million Kroner)		
Svenska Handelsbanken	313	2,800	346	3,540	4,217	
Skandinaviska Banken	213	2,400	319	3,146	3,895	
Sveriges Kreditbank	61	550	90	1,311	1,683	
Stockholms Enskilda Bank	18	550	125	1,116	1,347	
Göteborgs Bank	103	900	100	1,004	1,208	
Total 5 principal Banks	708	7,150	980	10,117	12,350	
10 Regional and local Banks (2)	333	1,585	209	2,361	2,791	
1 Bank of special character (3)	1	70	18	132	683	
All Commercial Banks	1,047	8,905	1,207	12,610	15,824	

(1) End of 1954 and « Number of Employees » approximately.

(2) Including: Skånska Banken, Sundwalls Enskilda Bank, Wermlands Enskilda Bank, Östergötlands Enskilda Bank, Uplands Enskilda Banks, Skaraborgs Enskilda Bank, Smålands Banks, Jämtlands Folkbank, Gotlands Bank (now — end of 1955 — merged with Svenska Handelsbanken and Sveriges Kreditbank), Bohusbanken.

(3) The special bank is the Sparbankernas Bank.

interest rate, which at present is $3\frac{3}{4}$ per cent, for amounts deposited in 1955 and one of 15 per cent for amounts deposited in 1956.

While we are considering the liabilities of the banks, it is interesting to note that the Swedish banks' capital ratio (and especially the Stockholm Enskilda Bank's) is relatively high at slightly more than 10 per cent. In addition they have substantial hidden capital reserves. These are concealed by a conservative valuation of assets which is greatly assisted by the Swedish tax laws. In the Swedish Bank Act there is a statutory provision that the larger banks must maintain a capital ratio of not less than 10 per cent and the smaller banks a somewhat higher one.

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In the employment of their funds Swedish banks differ greatly from their English counterparts. An outstanding feature is the very high proportion of loans and advances and the correspondingly low proportion of investments. At the end of 1956 loans and discounts accounted for 67 per cent of total assets, while the holdings of Government securities amounted to 19 per cent and cash to 6 per cent. Lending to customers through loans and advances takes four different forms — discounting of commercial bills, credits on current account, loans and documentary credits. An observer from the United Kingdom will note with interest that the use of commercial bills of exchange is still widespread although with the increasing integration of the economy it has diminished in recent years. At the end of 1955 the portfolio of bills was 25 per cent of the total assets in this category. The commercial bill of exchange is the customary way of financing the sale of goods from manufacturer to wholesaler and from wholesaler to retailer and is the predominant form of credit for the seasonal financing of agriculture and in the retail trade for motor cars. Credits on current account, which accounted for 23 per cent of total lending, are similar to overdrafts in the English system being authorisations for the customer to draw cheques up to a certain figure. Interest is charged on the actual credit used but in addition the customer is charged 1 per cent per annum on the total amount which was originally granted whether it has been used or not. Quantitatively the predominant form of lending is by loans or advances of the English type against note of hand which account

for 50 per cent of the total. For such loans security in some form is required. The most common types of collateral are mortgages on buildings and plant, bonds, shares, personal guarantees and, in certain cases, merchandise. Mortgages predominate as they account for 60 per cent of the total. Documentary credits, which as an international form of credit do not call for any further description, are of minor importance.

At first glance it would appear that Swedish commercial bankers place as much emphasis on the short-term nature of their assets as do their English counterparts. In fact until the regulation of the new Bank Act of 1956 came into force they were legally required by their bye-laws to limit all accommodation to a period of six months or, alternatively, to grant it subject to the right to repayment at three months notice. But in actual practice there has frequently been a tacit understanding that these credits would be successively renewed and many have remained outstanding for long periods. Consequently they have been used by the borrowers for the extension of their fixed capital on a medium-term and long-term basis. Had it not been for this evasion of the spirit of the bye-laws, the consequences for the growth of the Swedish economy might have been serious. The Swedish man-in-the-street does not show much inclination for direct investment in industry and prefers to entrust his savings to the various credit institutions. Thus Swedish industrial development might have been seriously hampered through lack of funds had it not been for the help of the commercial banks in extending the country's fixed capital. The new Bank Act has given legal recognition to this accepted practice of the successive renewal of loans, for it contains a provision whereby the banks are enabled to give long-term loans within certain limits. Fixed credits for a period of 10 years may be granted up to a maximum of 150,000 kronor on each loan on condition that the total amount of such loans does not exceed 20 per cent of the bank's capital and reserves.

Contrary to English practice the commercial banks play a major role in the market for real estate. Mention has already been made of the importance of loans on mortgage in their portfolios. They also finance the erection of new buildings by making « building credits » which are granted in the following way. After the bank has examined and approved the plans and estimates for the projected building, a contract is drawn up between the bank

and the builder whereby the bank grants a credit of from 60 to 75 per cent of the total cost of the building. This credit is paid out in instalments while the building is being erected in such a way that the bank at no time pays out a greater proportion of the amount invested at the time of drawing the credit than it originally undertook to finance. As security, mortgages are taken out on the property and a commission of 1 per cent is payable by the owner of the property on the total amount of the credit granted as with an ordinary credit on current account. Swedish bankers have justified these credits in the past because they have maintained that in theory they were self-liquidating for on completion the asset could be shifted on to one of the other mortgage institutions. In practice building credits have increasingly tended to remain on their books as loans on mortgage, because during the long period of low and stable rates of interest property owners had little incentive to borrow on long term. Whatever the cause, the commercial banks are now second only to the savings banks as a source of funds for the mortgage market. Swedish bankers somewhat self-consciously explain to students of English banking that this is not such a reprehensible departure from the canons of good banking because these mortgages are highly shiftable in a mortgage market which is so highly organised and sensitive. Official policy has increased the proportion of their funds which in one way or another are lent to the housing market. For on most occasions on which the banks have been requested to restrict their loans and advances building credits have been specifically exempted. For example from the end of July 1955 to the end of August 1956 bank credits for building purposes increased by about 300 million kronor or 25 per cent while credits for other purposes were reduced by 600 million kronor.

So far we have implied that all loans and advances must be covered by suitable collateral but in actual fact certain exceptions are permitted. Blank credits may be granted to the State, to local authorities and to Swedish and foreign banks. Under the new Bank Act of 1956 they may now be granted to small enterprises for periods up to 10 years so long as individual credits do not exceed 75,000 kronor.

Investments consist mainly of Government Treasury Bills and Bonds of comparatively short duration — usually less than five years. As the Swedish National Debt has not grown as rapidly in relation to the national income as in many other countries, the

proportion of Government paper in the banks' portfolio is not as large as in many other countries. It is usual to regard Government securities as part of the banks' liquid reserves — a tiresome necessity — but not desirable earning assets. Consequently the banks do not like to purchase long-term bonds. Even in 1945, when the proportion had reached 50 per cent of total assets, their holdings consisted mainly of Treasury Bills.

The remainder of their assets are held in cash. At the end of 1955 the amount of cash held by the commercial banks was 422 million kronor or just over 4 per cent of total deposits. Though certain minimum requirements are laid down by law, the Swedish banks have never maintained any fixed or conventional cash ratio and in fact the relative size of cash holdings has varied greatly over the years. In the late 1920's the cash ratio was as low as 3.5 per cent, but in the late 1930's was as high as 15 or 16 per cent. Since 1945 it has varied between 5 and 9 per cent. But even allowing for these variations it is relatively lower than the corresponding ratios for the U.S.A. and the United Kingdom. Some Swedish writers have given as a justification for this difference the higher proportion of time and savings deposits, but this is theoretically dubious.

It has already been stressed that legal requirements have made it difficult for mixed banking of the continental type to develop in Sweden. Nevertheless an important part of the banks' activities is concerned with the making of capital issues both of bonds and shares. There are no specialist « Issuing Houses » like the London merchant bankers and all public issues of capital are managed by the banks who act as intermediaries between the borrowers and the various financial institutions such as the insurance companies and the savings banks, which supply long-term funds. The banks also underwrite issues of bonds and handle shares on an agency basis. Although the banks are forbidden by an amendment to the Bank Act, which was passed in 1933, to own or acquire shares, they still have some in their portfolio. For this amendment contained a clause whereby the banks were allowed to take over shares offered as security whenever lenders defaulted, provided that they disposed of them at the first opportunity of selling without loss. After the Kruger crash they were compelled to take over a considerable number of shares some of which still remain on their books. An outstanding Swedish company, the Swedish Cellulose Corporation, which is the country's largest producer of

pulp, was taken over by the banks during the thirties and was finally resold in 1950 through an issue to the public. The larger banks have formed subsidiary holding companies like Custos, A.B. Providentia and Industrivärden, to manage some of the firms which they have been forced to take over under this clause. In practice the relationship between industry and the banks is probably closer than the legal and institutional framework would imply because the directors of the large banks hold many directorships in industrial companies so that the opportunities for informal cooperation are great.

The banks also provide many other services. They are authorised dealers in foreign exchange, although they have no overseas branches. They act as stockbrokers and between them handle more than 95 per cent of all transactions on the stock exchange. They act as executors and trustees for personal estates. And in connection with these auxiliary functions the larger banks have well-developed intelligence departments which not only publish economic and financial reviews but also offer their customers excellent information services. The charges for these services are influenced by the oligopolistic structure of the banking system. All the banks except the Sveriges Kreditbank and the Sparbankernas Bank are members of the Swedish Banks' Association through which they negotiate agreements on charges. In the absence of price competition there is keen competition in the quality of service offered.

The highly-organised and competitive nature of the Swedish credit market produces a structure of interest-rates the chief feature of which is the narrow margin between the borrowing and lending rates of the institutions. It varies between $\frac{1}{2}$ and $1\frac{1}{2}$ per cent for the commercial banks and in the mortgage market the competition is so keen that the urban mortgage associations operate on a margin over costs of only 0.1 per cent. It is important to note that the lending rates of the commercial banks are differentiated according to the security pledged as collateral and at the moment vary between $4\frac{1}{2}$ per cent and $6\frac{1}{2}$ per cent. The most favourable rates are obtainable on the security of Government bonds and the least favourable on the security of mortgages on agricultural or house property. Differentials of approximately $\frac{1}{2}$ per cent exist between the rates on new loans and on renewed loans and also between the rates on loans for periods of under and over three months. There is a further differential between the charges on

loans and overdrafts for, as was mentioned above, the latter are subject to a commission of 1 per cent which is levied on both the used and unused portions of the permitted sum.

The commercial banks' earnings are derived from two sources, the margin between their borrowing and lending rates and the payments for their subsidiary services. In the immediate post-war period the banks' profits from their ordinary banking business were relatively low for two reasons. Firstly, the pursuit of a cheap money policy reduced the margin between deposit rates and lending rates. Secondly, inflation greatly increased their costs of administration. But their profits were not adversely affected because the contribution of their subsidiary functions to earning capacity has been particularly great since the war. It has been estimated that the net income from these services has accounted for between $\frac{1}{2}$ and $\frac{1}{3}$ of their total profits.

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As has been indicated above, the Swedish banks are subject to close legal control. The first banking legislation was introduced as early as 1846 but legal restrictions have become much more extensive since the Act of 1933, although its provisions have been slightly modified in the new Bank Act of 1956. The regulations, as they now stand, prescribe certain minimum liquidity and capital ratios. The banks must have holdings of cash and « cash reserve assets » (5) which together must represent at least 25 per cent of their sight liabilities — cheque accounts and the unutilised portion of credits already granted. As was stated above, their capital ratio must not fall below 10 per cent of their total liabilities. Other regulations lay down the kind of assets which they may hold and amongst other things the banks are not ordinarily allowed to hold industrial shares (except in the circumstances mentioned above) or invest in real estate. Another clause charges the banks to grant loans only against specific security except that they may grant blank credits without formal security in sums not exceeding 75,000 kronor provided that altogether these credits do not exceed 10 per cent of the banks' capital reserves.

The purpose of most of the legislation since 1933 has been to protect the interests of depositors. That is also the chief motive

(5) These are sight claims on other banks, Treasury bills and other government securities.

behind the activities of the Bank and Stock Exchange Inspectorate which is the Government department responsible for the control of the banking system. Its functions consist of ensuring that the banks comply with the provisions of the Bank Act and their bye-laws and of making periodic analyses of the banks' advances and deposits. In the case of the latter the Inspectorate aims to protect the interests of the depositors by ensuring that the banks' risks are adequately spread and that they are not too deeply committed to any single firm or industry. Special attention is given to their credits to companies in which they have a direct or indirect interest.

In addition they are subject to the control of the central bank — the Riksbank. It is a state-owned institution with capital and reserves amounting to 135 million kronor. The annual profits which was 29 million kronor in 1955, is included in the Government's revenue. An unusual feature is that technically it is under the control of the Swedish Parliament and not the Government. All but one of the seven directors of the Bank are elected by the legislature: the odd man out, who also acts as Governor, is appointed by the Government. The Board of Governors elects from among its members the President of the Bank who may be and frequently is someone other than the Governor. The theory behind this formal Riksbank independence of the Government as established by the Constitution was presumably that it was necessary that central banking policy should be independent of the Government. But the long-term trend has been for the real influence on the policy of the Riksbank to be placed to an increasing degree in the hands of the Government, as central banking policy has become more firmly integrated in general economic policy. Consequently the composition of the Riksbank management has been more and more influenced by political factors. It is symptomatic that when a new Governor had to be appointed in 1955 the candidate least acceptable to the parliamentary opposition was selected (6).

The Riksbank has its head office in Stockholm and branch offices in 23 other important cities and towns. In addition to its central banking functions it also carries on a very limited amount of ordinary lending business. It makes loans to state-owned or semi-official corporations and distributes grants from special funds

(6) Herr Per Asbrink. It should be recorded that since then his independent attitude in that office has frequently been praised by members of the banking community.

appropriated by the legislature for certain objects of a social character.

The Bank has the monopoly of the note issue and its notes are full legal tender. Prior to 1931 the power to issue notes was limited solely by the size of the gold reserve. After the gold standard was suspended the size of the permitted note issue was geared to the size of the gold reserve although the minimum gold cover was reduced several times. Since 1948, however, the link with gold has been purely nominal and Parliament has passed annual resolutions granting the Riksbank exemption from the liability to redeem notes in gold but placing a legal ceiling on the note issue (7). Recently a special Government Commission made certain recommendations about future policy over the note issue. It came to the conclusion that the rule requiring notes to be redeemed in gold should be annulled. But it considered that the waiving of the liability to redeem notes in gold increased rather than decreased the Riksbank's responsibility to maintain the value of the krona. The more to emphasise this it suggested that the law should be amended by the introduction of a clause to the effect that the responsibility of the Riksbank to maintain the value of money is a matter of paramount importance. As yet no action has been taken by the Government.

Like other central banks, the Riksbank acts as banker to the commercial banks and to the Swedish Government. It acts as a lender of last resort by standing ready to rediscount first class commercial bills or more usually nowadays to grant accommodation loans against Government bonds pledged as collateral. It also uses the customary weapons of open-market operations, exchange rate policy and more recently variations in the liquidity ratios imposed upon the commercial banks. The official discount rate which until 1952 was $\frac{1}{2}$ per cent above the rediscount rate is traditionally normative for the determination of lending and deposit rates. Since 1952, the authorities have reserved the right to fix the rediscount rate independently of the official discount rate according to the prevailing situation in the credit market. The apparent objective was to make banking policy more flexible but in practice the change has been of no importance because rediscounting has gradually fallen into disuse since the early 1930's.

(7) At present 5,800 million kronor.

As in many other countries the exceptional liquidity of the banking system has created special problems. In the immediate post-war period Swedish monetary policy was almost completely passive and the Riksbank played a minor role in the control of the economy. Its chief responsibility was to stabilise interest rates at a low rate in order to stabilise certain prices, especially rents, and thereby indirectly making it easier to stabilise wages. The first retreat from this policy occurred in 1950 when it ceased to support the price of bonds by open-market purchases and allowed the yield on long-term Government securities to rise above 3 per cent. At the same time both quantitative and qualitative credit control was introduced. Firstly, an enabling law for controlling the banks' cash reserves, originally passed in 1937, was brought out of cold storage in order to impose the following compulsory reserve ratios. The « Big Five » banks were required to hold cash and cash reserve assets (Treasury bills, Government bonds and claims against other banks) of at least 10 per cent against their total liabilities exclusive of savings deposits. For the medium-sized banks (issued capital between 10 million kronor and 50 million kronor) the ratio was fixed at 8 per cent and for the smaller ones at 6 per cent. In addition not less than 40 per cent of these ratios was to be held as cash and of this at least 25 per cent was to be held on deposit at the Riksbank. Secondly, the banks agreed voluntarily to cooperate with the authorities in following certain recommendations about the distribution of credit. These were similar to the directives issued in the United Kingdom to the Capital Issues Committee. For example, essential production and exports were given a high priority while the finance of speculative activities was to be avoided at all costs.

This policy was a failure mainly because the Riksbank shrank from an inevitable consequence of credit restriction — the rise in interest rates. At the end of December 1951 it re-entered the bond market as a purchaser and stabilised the long-term rate of interest at the new level although it had risen only $\frac{1}{3}$ per cent. This monetisation of debt along with the inflow of gold and foreign exchange so increased the commercial banks liquidity that the restrictions became completely ineffective and there was a large expansion of credit.

The authorities reacted by passing a new law empowering the Riksbank either to forbid an increase in interest rates or to fix

maximum interest rates on loans and minimum interest rates on bank deposits. At the same time the Riksbank opened negotiations with the commercial banks and other credit institutions in order to establish a more restrictive monetary policy on a « voluntary » basis without a general rise in the level of interest rates. These resulted in new « voluntary » agreements in 1952 whereby the commercial banks promised to fulfil definite conditions of liquidity within a given time. The former cash reserve requirements were abandoned and were replaced by new liquidity ratios which were defined as the quotient of the sum of cash, deposits at the Riksbank, outstanding claims on other banks, and short-term government securities on the one hand, and the sum of deposits (except those in savings accounts) on the other (8). These ratios, which are still observed, were graded according to the size and importance of the banks. The larger the bank, the higher its ratio. For almost all the banks these ratios were fixed at a higher level than their actual liquidity at the time of the agreements. It was understood that until the agreed ratios had been reached any increase in the funds deposited with the banks should be used to augment their liquidity and not to grant new advances. At the same time the original qualitative controls were retained and in addition the banks were asked not to reduce the proportion of housing credits in the total lendings. In the execution of this policy the Riksbank to some extent has stepped away from its function as a lender of last resort for, whenever one of the commercial banks has approached it for a loan against the security of Government bonds, the rate has been fixed on an ad hoc basis. Thus any bank, which in the opinion of the Riksbank has been unduly dilatory in achieving its agreed liquidity ratio, is liable to be charged a high discriminatory rate.

This policy of « voluntary » credit restraint was reinforced in April 1955 when the official discount rate was raised from $23\frac{3}{4}$ per cent to $33\frac{3}{4}$ per cent with accompanying increases in other short-term rates. At the same time further pressure was put on the banks to maintain their liquidity ratios. The Riksbank announced that unless the banks had raised their holdings of liquid assets to the required levels by August 1955 it would invoke the emergency

(8) These ratios are calculated « net ». Any loans from the central bank are deducted.

law (g) empowering it to prescribe, whenever necessary, a liquidity ratio of up to 50%.

Later in the year the policy of quantitative control was given a new twist when the Riksbank requested the banks to reduce their advances for any purposes other than housing finance by 1 per cent below the July 1955 level. This direct restriction of bank lending was intensified in April 1956 when the Governor of the Riksbank ordered the banks to curb their advances before the end of August 1956 by 5 per cent below the level existing at the end of July, 1955. Finally on November 22nd, 1956, the Riksbank raised its Bank Rate to 4 per cent and at the same time the National Debt Office issued a new $4\frac{3}{4}$ per cent loan with 24 years to maturity in order to absorb excess liquidity in the money market.

This description of the chronological sequence of events since 1950, when the policy of the Riksbank ceased to be completely passive, should serve to show how varied have been the measures used by the authorities. Broadly speaking they have rejected the traditional weapons of central banking and have relied heavily on « moral suasion » to exert pressure on the banks' liquidity in order to restrict the supply of money. Interest rates have only been raised in order to support quantitative control and not to introduce greater flexibility. Similarly open market operations have only been used when necessary to intensify the pressure on the banks' liquidity and usually with such vigour that they have caused periods of stagnation in the capital market.

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An English observer surveying the Swedish banking system as a whole can hardly fail to be impressed by its efficiency. The commercial banks, although they act oligopolistically in relation to each other, are subject to fierce competition from other credit institutions such as the Savings Banks, the Post Office Savings Bank and the Postgiro. Nevertheless they have maintained their position by being flexible in their policies and adaptable to the changing financial environment within the limits which legal restrictions have placed upon them.

(g) The enabling law about liquid reserves originally passed in 1937 and amended in 1950 was further amended in 1954 when it was stipulated that the reserves should be 50% (and not 25% as in 1950).

The weaknesses of the system, as revealed in recent years, stem mainly from the policies and methods of the Government and the Riksbank. The authorities have conspicuously failed to create conditions in which the banks could confidently fulfil their normal banking functions subject to the general discretionary control of the central bank. They have chivied and threatened the banks by a variety of ad hoc measures which recurring inflationary pressure has made necessary, but have failed to devise adequate methods of general control to curb the system's present inflationary bias.

In the field of policy three points may be made. Firstly, the Bank and Stock Exchange Inspectorate is now largely an anachronism, for the emphasis of its operations is on the security of deposits. But the Swedish banking system is now sufficiently stable so that the danger of depositors suffering losses through imprudent policies is remote. Secondly, the timing of the establishment of the State commercial bank, the Sveriges Kreditbank, in 1950 could scarcely have been less opportune. While there are good grounds for making an oligopolistic system compete with a state-owned institution, it is unwise to begin the experiment during an inflation. For, if the existing banks are losing business to the new institution, they are more likely to lower their standards of credit worthiness than to raise them as an inflationary situation demands. Thirdly, the series of directives and requests to comply with certain arbitrary standards of liquidity and to reduce advances by given percentages may have helped to cope with each short period problem, but have hindered the development of central banking techniques suitable for long-period control. Liquidity ratios which were chosen for the purpose of a particular objective in 1952 have been adhered to ever since although in Sweden they are subject to extreme seasonal fluctuations beyond the banks' control. Had this been the first step in the evolution of new methods of control through either primary or secondary liquidity ratios similar to those used elsewhere the whole policy could have been viewed in a more favourable light. As it is, there is still an urgent need for the authorities to reconsider the principles of banking policy and devise new methods of control so that it becomes a more flexible and effective instrument.

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