Sweden: first state bankruptcy in Europe?

by William Engdahl

While attention in recent weeks has focused on the historic fall of the U.S. dollar against the Japanese yen and the German mark, the outcome of the crisis of the Swedish kroner could set a dramatic precedent for other highly indebted industrial economies.

Since Dec. 31, 1994, the kroner has fallen 11% against the mark. Because of the relatively small volumes of kroner traded internationally, few outside Scandinavia took note of what could develop into another international debt crisis, similar to that in Ibero-America in the early 1980s. Since the European currency crisis of September 1992, when the British pound and Italian lira were forced to leave the fixed exchange rate bands of the European Rate Mechanism, the kroner has fallen 36% against the mark.

The continuing fall of Sweden's currency is alarming because of its impact on Sweden's public debt burden. Unlike Italy, which has a far higher public debt ($1.2 trillion), Sweden in recent years has become dependent on foreign currency borrowing to finance its deficits. While Italy's public debt is 130% of GDP, most of it is financed domestically. When the lira fell in 1992 by 30%, the principal effect was to give Italian auto and machine tool exports a competitive advantage. Not so with Sweden.

To grasp the significance of what is taking place in Sweden, with the government scrambling to prepare emergency austerity cuts and the kroner falling faster, it is necessary to understand the early roots of the present crisis, which is only dimly understood by most. Sweden today is the victim of a sickness which overwhelmed most industrial nations in the 1980s, namely, the disease of Thatcherite "free market" deregulation and abandonment of sound national economic policy.

During the latter part of the 1980s, the Swedish government took measures to imitate the financial and monetary policies of British Prime Minister Margaret Thatcher. Swedish banks were freed from decades of restriction on lending practices, restraints which had helped control real estate speculation and rents. Commercial banks, as a result, plunged into the domain traditionally served by Sweden's savings banks, and began wildly speculative, unsecured real estate lending in areas in which they had no experience. Huge office and residential projects suddenly began to spring up in Gothenburg, Stockholm, and other cities.

The Social Democratic role

Ironically, the bulls of speculation were let loose by the Social Democratic government of Ingvar Carlsson. Perhaps eager to stimulate employment through a construction boom for election reasons, Carlsson and his finance minister, Kjell-Olof Feldt, removed controls on banking and lifted the decades-long controls on foreign capital flows into and out of Sweden.

The situation began to unravel by 1989-90, when the major industrial economies of the world, led by the United States and Japan, sank into the deepest industrial depression since the 1930s, and world trade fell sharply. The impact on Sweden, an export economy, was devastating. Unemployment soared from 2.5% in 1988 to more than 16% in 1994. As the domestic economy went into the deepest depression since the 1920s, the real estate bubble also collapsed. No one could afford luxury new office space; workers who had planned to finance new homes were suddenly out of work. Banks which had lent to builders in the boom years suddenly found themselves in trouble.

At that point, the first fruits of the "Thatcherite experiment" were evident. Sweden's banking system went into deep crisis. Every major bank but one required some form of emergency state bailout. Most banks were nationalized, at taxpayer expense. The tab for the state's banking bailout had reached a staggering SKr 100 billion ($14 billion) by 1994. But state budget outlays, under Sweden's famous social welfare system, were also soaring in the depression of 1990-95. As unemployment climbed into the double digits, state outlays increased geometrically. By law, Swedish workers were entitled to be paid 90% of their normal wage by the government when unemployed. Today the government is trying to cut that to 75%.

The government's only response was simply to issue debt and go into deficit, and try to impose austerity in a vain attempt to control the rate of increase of the deficits, while hoping for an economic miracle.

Falling into a 'debt trap'

Over the past five years, Sweden's governments, Socialist, conservative, and since September 1994 again Carlsson's Socialists, issued debt at a record pace. Total public debt increased from 40% of GDP in 1991, to what today is estimated at more than 94% of GDP, a debt of almost SKr 1,400 billion. That, in less than four years!

But Sweden's economy had been transformed, primarily during the 1970s and 1980s, into a vast welfare state of bureaucrats—Olof Palme's vision of a post-industrial society. At the onset of the economic crisis in 1990, more than 66% of GDP was tied to the state sector. Serious cuts in the state budget would mean huge cuts in the overall economy, a self-feeding downward trend. As the tax revenue base collapsed and deficits soared, the government simply continued issuing debt, hoping for a miracle.

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That miracle has not arrived. Sweden today is locked into a "debt trap" of Ibero-American dimensions. Interest costs on debt are growing faster than the economy.

In 1994, the government was forced to pay nearly SKr 100 billion in interest on its debt, making it the second largest budget item—SKr 40 billion more than planned, because of the sharp rise in international and Swedish interest rates last year. The interest alone on the public debt is 50% of the current deficit, compounding state debt in a self-feeding manner. Such is the definition of a classical "debt trap."

Further, the kroner has continued to fall since September 1992, largely because international speculators have realized that the government is paralyzed from raising interest rates to attract foreign investment, because of the effect on the cost of this debt. George Soros's Quantum Fund began to abandon its Swedish holdings already last summer prior to the elections. As the state deficits continued to add to the debt, Soros and other speculators sold what they saw as an increasingly worthless kroner. In the last weeks, even Swedish multinational companies and banks, led by the Wallenberg family's SE-Banken, led the selling of kroner for marks. For the private export companies like L.M. Ericsson or Saab, the cheap kroner improves export prospects, but for the government it spells catastrophe.

Worse, with the domestic economy in depression and deficits rising at a pace of more than SKr 200 billion per year (13% of GDP), the government was forced in the past several years to turn abroad to finance its deficits, borrowing in dollars, marks, and yen to keep going. Here is where the crisis began to assume alarming dimensions.

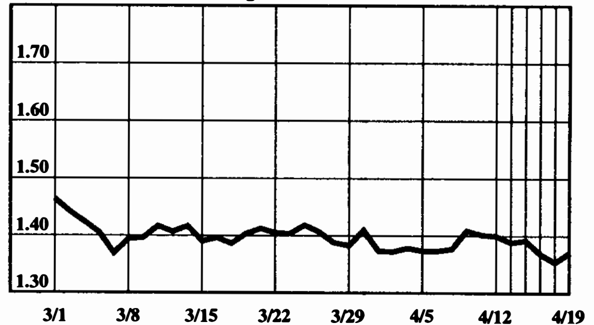
In order to finance its deficits amid what today is 14% unemployment, Sweden's government has been forced to borrow abroad in foreign currency for 30-40% of its public debt of SKr 1,400—a debt that equals the total of all national production and services of the Swedish economy for one year. And with 40% of that debt ($80 billion) held in marks or other currencies, that foreign part of the debt alone has cost an added $10 billion since January.

Worse, most of this foreign borrowing can only be done on the shortest-term basis (less than one year), forcing it to roll over the debt at an ever more rapid pace. This has led R.G. Andersen, chief economist of the Norwegian investment firm FIBA Nordic, to call Sweden today "the Mexico of the North." At this point, the scale of budget cuts the Carlsson government is debating, Skr 10-15 billion in its supplemental budget released on April 25, is insignificant compared to these numbers. Given Sweden's net foreign debt of some 54% of GDP, it is like a Third World country, not an OECD economy. At the present rate, Sweden would have to raise interest rates astronomically in order to upvalue the kroner by 25%, or to run heavy trade surpluses for the next 50 years. Neither is possible under current terms. If nations could go bankrupt like corporations, Sweden could be the first.

Currency Rates

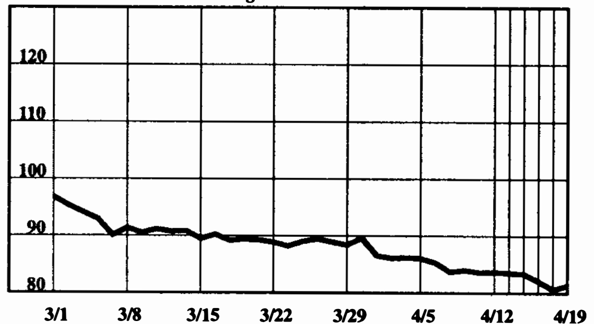
The dollar in deutschemarks

New York late afternoon fixing



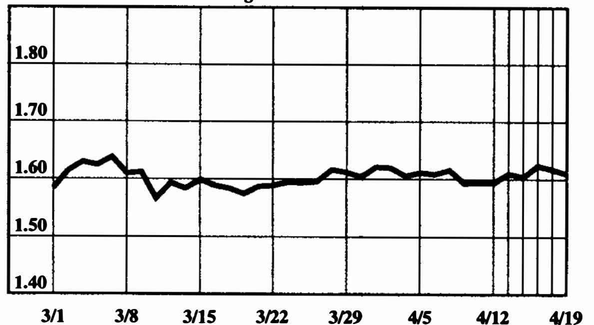
The dollar in yen

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing