The State as Last Resort in two Scandinavian Banking Crises

A comparative case study of Denmark and Sweden

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ABSTRACT

This article treats the role of the state in the banking sector, especially government objectives and measures. The purpose is to unveil how and why the role of the state in banking crises differed between the two Scandinavian countries, Denmark and Sweden, and thus critically analyse which objectives justified public enterprises in the banking sector. Our theoretical point of departure is strands of literature within political science, financial economics and economic history. Empirically, we start by comparing the transferring of private banks into state-controlled banks during two crises, the banking crises of Sweden 1990-1993 and the crisis of Denmark 2008-2012. We compare the intrinsic principles and perceptions as well as the very policies implemented during the crises, with a focus on government objectives and state intervention. We argue that reasons for observed differences in the implementation of measures in Sweden and Denmark date back to the early phases of capitalism in the 19th century, i.e. is part of an historical institutional pattern. Sweden was marked by many central state-oriented modernization initiatives while the modernization process in Denmark was marked by uncoordinated local initiatives. Our results and proposed policy implications are related to the discussion of launching effective and legitimate state policies in Europe after a severe financial crisis.

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1. Introduction

Crises are an indispensable part of capitalism, but responses to crises have varied between countries and over time. If an economy is hit by a systemic banking crisis, the government has to make important decisions regarding the extent and type of intervention that has to be undertaken.[1]It could leave the responsibility to the business itself. This calls for a structural change, where illiquid banks are bought up by liquid ones, while other banks are going bankrupt and totally disappear from the scene. A second possible solution is that the central bank steps in, as a lender of last resort, by guaranteeing the payment system and increase the liquidity in the interbank market. The reason is liquidity problems and financial stress in the market and among certain banks. A third type of solution is that the government intervene, targeting problems of insolvency in the banking sector. This third type of intervention could take six different forms.[2]

1) deposit guarantees to help prevent bank runs;

2) explicit guarantees on liabilities to help banks retain access to wholesale funding;

3) capital injections to strengthen bank´s capital base;

4) purchases or guarantees of impaired “legacy” assets to help reduce the exposure of banks to large losses in their asset portfolios.

5) state ownership control in one or more insolvent banks

6) establish new organisations for financial stability

The objective of these six forms is to bring back the confidence in the credit market. If the risk of insolvency is severe, and not reduced by the first four interventions above, the government has the

[1] The literature distinguishes between crises in individual banks and systemic crises, where the latter threaten the stability of the whole financial system.
[2] Østrup, ‘Danish banking’ (2010).

alternative to take ownership control in one or more insolvent banks set up new organizations for financial stability (five and six). Those are the most far-reaching forms of government intervention. The government rescue plans are not mutually exclusively, which means that they could be mixed, more or less simultaneously.[3]

State ownership control in the banking sector means that the government has to make long-term strategic decisions. How many of the banks and how much of the non-performing loans have to be taken over, and for how long? A systemic banking crisis is an extreme event. Thus, in the longer run, when the economy improves, the government must have other motives to keep bank assets than just rescuing illiquid banks. This calls for a general discussion of whether state-owned banks in a market economy are preferable or not. The banking crisis might have forced the government into state control, to restore financial stability and avoid a collapse of the credit market and losses among depositors. But the rationale of keeping state-owned banks is another and a much larger issue, which calls for a discussion of the appropriateness of using a government as a major shareholder in the banking system. Which objectives justify public bank ownership? And, in the context of Danish and Swedish banking crises, how are objectives executed, and why have objectives and strategies possibly been different in Sweden compared with Denmark?

To study banking crises in relation to the most far reaching form of state intervention – state-owned banks - is crucial for our understanding of public policies following a crisis. Our objective in this article is to analyze the intrinsic principles and perceptions of this far-reaching form of state intervention and how these principles and perceptions should be explained. Besides, we are arguing for a pragmatic view on state intervention as a legitimate strategy for solving structural banking

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[3] Kindleberger, *Manias* (1996); Panetta et al., 'Assesment' (2009).

crises. This suggests a capability for key actors to implement appropriate forms of measures in due course, in order to gradually reduce risks in the financial system. The historically rooted perception of the rule of the state creates possible restrictions for the key actors. To give answers and argue for this, we will present a comparative analysis of Denmark and Sweden during the two recent banking crises respectively, 1990-1993 in Sweden and 2008-2012 in Denmark. The article is based on a combination of open sources and access to archival material, eg. the Danish state-owned financial holding company "Finansiel Stabilitet A/S".

Denmark and Sweden passed similar phases of regulatory regimes during the 20th century. The first phase was "The Early Regulatory Regime", which lasted from the turn of the century to the 1930s. This period was in both countries marked by many banking crises, in Denmark more than 70 of the 208 banks that existed at eve of the First World War disappeared in the ten years from 1921 to 1931, and some of the largest and most important banks were involved in the crises.[4] In Sweden, the number of commercial banks went from 41 to 28 banks between 1920 and 1935. In both countries, the banking crises were followed by more restricted regulations and "The Hard Regulatory Regime" lasted from the mid-1930s to the late 1970s. This period was marked by stability in both countries, with few critical bankruptcies in the banking sector. The final phase from around 1980 to 2010 can be labelled as "The Soft Regulatory Regime" marked by a combination of much less restrictive regulation and new international regulatory regimes, such as the 1988 Basel Accord, the Basel II agreement in 2004 and the EU common market legislation including the Second Banking Directive in 1988. In combination with new IT-opportunities in trade and banking, these regulatory changes marked a more innovative, growth-oriented and instable banking sector in

[4] Hansen, 'Bankredninger' (1997), 53.

both countries. This article is focused on banking crises in the soft regulatory regime, investigating the role of the Danish and Swedish governments in the 1990s and 2000s.

In the following section, the rationale for state intervention is highlighted, with a discussion of pros and cons for state-owned banks. The next two sections are devoted to the context of the Swedish and Danish banking sectors and the most recent systemic banking crisis in each country. Then we provide a comparative analysis of intrinsic principles and perceptions of state-owned banks. Our main findings are summarized in the conclusion.

2. The rationale for government intervention

The motive of government intervention, in terms of government banks, could be economical, to compensate for various types of market failures (social externalities, asymmetric information and enforceability).[5] Another reason might be to increase the competition in the banking sector. State-owned banks with less shareholder value incentives opens up for interest rates below the prices in the private market (kind of state subsidy). There could also be political and social motives, if profitable investments are underfinanced by the private sector and the existence of state-owned banks are believed to enhance certain public investments. In addition, and on a more general level, some argue that since banking is more integrated in the economy than other businesses, reflected in laws, regulation and supervision, these activities should not entirely be handed over to actors driven by profit-maximisation and share-holder values. Rather, banking should be motivated by incentives

[5] La Porta et. al, ‘Government’ (2002).

emanating from a wide spectrum of stakeholders, including environmental and social responsibility concerns.

Agency costs might also be a reason for government to pursue state ownership in the banking sector, since state-owned banks better would look after needs of public firms and organisations, and for example give service to the payment system in the public sector. Thus, state-owned banks is said to compensate for various market imperfections, including forthcoming banking crises. In the latter case, one or more state-owned banks ideally will function as benchmarks for sound banking. This might reduce the problem of moral hazard, when private banks are harvesting the ripe fruits of their customers by increasing bonuses and dividends in good times, while counting on public help during bad times, i.e. bailout by the state because of too high risks in a previous period.[6]

The moral hazard problem is often discussed in relation to public bailouts in the banking sector to find out to what extent this type of safety net leads to additional risk taking. A study of the German banking sector 1995-2006 could confirm that there was a moral hazard effect of bailout expectations on bank risk, since a change of bailout expectations increased the probability of official distress from 6.6 per cent to 9.4 per cent.[7] However, government-owned banks could also play a role of balancing between risk profiles, which was shown in a comparative study of lending responses to financial crises across government-owned and private banks (764 major banks headquartered in 50 countries over the period of 1994–2009). Since government-owned banks increased their lending during crises relative to normal times, while private banks' lending

[6] Moral hazard could be defined as actions of economic agents in maximizing their own utility to the detriment of others, in a situations where the agents do not bear the full consequences of their actions, due to uncertainty and incomplete or restricted constraints which prevent the assignment of full damages to the agent responsible. Kotowitz, 'Moral hazard' (1989).

[7] Lammertjan/Kotter, 'Bank Bailouts' (2012).

decreases, the former actually counteract the lending slowdown of private banks. This finding suggests that the state can play an active counter-cyclical role in their banking systems directly through state-owned banks.[8]

However, state-ownership does not always have a positive effect on corporate governance. In a study based on non-financial and financial firms from the European Union, it was found that government ownership was associated with lower governance quality. However, this was not true for all countries: while state intervention was negatively related to governance quality in civil law countries, it was positively related to governance quality in common law countries. The author also found the preferential voting rights of golden shares were especially damaging to governance quality.[9] Since both Denmark and Sweden has civil law, we might, on basis of these results, expect lower governance quality in state-owned banks compare to private banks. Finally, the state intervention might appear as a result of maturity mismatch, the tendency of a business to mismatch its balance sheet by possessing more short-term liabilities than short-term assets and having more assets than liabilities for medium- and long-term obligations. When every economic actor is part of this mismatch, authorities have little choice but intervening, creating both current and deferred social costs, according to the study.[10] This observation underlines our hypothesis of seeing the state as the last resort.

Evidently, the problem in a post-crisis period is to find a trade-off between government failures and market failures. The crisis might have revealed shortages in the private banking sector, but is state-owned banks a better choice in the long run? There is obviously an economic, political and social

[8] Brei and Schclarek, 'Public bank' (2013).
[9] Borisova et. al., 'Government ownership' (2012).
[10] Farhi/Tirole, 'Collective' (2012).

rationale for state-ownership in the banking sector, if the government should decide to keep control after the bank crisis. However, there are also many arguments and empirical evidences for the opposite, i.e. to close the banking-emergency organization as fast as possible and leave banking to the business of private investors.

Early studies showed an optimistic view on state ownership in the banking sector. Gerschenkron emphasised the role of government ownership in strategic economic sectors, and took Russia in the 1890s as an example: it was the government that generally fulfilled the function of industrial banks.[11] Along the same line, Myrdal argued for state-owned banks in India and elsewhere in Asia.[12] Other scholars have suggested the same solution for economies in Africa and Latin America. This view of government participation in finance was part of the "Zeitgeist" up to 1970s, with request on socializing of private firms in certain business sectors. The agenda was based on a wish to speed up the process of economic growth in the developing world. The positive results of the government financing of industrialization in Russia was taken as a proof the correctness of the theory, according to Gerschenkron and Cameron.[13]

The idea of state-owned banks as a recipe for economic growth is still alive among economists. Yeyati, Micco and Panizza state four objectives for government intervention: maintain the safety and soundness of the banking system; mitigate market failures that stem for the presence of asymmetric information; finance socially valuable but financially unprofitable projects and promote financial development by giving access to competitive banking services to residents of rural and

[11] Gerschenkron, *Economic backwardness* (1962).
[12] Myrdal, 'Twenty' (1968).
[13] Cameron, *Banking* (1967).

isolated areas.[14] Prasad suggests that the subprime crisis might change the attitude towards government intervention: "…it may not be ruled out if some insights and ideas emerge during the process that make governments continue their engagement with banking institutions to some extent to ensure stability, growth and jobs, which are the prime concerns of the developed world today".[15] Evidently, the solution of the subprime crisis has led to certain hybrid organisations, i.e. government created entities that operate through market transactions and generally cover the costs of their own operations through their revenues. This has not only been the case in the US but also in other economics hit by banking and debt crises. In this sense the world financial systems have converged, since hybrid organisations are dominant both in state-controlled economies and market-oriented economies. In China the banks are publicly owned but operate under market conditions. However, hybrid organisations could also be partly publicly and partly privately owned, as the largest bank in Scandinavia, Nordea (former Nordbanken).

On the other hand, the idea of state-owned banks as drivers of economic growth has been contradicted in many recent studies. La Porta, Lopez-De-Silanes and Shleifer study state-owned banks in 92 countries around the world, covering both developing and developed countries.[16] The study states that government ownership of banks has been large and pervasive, at least up to the 1990s. But the consequences are less impressive: the existence of state-owned banks is highly related to backward financial systems and low levels of per capita income and low levels of productivity. However, since the study does not provide any comparisons with the relationship between private banks and macro-performance, it is difficult to make policy implications on basis of the empirical results. Within corporate governance literature, there is also a discussion on how

[14] Yeyati et. al., Reappraisal' (2007).
[15] Prasad, 'Rebalancing' (2011).
[16] La Porta et. al. 'Government' (2002).

different government interventions affect bank's lending behaviour, capital structure and risk taking. According to these models, the various forms of intervention change the incentives for banks regarding new business loans and the fragility of their capital structure. But these abstract models need contextual analysis and empirics to be fully credible.[17]

The pessimistic view of state intervention in the long run is confirmed in a study of German commercial banks during the latest crisis.[18] The state-owned banks studied had three times as large losses and those of their private competitors and the financial and managerial competence of supervisory board members was statistically significant lower in state-owned banks (based on 593 biographies in the 29 largest German banks). The study concludes that state ownership comes at the cost of weaker monitoring of bank managers, possibly higher risk exposures and higher bank losses in a financial crisis. Not surprisingly, the authors suggests that "state ownership in banking should be reduced as far as possible", and whenever avoidable, the financial competencies of the supervisory board should be strengthened.

The studies above treat all five forms of government intervention. Obviously, the far-reaching form of state-owned bank has been more criticised than the other forms of intervention. Empirical studies show that state-owned banks have been underperforming compared to private banks. This gloomy prospect applies to banks in the developing world as well as in state-controlled, co-ordinated and neoliberal welfare state economies respectively. The other forms of state intervention seem to have higher legitimacy among academic scholars. The reason might be the urgent situation to at least temporarily solve insolvency problems during an acute banking crisis. However, as the case of

[17] See for example Dietrich/Hauck, 'Government' (2012).
[18] Hau/Thum, 'Subprime' (2010).

Lehman Brothers tells us, no bank is too big not to fail. In addition, previous studies have been analysing state intervention on a short term basis only. Thus, they neglect to discern informal and formal institutions behind the principles and perceptions of current government interventions.

3. Swedish banking crisis and state intervention

The Swedish state has a long tradition of ownership control in the business sector. Already at the industrial breakthrough in the late 19th century, the state established a symbiotic relationship with key industries, through technological procurement, personal networks and state subsidies for investments.[19] The institutions within the financial system also contributed to a corporativistic culture. The state influence in the banking sector rapidly increased in the early 1920s, following the deflations crisis. In the 1950s and 1960s, there was strong political motive in the parliament, led by the Social-democratic party, to strengthen the state control in both society and business. During this period, private firms and whole sectors were nationalized, at the same time as new state agents were established, not at least in the financial sector. One incentive to launch a state-owned bank was to match the interest of certain private banks, not at least challenge the power of the mighty private dynasty of the Wallenberg family.[20] In the 1970s, the enlarged state intervention in industry was involuntary, as a response to the structural crisis in the shipyard industry and the mining industry. Despite capital injections and ownership control, the state did not succeed to restore plan to rescue these industries and the job loss was immense. From the mid-1980s, when the neoliberal wave swept in, the state started to withdraw from many ownership positions. However, in the case of the

[19] Sjögren, 'Swedish' (2008).
[20] Larsson, *Staten* (1998), 166-68.

banking sector, this process was interrupted and reversed, when the economy was hit by a banking crisis in the early 1990s. Even this time, like in the 1920s and the 1970s, the state intervention was involuntary, as a result of insolvent key actors in certain businesses.

In the 1980s, the Swedish financial sector underwent a substantial transformation. A market that for thirty years had been thoroughly regulated and shielded from the rest of the world was gradually replaced by several sub-markets with considerably more liberal guiding rules than before. During a relatively short period, loan ceilings for banks were abolished, along with interest rate and currency regulations. Meantime, new financial instruments were introduced and the number of financial actors in the market increased substantially. The situation gave rise to a number of imbalances which hounded the Swedish economy for years to come. Three types of systematic problems arose: institutional, i.e. associated with legislation and legal practice; organizational, i.e. conditional on inefficient business structures; interactive, i.e. the interrelationship between the behaviour of actors and regulations in the market.

The deregulation of the financial market led to a considerable expansion in lending, which further increased already ample access to capital and in turn led to lower interest rates. The bank lending more than doubled from 1980 to 1990, in fixed prices. The most rapid increase appeared within private business. Between 1985 and 1990 the price index for residential blocks and commercial properties jumped from 100 to 248 respectively 230. A reason of this spiralling trend was the substantial increase in competition between banks and finance companies in a deregulated market. To gain market share the agents accepted collaterals with high risks. The growth strategy was rewarded with profits in the short term but proved detrimental for many financial intermediaries in the longer run.[21]

Many institutions in the financial market were lifted, while other rules of the game in the economy remained the same. However, in the new context after the deregulation these rules *got another meaning*. Thus, a so-called institutional clash appeared. For example, while the restrictions on banks to lend money were lifted, the same old tax system that already favoured bank credits gave companies and households a further reason to increase their debt. Since it was possible to make substantial tax reductions for the interests paid on loans, the price of the credit was extremely low. Subsequently, private customers became less sensitive to increased indebtedness.

The institutional clash had many implications. Banks started to redefine their roles and risk preferences - from previously having strictly followed well defined rules and frameworks to selling loans and services in a much more competitive market. The many finance companies adopted a more aggressive sales approach than traditional banks and took larger risks, primarily in their lending to the real estate market. However, since many operations in the interests of the finance companies were funded by bank capital, the risks were part of the book of the banks. In fact, many finance companies were daughter companies of banks. Among banks, it was especially those without a history of lending extensively to large corporate clients and real estate companies, such as Gota Bank, Nordbanken and some savings banks, which took on huge credit risks (Table 1) by an aggressive policy of lending. By 1990 banks were still actively marketing their loans, although that year marked the turning point for the financial market´s success.

[21] Larsson/Sjögren, *Vägen* (1995), 63 and 183.

Table 1. Annual growth of total credit volumes in Swedish savings banks and commercial banks 1985–1989. Percentage.

	1985	**1986**	**1987**	**1988**	**1989**
Savings banks	11	27	9	36	25
Nordbanken	8	10	7	51	31
Handelsbanken	3	0	23	11	21
SEB	-12	9	27	26	26
Gota Bank	24	4	8	29	27

Source: Petersson 2009, p. 43.

In the early 1990s, the Swedish economy began to weaken. Industrial production declined and real estate prices fell. In 1990, a number of finance companies experienced major losses, for example Gamlestaden, Independent and Nyckeln. In September 1990, Nyckeln suspended its payment. The situation for these companies was made worse by a substantial rise in interest rates, causing lower demand for loans and cutting into their earning capacity. The drop in real estate prices was a hard blow especially to finance companies, since a large part of their lending was in this sector.

In the downward spiral, the value of collaterals for loans decreased rapidly, and lenders became more restrictive in their lending (credit crunch). Borrowers reacted by selling their collateral, which further contributed to falling prices. Business liquidations and bankruptcies among borrowers followed in quick succession. The financial institutions that were hardest hit by the crisis were obviously those that had taken the greatest risks and thus contributed to the speculation. In the early this trend was magnified by an international recession. What had initially been a financial crisis caused by a price decline in one sector, the real estate market, now took on the appearance of a full-fledged industrial structural crisis. Business bankruptcies rapidly rose in number and added to banks´credit losses. The large share of credit losses were attributable to commitments toed to finance and real estate businesses. Credit losses in the consumer lending sector, on the other hand, were kept at a relatively low level.

Since the crisis deepened, the government had to step in as a lender of last resort, to assume responsibility for the financial system. In other countries, governments have resorted to measures of various sorts primarily to avoid panic and bank runs and thereby ensured that investors and depositors did not lose any money. When the Swedish government in 1992 adopted a series of measures to strengthen the financial system, it decided to go a step further. The government offered to guarantee that banks and certain credit institutions would meet their commitments on a timely basis. This would be accomplished by providing financial support to viable organisations that could be expected to be profitable in the long run. The so-called Bank Support Authority (Bankstödsnämnden) was established to implement these support means. The bank support was designed along the same line as was used in previous crises, since the early 19th century.[22] Most of the support this time went to the state-owned bank, Nordbanken, and the rest to the other banks that have adopted an aggressive policy of lending in the 1980s.

[22] Hagberg, *Bankkrishantering* (2007); Kärrlander, *Malmö* (2011).

In June 1996, a total of approximately SEK 65.3 billion had been paid out via the government bank support. However, a substantial part of these money was recovered. The net cost for state has been estimated to 35 billion.[23] This figure measure the reduced wealth of the state, but does not consider other effects on the state budget or any effects on the national economy, such as increased costs because of a higher rate of unemployment. The government has not only to decide about the depth of the support, but also the length of the intervention. In comparison with previous crises, the time of the rescue operation during the 1990s crisis was shorter. In the crisis of 1870s, it took 14 years before the railroad fund was eventually dismantled, and in the crisis of the 1920s, the government guarantee was retained for 15 years. In the rescue operations of banks in the 1990s crisis the process was over in 6 years.[24]

Already before the crisis, the badly hurt Nordbanken was a partly state-owned bank, as a direct result of the state intervention during the banking crisis in the early 1920s. During the Deflation Crisis 1920-21, the private bank Svenska Lantmännens Bank suffered from huge credit losses. In the reconstruction of the bank, the state took 90 percent of the voting stock and the name was changed to Jordbrukarbanken. In 1951, the state ownership was transferred into a larger commercial bank by the establishment of Kreditbanken. In a merger with Postbanken in 1974, the state-owned PK-Banken, the state ownership increased even further. Two main motives of a strong alternative to private banks was to 1) control transactions and manage credit within the growing public sector, 2) increase the competition in the credit market and reduce undesirable effects of the power of private capitalists. However, the state played a passive role as shareholder and the state, both the main right-wing and left-wing political parties, declared that bank should operate on strictly commercial

[23] Jennergren/Näslund, 'Efter bankkrisen' (1998).
[24] Larsson/Sjögren, 'The Road' (1997), 7.

basis. Many other state-owned companies at this time were part of regional political programs, but PK-Banken was not, which confirms the arm´s length distance to the state. This market-based view was deepened in the 1980s, when they state lifted most restrictions on the capital market and rule its possibilities to control the banking industry.[25]

In 1990, PK-Banken bought up the smaller Nordbanken, and changed name to Nordbanken. PK-Banken had started a process of privatisation, and the intention from the state was to reduce its ownership. However, in the following crisis, the new Nordbanken experienced substantial liquidity problems and the government decided intervene, by a capital injection and increasing the ownership to 100 per cent of the voting stock. The financially reconstructed Nordbanken continued to operate, while non-performing loans in the bank were transferred to a so called bad bank – Securum. The government also decided to rescue the private commercial bank Gota Banken, where non-performing loans were placed in the bad bank Retriva. In 1993, even this bank had to be taken over by the state, with the same motive as in the deflation crisis 1920-21, to guarantee the deposits of households and firms (no law of deposit insurance at this time). The government also supported in the reconstruction of the private bank Första Sparbanken, by giving non-interest bearing loan and providing bailments. All these operations were done within the framework of the Bank Support Authority.[26] The Minister of Finance in the right-wing government, Anne Wibble, argued that holdings and assets have been taken over by the state should be sold out, but she also stressed that there was no hurry.[27] The dip in the market for properties and the turbulent financial market

[25] Larsson, *Staten* (1998), 160-76.
[26] Bergström et. al. *Securum* (2002).
[27] Regeringens skrivelse 1992/93:251.

suggested a slow process of divestment, in order to wait for better prices and subsequently less losses for the state.[28]

Table 2. Number of savings banks and commercial banks selective years 1985–2010.

	1985	**1990**	**1995**	**2000**	**2005**	**2010**
Savings banks	139	104	91	79	68	50
Commercial banks	15	21	30	47	56	62
- **of which foreign banks**	0	9	11	21	28	29
Savings bank offices	1265	1228	349	269	232	182
Commercial bank offices	1451	1366	2252	1790	1805	1701

Source: Petersson 2009, p. 43; Swedish Bankers´Association, Bank- och finansstatistik 2011, p. 3.

Remarks: Every head office is included in the number of offices. Bank branches are included in foreign banks.

Evidently, state intervention during bank crises is a tradition in Swedish finance, an institution characterized by strong path dependency. Nevertheless, the rescue operations and public financial support in the 1990s crisis led to a political debate on long-term state intervention and nationalized commercial banks. Since the state-owned bank – Nordbanken – had proven to be one of the worst

[28] Swedish Government, *Propositioner (Government Bills)*, 1991/92: 153; 1995/96: 172.

examples of speculative lending and credit losses, the argument for more extensive state-ownership was less valid, however. Besides, various motives for state ownership in the banking sector that was prevalent in the 1970s became obsolete after the deregulation of the credit market in the 1980s. However, some motives still remained in the 1990s. The former chairman of Norbanken, Tony Hagström, argued that state-ownership fulfilled a national interest, with the means to prevent that the domestic market would be taken over by foreign banks. Another argument was that a state-owned bank could be used for regional policy interests, but also to satisfy financial needs within housing programs and during periods of structural transformation. The motive was that certain financial transactions and infrastructural investments would never became enough profitable for private banks to consider. Thus, an optimal exploitation of capital in a developing and democratic wealth society needs a back-up from a close ally as a state-owned bank. But even these motives, mainly emanating from left-wing representatives of the state, were surmounted in the political rhetoric under the era of market-orientation that directed the policies and strategies in the 1990s.[29]

Once the crisis management was over, the intention by the state to reduce their ownership in the banking sector was on top of the agenda. In 1995 one third of the stocks were sold out and in a governmental bill the year after, the social democratic finance minister Göran Persson stressed that the parliament has agreed on selling out all shares in Nordbanken. He also put attention to the fact that one of the objectives of the Bank Support Authority was to prepare Nordbanken for a total sale, i.e. to dress the bride before the wedding.[30] However, the selling-out of shares turns out to be a slow process. Between 1997 and 2001 Nordbanken became a part of the new banking concern that was

[29] Larsson/Sjögren, *Vägen* (1995), 156-69; Larsson, *Staten* (1998), 216; Anell et al., *Staten* (1992), 163-68.
[30] Swedish Government, 'Propositioner' (1995/96), 45.

established in Norden: Nordea.[31] In 2007, the right-wing government was repeating the intention to sell out all shares, but in the sub-prime-loan crisis starting in 2008, the state had to activate its role as a lender of last resort once again: the state participate in the new issue of shares by making use of all its subscription rights. In 2011, finally, the state ownership in Nordea was reduced, from 19,8 per cent to 13,5 per cent.[32]

4. Danish banking crisis and government intervention

In contrast to Sweden, Denmark has a limited tradition for state ownership of industrial firms in general and financial institutions in particular. The technological, political and economic modernization processes in the early Danish capitalism was marked by a relatively weak state. It was characteristic that the imperative introduction of new dairy methods in the agricultural sector in the 1880s resulted from private, decentralized initiatives as did the establishment of new infrastructures such as telecommunication in the 1890s and electrification in the 1900s. The Danish state was also absent in the formal institutional setting concerning the regulatory market formation processes. The initial banking law came as late as 1919 while the earliest competition law came in 1931. The financial sector was thus relatively unregulated from the establishment of the first bank in Copenhagen in 1857 to the 1910s.[33]

The possible need for banking regulation was present in the contemporary economic-political debates – in particular following the banking crisis in 1907-08, caused by a building boom in

[31] Nordea was founded as a result of a merger between the Danish Unibank, the Finnish Merita Bank, the Swedish Nordbanken and the Norwegian Kristiania Bank.
[32] Swedish Ministry of Finance, ‘Press release’ (2011).
[33] Iversen/Andersen, ‘Cooperative’ (2008).

Copenhagen. The crisis caused state intervention but a legal enforcement of financial rules and regulations was avoided by a coalition of the agrarian and liberalistic political party ”Venstre” and the industrial classes in the right wing conservative political party.[34]

The First World War was followed by a new banking crisis. The government made an intervention providing access to liquidity when the largest Danish Bank, Landmandsbank, came in server problems in the 1922. In contrast to Sweden the Danish banking crisis of the 1920s did not lead to long-term state ownership of the Danish banks. The reconstruction of Landmandsbanken was a complicated and politically sensitive process and only in 1928 the Danish state did initiate a long term agreement for the continuation of the bank. The influential and wealthy shipowner, A.P. Møller, decided to invest in the bank in the mid-1930s by an ownership of approximately 20 per cent. The shipowner publicly expressed that the motive was to avoid permanent state-ownership of the bank and consequently political influence on its businesses.[35] A new restrictive banking law followed in 1930 and consequently the limits for banking operations, bank management and bank investments became explicit. A long stable period followed with national-based, restrictive legal framework and only few banking crises.

The deregulation of the Danish banking sector in the 1980s was a gradual process, initiated by the termination of the strict restrictions on lending and interest rates levels in respectively 1980 and 1981. These measures were followed by the implementation of international regulation standards in the early 1990s in particularly the second EU banking directive. As was the case in Sweden the deregulation of banking sector caused an increase in the risk taking and lending profile of a number

[34] Hansen, ‘Bankredninger’ (1997).
[35] Hornby, *Ved rettidig* (1988).

of primarily regional and local banks. Still the Danish banking crisis of the late 1980s and early 1990s was solved by the industry it-self and it was not a systemic crisis.[36] There have been pointed at two important reasons for the relatively mild Danish banking crisis of the late 1980s and early 1990s. Firstly the Danish banks had gradually implemented their growth strategies accordingly to the changing regulatory regime and the national and most important banks kept a sound balance between lending and deposits. Secondly the Danish crisis was encapsulated by the consolidation of the industry. In 1990 six of the largest Danish banks merged into two major national banks: Den Danske Bank and Unibank, and simultaneously relatively large banks such as Sydbank and Jyske Bank acquired a number of local and regional saving banks and private banks.[37]

Table 2. Number of commercial banks, foreign banks and bank offices in Denmark 1991–2013.

	1991	**1995**	**2000**	**2005**	**2010**	**2013**
Danish banks	219	198	185	161	123	88
Foreign banks	6	11	19	22	12	15
Bank offices	2652	2215	2159	1975	1598	1155

Source: Finansrådet, 'Pengeinstitutter' (2014).

In the decade from the mid-1990s to mid-2000s the Danish financial sector went through a formative phase marked by aggressive growth based on three fundamental strategies. Firstly the large banks mentioned above made a related, national diversification acquiring insurance

[36] Hansen, 'Bankredninger' (1997).
[37] Abildgren/Thomsen, 'En fortælling' (2011).

companies, mortgage institutions and investment banks. Secondly the large banks internationalised. The pan-Nordic bank Nordea was established in year 2000 and Danske Bank internationalized through acquisitions in Scandinavia and Ireland and Northern Ireland - culminating with the acquisition of Finnish Sambo Bank in 2008 – the hitherto largest acquisition in Danish business history. Thirdly Danish banks expanded their activities by increasing lending and by introducing new innovative financial products. In 1996 the Danish Mortage Banks introduced a new flexible loan with a variable interest level based on short term loans. This flexibility was enhanced with a new legislation in 2003 which made it possible to include up to ten years postponement of the repayment.[38] From 2003 to 2006 in particular a number of regional and local banks introduced more aggressive growth strategies congruently with a high growth in the real estate prices in particular in Copenhagen.

Table 3. Annual growth of total credit volumes in various Danish banks 2003–2007. Percentage.

	2003	**2004**	**2005**	**2006**	**2007**
Danske Bank		11	20	15	25
Nordea	0	10	17	-3	14
Jyske Bank	-33	17	22	18	25
Sydbank	14	22	28	20	3
Roskilde Bank	13	39	55	59	37
Amagerbank	-4	16	59	38	36

Source: Iversen, *Sidste udvej* (2013).

[38] Rangvid, *Den finansielle* (2013).

In 2006 the profitability of Danish banks peaked when the return on equity reached an average of 19 per cent for the 20 largest banks.[39] In the same year total lending of Danish banks grew by 26 per from 2005 to 2006 from 1,342 million DKK to 1,691 million DKK– equivalent to almost 100 per cent of the Danish GDP. Deposits on the other hand only grew by 9.4 per cent to 1,290 billion DKK.[40] This growing misbalance combined with a general high exposure towards property and construction mirrored a rising fragility of the Danish banking sector, particularly in the five years from 2003 to 2008. From the spring of 2007 the general Danish demand for property stagnated while the supply continued to rise. That eventually caused falling real estate prices from the summer of 2007. For some of most risk-oriented banks the combination of falling property prices and increasing demand caused an immediate pressure on some of the large real estate customers.

Roskilde Bank, one of the ten largest banks in Denmark, experienced a liquidity pressure in June 2008 and the national bank decided to ensure the short term survival of the bank by issuing a non-limited credit facility. By late August 2008 the Danish national authorities had to realize four important interrelated characteristics of the situation: Firstly it was clear that Roskilde Bank did not live up to the legal solvency demands. Secondly no private institutions had showed any interest in acquiring the bank. Thirdly the situation in Roskilde Bank, with substantially higher lending than deposit combined with high exposure towards large costumers in the troubled Danish real estate market, was not unique. At least 5 to 10 local, regional and in the worst-case national banks faced similar problems. Finally a global financial crisis developed week by week and consequently the

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[39] Finansrådet, 'Pengeinstitutter' (2014).
[40] Iversen, *Sidste udvej* (2013).

troubled bank faced accelerating problems in the daily access to capital, which ensured the necessary solvency degree.

As a response to these challenges the Danish government, the financial supervisory agency (FSA), the national bank and the organization of private banks (Finansrådet) initiated negotiations for the introduction of measures, which could ensure the financial stability of the country. The result was the so-called "stability package" which consisted of two important measures. Firstly the Danish state provided an unlimited guarantee on all deposits and other unsecured claims. The unlimited guarantee was temporary for two years until the end of September 2010. The guarantee was provided to all Danish financial institutions, which were members of the "Det Private Beredskab" – an organization for sectoral self-insurance in relation to deposit guarantees. Secondly a new state-owned financial institution was founded that could take over the obligations of troubled banks: Finansiel Stabilitet A/S.[41]

In relation to the actual structure of the intervention already the initial negotiations in September 2008 showed that the Danish state and the private actors of the banking industry agreed that the private sector should as far as possible solve the crisis itself by paying a "self-insurance" to the state for providing a guarantee which could ensure domestic and international trust in the Danish banking system. During the negotiations it became clear that a number of Danish banks were so economically strained that on the one hand they could not live up to the legal solvency requirements and on the other hand no private banks were willing to take over there portfolio of loans. In the by-laws of Finansiel Stabilitet it was stated that primary purpose of the organization was to dismantle

[41] "Det Private Beredskab til Afvikling af Nødlidende Banker, Sparekasser og Andelskasser" (Det Private Beredskab) was founded June 13, 2007 by the Danish organization of private banks (Finansrådet). This guarantee was limited to 300,000 DKR or app. 40,000 Euro.

its own assets. It was regarded as a temporary organization which should ensure the Danish financial stability in a transitional and turbulent period. The costs of setting up Finansiel Stabilitet were until October 2010 covered by the private sector which continued to contribute to the reconstruction of other private banks.

The board of directors of the Finansiel Stabilitet was appointed in November 2008 and the Danish state decided to appoint two private bankers for the chairmanship, as chairman former bank manager in Nordea, Henning Kruse Petersen and as vice-chairman former bank manager in Danske Bank, Jacob Broholm. These two private actors then decided to employ the former manager of the Danish financial supervision agency (FSA), Henrik Bjerre-Nielsen as daily leader of the new institution. The objectives of Finansiel Stabilitet were discussed in a board meeting in mid-December 2008. In the discussion Mr. Bjerre-Nielsen emphasized that it was "a new company, with an unusual business". The objective of Finansiel Stabilitet was, according Bjerre-Nielsen, to ensure financial stability by "... fulfilling its obligations under the guarantee scheme as cheaply as possible."[42]

It was established that Finansiel Stabilitet was partly a public enterprise under the Economic and Business Ministry and partly - as a result of the formation of the first subsidiary, EBH Bank A/S, overtaken two weeks earlier - a financial holding company. This was followed by an outline of an overall business strategy. The CEO emphasised that a swift dismantle of assets was desirable but at the same time “it would be appropriate to keep those activities where a quick sale due to a temporary loss of demand can only be done at prices that do not reflect expected future earnings -

[42] Finansiel Stabilitet Archives (FS), Board meetings, 16 September 2008.

eg. in real estate."[43] The objective of Finansiel Stabilitet was thus to define the balance between the desire of swiftly divest activities of the failed banks and on the other hand to maintain assets if there was a legitimate expectation of improvement in the economy and thereby increasing prices.

In February 2009, the Danish government decided upon a second banking legislation "package", which aimed to support the liquidity of the Danish banks – and thus the general access to credit in the Danish economy. The law was two-fold with a scope of three years. Firstly, it was decided that Danish banks could apply for access to hybrid core capital injections from the Danish state and secondly the banks could apply for an individual state guarantee, which could be used in relation to the issuance of bonds. The Danish Ministry of Economy and Commerce should administer the former scheme while the new state owned bank, Finansiel Stabilitet, should administer the latter.

Finansiel Stabilitet's activities were thus separated in two important spheres: (1) The take-over, sell off and continuation of troubled banks and (2) the assessment of applications for individual state guarantees including a monitoring process. From the founding in October 2008 to the end of 2012 Finansiel Stabilitet (and thus the Danish state) took over three medium-sized regional Danish banks and six smaller banks:

1. EBH Bank (November 2008)
2. Roskilde Bank (July 2009, after one year ownership of the National bank),
3. Amagerbanken (February, 2011)
4. Fionia Bank (March 2009)
5. Capinordic (April, 2009)

[43] Iversen, *Sidste udvej* (2013).

6. Løkken Sparekasse (June 2009)
7. Eik Banki (January 2010)
8. Fjordbank Mors (June 2011)
9. Max Bank (October 2011)

Despite the administrative division and sale (green bank) of these banks, Finansiel Stabilitet provided individual state guarantees to 56 Danish banks amounting to 335,7 billion DKK out of which guarantees of 191,7 billion DKK were used to issue bonds on the financial markets. In its annual report of 2011, Finansiel Stabilitet stated a total balance of 54,5 billion DKK and the state owned holding company employed approximately 500 people. Despite the Danish tradition for limited state ownership, the Danish state was, two and half year after the acceleration of the financial crisis in the summer of 2008, now deeply involved in the Danish financial sector: From dictating the rules of the games, to providing hybrid capital injections and state guarantees while acting as owner and employer. These were large and historical changes – unique in Danish business history.

5. The perception of the state – a comparative analysis

A comparison of the political responses to the Swedish banking crisis in the early 1990s and the Danish banking crisis in the late 2000s unveils important similarities and differences. The similarities include the background of the crises, on the one hand pressure on the solvency in a number of banks which in the previous booming years had executed an aggressive growth strategy, and on the other hand lowering price levels on the domestic housing market. At the time of the each crisis, the state interfered in a number of ways in order to encapsulate the crisis and ensuring financial stability. In both cases the governments combined all types of banking intervention measures, which illustrates the gravity of the crises.

Another notion is that the financial system of Denmark and Sweden underwent the same process before, during and after their respective crisis (re-regulation during a long period of boom, financial innovations, surplus of liquidity, debt accumulation among firms and households and burst of the bubble). These similarities confirm the existence of a deterministic cycle of crisis, suggested by Nordic financial historians.[44] This model also predicts an active role play by the state, after the bubble has burst and the banking industry has to be restructured. Besides, we can´t leave out the possibility that the successful way of banking crisis management in Sweden, both encouraged and helped the Danish government to direct the acute problems in the banking sector. Interestingly, the contagion from the sub-prime loan crisis hit Denmark much harder than the other Nordic countries, while Denmark only experienced a mild crisis in the early 1990s, when the other three economies underwent deep crisis. In the post-crisis period Finland, Norway and Sweden implemented stricter norms in the credit market and did not take part in the hausse that characterized the many assets markets before the sub-prime-loan crisis. The Danish banking sector lacked that discipline. Instead, new high-risk financial innovations were introduced, and loans and prices on the property market sky-rocketed up to 2008. The Danish banking sector became fragile and their customers heavily indebted. Not surprisingly, Denmark suffered most among the Nordic countries during the latest world-wide crisis.

[44] Sjögren/Knutsen, 'Why do' (2009).

In this comparative analysis, we will focus on the most radical type of intervention: when government set up a new organization for financial stability and take direct ownership control in one or more insolvent banks. Here it is possible to disclose important differences between the Swedish and the Danish case. In fact, already at the beginning of each crisis, there were significant national institutional features, which explain the further outcomes. First, one of the troubled Swedish banks, Nordbanken, was owned by the state prior to the crisis. In the Swedish case the financial stability was ensured by direct state investments in three troubled banks: Nordbanken, Gota Bank and Första Sparbanken. When the Swedish economy recovered from the mid-1990s, marked by lower interest rates, the government start to sell out assets, and the public bank support could close earlier than was expected (mid 1997). The state ownership in Nordbanken and later Nordea was reduced gradually from 1995 and onwards.

In the following public debate of state ownership of banks in Sweden, two lines of reasoning were evident. The state intervention measures were either criticized for being too generous, or for not doing enough. Regarding the first, the argument was that it is not a purpose for the state to preserve the structure of financial market. Rather, it should be stated that there are high risks involved in banking. Consequently, when performing poorly, they should go into bankruptcy. The reasoning reflected the dilemma of moral hazard: in case of bailout expectations among the banks, they will take on additional risks. In the second line of reasoning, the focus was on the risk of spill-over effects on the inter-bank market and the risk of a debacle of the entire financial industry. Besides, the fact that the Swedish customers did not have any deposit insurance was said to be a large problem: that institution was introduced after the crisis. Thus, there was a public opinion in favor or massive bailouts and reconstructed banks. But there was also a third type of reasoning. Some representatives of left-wing parties saw the crisis as an opportunity for increasing the state ownership in the banking sector.[45]

In Denmark the liberal-conservative government coalition proclaimed already at the end of 2008 that it was not the ambition of the state to become an owner of the banks. There were two guiding principles in the crisis legislation, which differed from the Swedish case of the 1990s. Firstly it was stated that the assets taken over by the state should be divested as soon as it would be economically viable. Any possible advantage of long-term state ownership was not considered in the legislation, the by-laws, the strategy discussion or even the public debate. The second guiding principle was "self-payment". It meant that the private sector in principle should cover the expenses of the state intervention. During the negotiations between the Danish government, the Danish financial supervisory agency (FSA), the national bank and the bankers association, the liberal-conservative minister of commerce, Lene Espersen, presented the funding solution as an "insurance-system". It meant that the private sector should pay an insurance fee of 15 billion DKK for the state guarantee, plus an additional 10 billion DKK which covered the running costs of dissolved banks over two years. At the end of September 2010 the self-payment proved a surplus of 2,5 billion DKK which then was transferred to Finansiel Stabilitet in order to finance the following cases of disrupted banks. The combination of divestment as the guiding principle and self-payment mirrored that the crisis violated a specific Danish liberal tradition of solely private ownership. The state and private actors were forced to identify solutions which could limit long-term state ownership, and at the same time enforce the view of the private banking sector as one that is able to solve challenges without the support and guidance of the state.

[45] Larsson/Sjögren, *Vägen* (1995), 164.

The Ministry in both Denmark and Sweden declared the intention to sell out assets that have been taken over in the bailouts as soon as possible. However, in Denmark this policy was put forward more explicit and implemented as an immediate response to the crisis in the fall of 2008. In the Danish case there was no tradition for state-ownership of banks when the financial crisis started in the late 2008. The perception of the state as a possible owner of financial institutions was thus different in Denmark than in Sweden. The different more private-oriented perception had direct consequences for the Danish banking crisis in at least two ways: firstly for the structure of the state intervention, and secondly for the following public debate about the banking crisis. The debate in Denmark in 2010 and 2011 did not questioning the two above mentioned guiding principles. On the other hand, it was questioned to which extent Finansiel Stabilitet had been efficient enough in securing the interests of the state. The most important performance criterion of Finansiel Stabilitet was thus the highest possible level of divestment under the lowest possible level of overhead.

Both the actual structure of the Danish interventions and the following public debate mirrored a Danish perception of the relationship between the state and the private banks which was remarkably different that the perception of the state in the Swedish case of the 1990s. We know that institutional change is a deliberate process shaped by "the perceptions of the actors about the consequences of their actions", and that these perceptions partly result from the cultural heritage.[46] Thus, even perceptions concerning state intervention in the banking sector is a result of actors trying to explain and interpret the world around them. Both banking crises caused formal institutional changes in terms of new regulations and laws and also informal institutional changes in terms of changed behaviour in the banks in particularly towards less risk and growth oriented banking practices. The Danish and Swedish cultural heritage was remarkably different in terms of

[46] North, *Institutions* (2005), 22-23.

traditions for state ownership of banks. The Swedish intervention in the early 1990s followed on a long tradition for state ownership, while the Danish solutions to the accelerating crisis in the fall of 2008 built upon a deeply rooted aversion against state ownership, which was shared between the private and the public key actors. Nevertheless, the Danish state owned and controlled Finansiel Stabilitet in the fall of 2014, six years after banking crisis began. Possible changed perceptions to state ownership are still unwritten.

6. Conclusion

The many banking crises in Europe, after the sub-prime loan crisis in the US, bring up to date the role of the state in the financial system. To rescue the system and stabilize the banking sector, various national states have been forced to make extra ordinary operations. In some cases, these activities have led to private banks becoming state-owned. Since these far-reaching governmental interventions have not always come uncompelled, we need to analyse motives behind the public policies during and after banking crises. In this article we analyze objectives that might justify public bank ownership. Especially, we follow intrinsic principles and perceptions, and explain them in historical and a contextual manner. Our empirics come from the latest banking crises in Sweden and Denmark.

Our study shows that bank crises are major issues for each government to tackle, since the consequences of bank failures could be disastrous for the whole economy. This consideration lead to a pragmatic view on state-ownership in the banking sector: from an economic and democratic point of view the alternative to bailouts might be even worse. However, the perceptions and the argumentation from ministers reflect previous national experiences. The Danish and Swedish economy history is quite different in terms of traditions for state ownership of banks. Thus, the Danish government has been reluctant to accept state-ownership, while the operations made by the right-wing government in Sweden in the 1990s followed on a long tradition of state involvement. In a European perspective this notion is interesting, since it implies that contemporary ideology and party-colour means less. Rather, the way the crises were managed illustrates a high degree of path-dependency in relation to the state interference, regarding the choice of measures and the implementation in terms of either taking control of existing troubled banks (Sweden) and/or setting up new holding companies for bad loans (Sweden and Denmark).

Although governmental intervention as state monitoring of banks is used by both liberal market economies, such as the UK, and coordinated market economies, such as Germany and the Nordic countries, the motives on behalf of the government have to be adjusted to previous experiences and handling of crises.[47] Our results suggest that the argumentation for state intervention has to be massive, resolute and rapid. The reason for that is that all types of state intervention affects market incentives and tax payers in the long run. Thus, for an intervention to be economically effective and democratically accepted, the public argumentation has to be explicit, especially if it causes a break to what historically is viewed as a norm.

The policy implication of the treatment of the two Scandinavian crises is that state intervention in terms of state-ownership and state-controlled bad banks are effective ways to stabilize the financial system. In fact, the institutional arrangement set up internationally d to handle crises has been

[47] Hall/Soskice, *Varieties* (2001).

inspired by the treatment of the Danish and the Swedish banking crises.[48] With an explicit target - to reach the highest possible level of divestment under the lowest possible level of overhead – the governmental operations have a chance of being successful, not being a financial burden for the taxpayers.

Every crisis induces a great opportunity to implement more effective principles of corporate governance in the banking sector. Thanks to the crisis, there will be a change of business leaders, a replacement of board members and a reintroduction of less speculative banking practices. Besides, the public view on excesses in the financial sector will be strongly negative. The new public policy should also emphasise the importance of discipline and a higher level of equity capital in relation to credit volumes.

[48] Economist, 'Swedish model'.

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