

# Financialization in Swedish Capitalism

*Debt, inequality and crisis in Sweden, 1900-2013*

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Academic dissertation for the Degree of Doctor of Philosophy in Economic History at Stockholm University to be publicly defended on Friday 22 December 2017 at 13.00 in hörsal 2 hus A, Universitetsvägen 10 A.

## **Abstract**

This dissertation addresses financialization – the increasing role of financial activities in the overall economy – in Sweden in 1900-2013. The focus is on the long run relationships between private debt, asset markets, inequality and financial crisis during this period. In line with established scholarship, the present study finds that changes in bank debt had a positive impact on the probability of financial crisis in Sweden. Functional income distribution between profits and wages was an underlying factor influencing the formation of bank debt levels through its impact on collateral in stock markets. Expenses related to the Swedish welfare state – the size of the public sector, government investment and housing construction – had a long run relationship with the wage share. The welfare state has been an effective counter-measure not just against a high profit share, but also against financialization. Moreover, the dissertation shows that the recent era of financialization in Swedish capitalism is not unique in kind. Rather, recent financialization is very similar to the macroeconomic situation during the early decades of the 20<sup>th</sup> Century. These findings are consistent with much of heterodox economic theory, in particular the Neo-Marxist approach.

**Keywords:** *debt, inequality, financialization, financial crisis.*

Stockholm 2017

<http://urn.kb.se/resolve?urn=urn:nbn:se:su:diva-148711>

ISBN 978-91-7797-063-7  
ISBN 978-91-7797-064-4  
ISSN 0346-8305



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ISBN print 978-91-7797-063-7

ISBN PDF 978-91-7797-064-4

ISSN 0346-8305

Printed in Sweden by Universitetservice US-AB, Stockholm 2017

Distributor: Department of Economic History

To Runo





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## Acknowledgments

I wish to thank my mother Marianne Ahnland and my late father Runo Ahnland for raising my interest in politics and economics at a young age. I also want to thank my wife Lotta Ahnland and my children Anton Ahnland and Maja Ahnland for moral support and sacrifices made during this journey. I thank my supervisors Dr. Rodney Edvinsson and Dr. Jonathan Michael Feldman for invaluable support and encouragement during the writing of this thesis, which would not have been possible without their help. Additionally, I thank my colleagues at the department of Economic History at Stockholm University for feedback on drafts and for their wisdom in general – particularly I wish to thank Erik Hegelund and Susan Jackson in this respect. I also want to thank Jan Wallanders och Tom Hedelius Stiftelse for giving me the opportunity to continue the research in this thesis.

## Abbreviations

ADF-GLS	Augmented Dickey-Fuller test with generalized least squares
FIH	Financial instability hypothesis
GDP	Gross Domestic Product
IMF	International Monetary Fund
IRF	Impulse-response function
KPSS	Kwiatkowski-Phillips-Schmidt-Shin test
LO	Landsorganisationen i Sverige
NDP	Net Domestic Product
OECD	The Organisation for Economic Co-operation and Development
SAP	Sveriges socialdemokratiska arbetareparti
SAF	Svenska Arbetsgivareföreningen
SSA	Social Structures of Accumulation
UK	United Kingdom
USA	United States of America
VAR	Vector autoregression
VEC	Vector error correction
VF	Sveriges verkstadsförening
QTM	Quantity Theory of Money

## Preface

During the Dot.com bubble in 2000 I met with a CEO from Merrill Lynch, one of the largest American investment banks at the time. He was thrilled about the growing number of Ultra High Net Worth Individuals, people with at least five million dollars of liquid assets, in Sweden. They represented one of the most important client groups for the bank. According to him, there were “several of those here. In that sense there is enormous welfare in Sweden” (Ahnland 2009, p. 62).

One year before, the government had released a report on the social development in Sweden during the 1990s (SOU 2001:79). In the aftermath of the bust of the previous boom – the 1980s stock- and real estate-bubble – the public sector had fired one out of five teachers and one out of four healthcare workers, as part of “cleaning up” its finances. Child and youth psychiatry had its share of the expenditure cuts as well, even though the number of young with mental health problems had tripled during the 1990s. Unemployment had five-folded during the crisis (Erixon 2010), and as inequality rose, families with children were particularly troubled. Immigrant children were the worst off. Similar human disasters occurred several times during the 1990s in crisis-struck countries around the World.

The global financial meltdown in 2008 took its toll on human welfare as well. For instance, at least 10.000 additional suicides have been linked to the crisis in Europe and North America (Reeves et al. 2014). The cost has also been political. The extreme right has strengthened its position all over the Western world. In Sweden, the persistently high unemployment since the 1990s has been fertile soil for the immigration-hostile Sverigedemokraterna (Ahnland 2014). A study covering 20 countries in over 140 years finds that far-right parties tend to increase their votes dramatically after financial crises, due to their ability to blame minorities or foreigners (Funke et al. 2016).

Rather than putting the spotlight on those at the bottom of the social ladder, this dissertation directs it towards the top. In 1999, the Swedish business man Robert Weil (2008) thanked the Swedish wage-earners for abstaining from wage gains and letting the capital-owners thrive, but claimed that “the party is now over for capital”. Nine year later he confessed that the statement had been wrong, and even though the financial world tumbled later that year, it would rise again. But history teaches us that financial excess does not last forever.



# 1. Introduction

This dissertation is about financialization in the modern history of Sweden. Financialization can loosely be described as the heightened role of financial markets for the operation of the economy in general (Epstein 2002). According to financialization theory, Western capitalism has become increasingly reliant on accumulation in financial markets for realizing surplus value since about 1980 (Foster and McChesney 2010). This dissertation shows that this phase in Swedish capitalism is not unique in kind, and that it displays many similarities to the situation of the early decades of the 20<sup>th</sup> Century. Correspondingly, the period in between can be characterized as a period of definancialization, due to political efforts to “embed” capitalism.

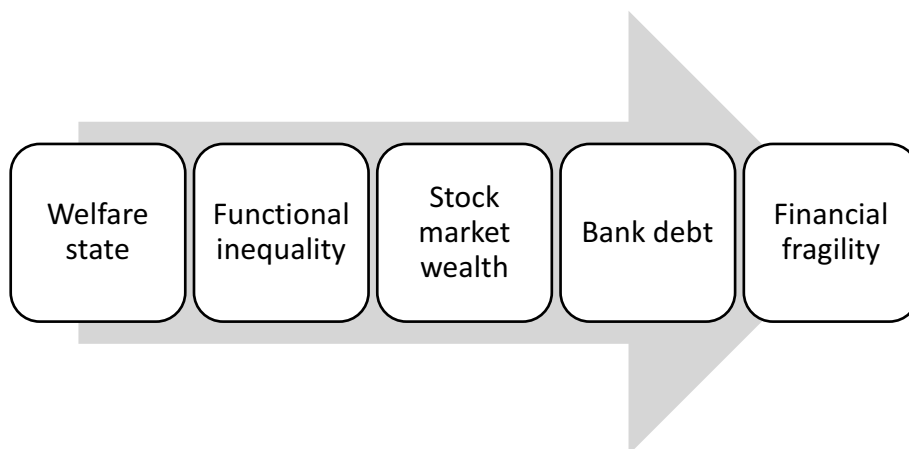
Though the concept of financialization has been loaded with different meanings, a comprehensive account of its meaning is offered by Palley (2007). Among the most central aspects are: increasing inequality (of both functional and household incomes), high asset prices, a high level of private debt, and an increasing frequency of financial crises<sup>1</sup>. This dissertation shows that these variables, in large part, share a co-movement in Sweden over the 1900–2013 period. More than just providing a descriptive narrative of financialization in the case at hand, the dissertation employs econometrics in order to propose a specific explanation for its development: I.e. functional income distribution can explain Swedish financialization, and the Swedish welfare state has limited this financialization process mainly through its impact on the functional income distribution.

Although the development of each variable is far from monocausal and relies heavily on history and institutional change, it is possible to propose a stylized causal mechanism in the case at hand based on the findings presented in this dissertation. This scheme is summarized in Figure 1 below.

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<sup>1</sup> Other important aspects of financialization, such as shareholder value orientation and stagnant or diminishing fixed investment, are briefly discussed in the Kappa, but are not part of the investigation.

Figure 1: Causal model of the dissertation



1. The extent of the welfare state determines functional income inequality.
2. Functional income inequality determines stock market wealth relative to GDP.
3. Stock market wealth provides collateral for bank debt.
4. Bank debt affects the degree of financial fragility of the economy.

The theoretical framework for explaining this process is predominantly Neo-Marxist, but is also complemented with other strands of heterodox economic theory, such as Post-Keynesianism and the Social Structures of Accumulation (SSA) approach. There are many common features between these economic traditions, particularly between Neo-Marxism and a brand of Post-Keynesianism sometimes referred to as “Left Keynesianism” (King 2003, pp. 49–52).

Sweden is a particularly interesting case to examine because the country has harbored one of the strongest working class movements in the capitalist world, and developed one of the strongest welfare states in the world, during the 20<sup>th</sup> Century. At the same time, financialization, according to some measures (such as the private debt to GDP ratio and the development of the top income share), was also among the strongest in the world since 1980, at a time when the expansion of the welfare state came to a halt. Also, the country is rich in historical data relevant to financialization.



## 2. Overview of the dissertation

The dissertation comprises four articles, which are summarized below. The rest of the Kappa consists of a discussion connecting the four articles to a broader theoretical framework. It shows that the articles together form a holistic perspective on financialization in Sweden during the period of investigation. Each article puts the spotlight on different and central aspects of this financialization process. Though different, predominantly heterodox, economic theories are emphasized in each article, they nevertheless complement each other and rest on a common ground, often at odds with mainstream economics. Specifically, the discussion shows how the assumptions of stability and long run general equilibrium are refuted in the theories, and explains why this is important for an analysis of the nonstationary time-series examined in the dissertation. Additionally, the Kappa includes a discussion of how theories of political economy, and the periodization inherent in these theories, shed light on the nonstationary processes discovered in the dissertation. This periodization is subsequently employed in order to explain the modern economic history of Sweden in light of financialization and definancialization. A concluding discussion shows how these various strands of argument are connected to each other.

## 3. The articles

### *3.1. Article I: Private debt in Sweden in 1900–2013 and the risk of financial crisis*

The first article makes two contributions. The primary contribution is the reconstruction of a time-series of private debt in Sweden in 1900 to 2013, divided into three sub-classes: bank debt, housing mortgage debt and “other debt”. The “other debt” category includes industrial, shipping and agricultural mortgage, credit companies, and finance companies. The secondary contribution is a first application of this data, as an independent variable explaining the risk of financial crises in Sweden during the period of investigation. The study finds a significant relationship between financial crises and bank loans two years before crises, indicating a possible causal relationship in line with theory. The theoretical framework used is the Minskian financial instability hypothesis (FIH), linking profit expectations, asset prices and debt levels to financial crises.

### *3.2. Article II. Inequality and bank debt in Sweden in 1919–2012*

The second article is a second application of the data presented in the first article of the dissertation. It tests the possibility of a long run relationship between inequality and the bank debt to GDP ratio in Sweden in 1919 to 2012 and finds that there is such a relationship. The period is chosen because of data availability on household inequality in Sweden. The hypothesis is that the profit share has an impact on the likelihood that companies and company owners will get a bank loan, since banks require security associated primarily with profits rather than wages. Any relationship between household income inequality and bank debt relative to GDP is mainly a product of the underlying relationship between functional income inequality and bank debt to GDP. These results are at odds with the dominant explanations on the relationship between inequality and bank debt found in the literature. The findings are robust when controlling for financial regulation.

### *3.3. Article III. Inequality, asset markets and bank debt in Sweden in 1900–2013*

The third article further investigates the long run relationship between the profit share and bank debt in Sweden, but in the 1900 to 2013 period and in the light of wealth in the stock- and housing markets. It thereby combines two research fields on what causes debt in the long run – inequality and asset markets. The study finds support for the hypothesis that the profit share is an intermediate variable between the stock market wealth ratio and the bank debt ratio. The findings suggest that stock market wealth in particular has a long run relationship with bank debt in Sweden during the period of investigation, but that the profit share is affecting the bank debt ratio indirectly through the stock market. The results are similar when total financial wealth is used instead of stock market wealth, but are not as robust as is the case for the latter. Moreover, the findings are robust when controlling for financial regulation, estimated by endogenous structural breaks. A finding that housing wealth is also a long run determinant of the debt level is not robust.

### 3.4. Article IV. The wage share and the welfare state in Sweden 1900–2013

The fourth article steps backward in the causal chain presented in the dissertation, and explores possible explanations for the changes in the functional income distribution in Sweden from 1900 to 2013. The main focus is on the impact of variables related to the Swedish welfare state on the wage share in the private sector. The study uses a novel approach where not only government consumption serves as a proxy of the welfare state, but also government investment and investment in residential house construction. As is shown in an historical narrative, housing policy has been an integral part of the Swedish welfare state throughout the period. Even though housing construction has been carried out in part by private enterprise, it should be included as a welfare-related variable. The only additional variable with robust significance is the exchange rate of the Krona, and a number of control variables are found to be insignificant.

## 4. Methodology

The methodology used in the articles is primarily econometric. The main focus is on long run changes, and different cointegration techniques are used in three of the articles. One of the articles, *article I*, only examines short run changes, since there are no techniques available which combines logistic regression and cointegration. In *article II*, the Johansen approach to cointegration is used. This allows for the possibility of testing more than one hypothesized relationship in a multivariate regression, as is suitable in *article II*. The short run relationships are also modeled in this article, since the methodology intrinsic to the Johansen test and its associated vector error correction can reveal temporal connections in both the long- and the short run, which may give clues about possible causal relationships in relation to theory. In *article III* and *four* however, a single-equation cointegration test is deemed more appropriate. The design of the Johansen test often tends to produce non-normality in the residuals. This is especially grave for the estimation of t-statistics, and associated p-values, of the coefficients. In both *articles three* and *four*, the Phillips-Ouliaris cointegration method is employed. The particular advantages of this method are discussed in detail in the articles. The downside is however obvious: What the Johansen test gains in terms of possible causal interpretation, the Phillips-Ouliaris method lacks. Consequently, only the long run is considered interesting in *articles three*

and *four*. Any short-term analysis is left aside. The Johansen test for cointegration is applied in robustness checks in both articles. In *article IV*, a modified version of the Johansen test including structural breaks due to financial regulatory regime changes is also applied.

A general problem in time-series analysis is that of endogeneity and feedback mechanisms. The term Granger causality refers to the possibility predict the future values of a time series by the use of prior values of another time series. Thus, if lagged values of one series are correlated with values of another one, this may be an indication that the first series is causal in relation to the second series. This method is far from perfect. One problem is that causality may operate at a higher frequency than the time unit used in the regression, for instance in a matter of months or days rather than a year. In rare cases, it is also possible that one thing happens after another, even if it causes the other. In this dissertation this is an obvious problem, since profit expectations and stock market valuation may be more or less correct in anticipating corporate profits in the near future. The best way to address this is to rely on theory, and to treat the results in a humble way.

The econometric approach is combined with a narrative account creating a context. This is achieved both through the historical settings provided in the articles, and in the interpretation of the findings. The purpose is not just a pedagogic one. The narratives also justify the choices of variables. For instance, the historical discussion in *article III* on stock market speculation justifies why it is important to take account of both listed and unlisted equity when measuring stock market wealth. In some periods, one or the other have been more important and only a measure combining the two will do justice to history. Likewise, in *article IV*, the historical narrative is of crucial importance for the justification of introducing residential housing construction as a variable in the study. This variable is not present in previous research on the wage share, neither internationally nor in Sweden. Nevertheless, the historical account shows that it is of central importance in the Swedish case.

## 5. Variables and sources

As already stated, the main contribution of *article I* is the compilation of a new historical time series on private debt in the modern economic history of Sweden. The data mainly comes from Statistics Sweden's annuals (several publications, see *article I* for details), Riksbankens annuals (several publications, see *article I* for details), and Hagström (1968). A number of minor adjustments have been made in order to link the series. In case of missing

observations, inter- and extrapolation have been used. This has however only been necessary for small credit categories for which there is a lack of data in some of the earlier years of the period. Cross-checking of observations in different sources has made sure that the values are correct. In some cases, different sources have used different accounting techniques, but the differences measured in per cent in observed values are low, especially for the important larger credit categories. Since the aim has been to only measure credit to private households and companies, there has been a special emphasis on eliminating the data from loans to municipalities. Further details of this compilation can be found in Appendix 1 of the article.

This time-series is used also in *articles two* and *three*. Much of the other data in the dissertation come from Edvinsson (2005; 2014; 2015; and 2016), Roine and Waldenström (2008; and 2014), Waldenström (2016; 2017a; and 2017b), and Statistics Sweden (several publications, see *the articles* for details). No data can ever be perfect, and even published and official source material should be scrutinized to some extent. Still, and with this qualifying consideration, the data provided by official Swedish authorities and other researchers are not discussed to the same degree as the material found and/or compiled in the dissertation. In cases when the series of one source stops and another begins, adjustments have been necessary. In some cases, more far-reaching procedures have been employed. For instance, in *article II*, lacking observations of the top income shares in Sweden have been estimated through single regression imputation of available data on the top income shares in Denmark. This can be motivated since the correlation (in first differences) between existing observations in the Swedish and Danish data is very high. In some cases, existing data may be considered slightly inappropriate for the purpose at hand, but still sufficient to be of value. This especially concerns data on wealth in stocks for Swedish households from Waldenström (2016 and 2017a). Since bank debt only includes households and non-financial companies, in the best of worlds, wealth data should also be on these two categories. To get as close to this as possible, the Waldenström series has been adjusted in accordance with such data from Statistics Sweden (2017) from 1980. Before that, it has only been possible to adjust for stocks owned by insurance companies, while stocks owned by investment companies have not been accounted for.

## 6. Theory and earlier research

Since heterodox economic theory is often articulated as a fundamental critique of mainstream economics, it is hard to avoid speaking about the mainstream when explaining the theoretical framework used in this dissertation. Another reason to get involved in a debate about economics is that it has greatly influenced the economy itself and with that the society at large. Paradigmatic shifts in economic policy, such as the breakthrough of Keynesian theory after World War Two and the breakthrough of monetarism and supply-side economics in the 1980s, have reshaped the balance between the state and the market, and have had a profound impact on the distributional struggle between labor and capital – the central node of this dissertation.

### *6.1 The ergodic principle*

The mainstream neoclassical economics, which has had several incarnations since the 19<sup>th</sup> Century, has received critique for being ahistorical (e.g. Davidson 1996; More 2006, p. 61; and Hein et al. 2014). Some scholars argue that mainstream economics is ill-equipped to deal with nonstationary variables, and since all the core variables in this dissertation are nonstationary in a hundred years plus, application of mainstream economics could have been problematic (e.g. Davidson 1996). According to Davidson (1996, p. 479), "most mainstream economists ... accept as universal truth the experience of a predetermined reality that can be fully described by unchanging objective conditional probability functions". This is known as the ergodic principle. In its most crude form, this view implies that the economy is stationary in the long run – a notion that is fundamentally incompatible with historical change (Davidson 1996). Samuelson (1969, pp. 184–185) openly argued that the assumption of ergodicity would remove economics from the "realm of history" and put it in "the realm of science". Correspondingly, breakdown of ergodicity means that "history matters" (Horst 2008, p. 1) and that there may be path dependency (Magnusson and Ottosson 2009, p. 3).

The assumption of an unchanging stationary economic reality goes back to classical economics. Say and Ricardo (e.g. Cotrell 1988, pp. 63–84) viewed the economy as a harmonious barter economy where supply (production) creates its own demand (consumption). This view was later referred to as Say's law, and it has survived in some form of mainstream economics ever since. In a barter economy, money and banks are obviously absent. The im-

plication of the Quantity Theory of Money (QTM), represented by thinkers such as Hume and (J. S.) Mill, was that this description was essentially accurate in a monetary economy as well. QTM said that change in the money supply affected only nominal values, not real ones. Accordingly, in classical economics, banks only intermediate between savers and investors (Cardim de Carvalho 2012) with money as only a medium, or a “veil”, through which the economy can be seen.

Wicksell ([1898]1936) saw the need to reformulate QTM. He recognized that banks create money when they issue loans, so that the supply of bank credit can diverge from the underlying supply of loanable funds of savings. Such divergences between savings and credit were a serious threat to economic stability in Wicksell’s view. He conceptualized a natural interest rate which balanced savings and investments and a market interest rate which determined the supply and demand for credit. Whenever the two interest rates were misaligned, the economy was in disequilibrium. Eventually however, the natural interest rate would prevail. In the long run, money was neutral (Wicksell [1898]1936; and Cardim de Cavallo 2012).

This view is essentially still the governing standpoint. Mankiw (1992, p. 561) has claimed that “the natural-rate hypothesis... interpreted broadly states that classical economics is right in the long run” and that “economists today are more interested in long run equilibrium”. Many economists argue that the long run equilibrium is a strictly theoretical construct which the system is moving towards, but which it may never reach. To Davidson (1996) this argument still implies ergodicity, though implicitly. Moore (2006, p. 115) argues that an economist assumes ergodicity whenever he or she uses the term “general equilibrium”. An escape route may be to acknowledge that “policymakers are always in the short run and policy always has real effects” as proposed by Bain and Howell (2009, p. 177). This approach still places economics outside of history however. Davidson (1996) argues that historical long run change has been regarded as an anomaly among mainstream economists, treated either as exogenous shocks to the system, or as something outside of the time-frame of the model.

There are signs that the mainstream may be relaxing the assumption of ergodicity though. For instance, the interest for multiple equilibria models have increased in the presence of the observed turbulence in financial markets (Masson 1999). In multiple equilibria models, outcomes are indeterminate and the chosen path is historically dependent (Barras 2009, p. 23). Other examples are the present debate on secular stagnation, (e.g. Teulings and Baldwin 2014), the debate on long run non-neutrality of money (Bain and

Howell 2009, p. 175), and the discussion on inequality in income and wealth (e.g. Piketty 2014; Stiglitz 2012; and Milanovic 2009).

## *6.2. Disequilibrium economics*

Heterodox economic theory on the other hand, has for a long time affirmed the notion of nonstationarity of economic systems. For instance, Post-Keynesian theories and models are historically and institutionally specific, and do not claim general validity. Equilibria may be better described as path dependent “temporary states of rest” (Hein et al. 2014). Non-ergodic path dependency is particularly salient in the institutionalism of scholars such as Polanyi (Ghezzi and Mingione 2007), and in Marxist-inspired schools such as the Regulation school (Magnusson and Ottosson 2009, p. 14) and the SSA approach (McDonough et al. 2010, p. 5). The notion of a general equilibrium is perhaps especially alien to Marxists. As McDonough et al. (2010) puts it, Marxist economics explicitly sees capitalism as an “inherently conflictual system, characterized by crisis tendencies”. The claim put forward in this dissertation, that inequality is causing such a crisis tendency in capitalism, is an important theme in many branches of heterodox economic thought. The idea is commonly referred to as underconsumption theory, and is especially present in traditions with a Marxist influence.

The beginning of the underconsumption debate might be traced to disagreements concerning Say’s law in the early 19<sup>th</sup> Century. Liberal economists such as Smith, Mill and Ricardo more or less equated savings with investment (Bleaney p. 23), and especially Ricardo unconditionally dismissed the underconsumptionist claims (Allgoewer 2002). Malthus on the other hand, advocated for a “theory of the golden mean” (Bleaney 1976, p. 49). He acknowledged the need for accumulation, but argued that it would cut its own throat if allowed to be carried too far. Sismondi was more radical. He argued that the division of society into rich and poor is the root cause of crisis, since the workers are too poor to buy their own product. A concentration of fortunes would therefore force industry to seek foreign markets (Bleaney 1976, pp. 62–77).

Marx acknowledged that money earned by the capitalists may be used as a store of value and be hoarded, rather than being reinvested directly in production or lent out via the banking system for production by other capitalists, and that this could create disruption (Marx [1885]1992), pp. 567–579). In Marx’s own words: “If this new accumulation meets with difficulties in its employment, through lack of spheres of investment, i.e. due to



surplus in the branches of production and an over-supply of loan capital, this plethora of loanable capital merely shows the limitations of capitalist production” (Marx, ([1894]1993), p. 639). Nevertheless, his position towards underconsumption theory is rather ambivalent (Bleaney 1976, pp. 102–118).

In the early 20<sup>th</sup> Century, Hobson and Luxemburg argued more clearly along Sismondian lines. In essence, they argued that unequal bargaining power between workers and capitalists would lead to systematic imbalance between consumption and savings. They saw imperialism, with colonial investment in armaments and railroads, as the main solution for capitalists to realize surplus value and avoid falling returns on savings in the 19<sup>th</sup> Century (Bleaney 1976). Luxemburg is particularly interesting here, since she explicitly emphasized the central role of international credit as a medium in this transfer (Luxemburg [1913]1963), pp. 419–421).

According to Bleaney (1976, pp 11–13), underconsumption theory claims that the economy tends towards a state of depression due to insufficient demand for consumption goods. As such, the theory can always be described as one of overproduction, he argues. Underconsumptionists in the 20<sup>th</sup> Century increasingly stressed overproduction, due to monopoly power of firms, as a source of crisis. To Marx ([1867]1990, pp. 777–780), capital concentration was an inevitable result of increasing economies of scale from mechanization and technological advances in production, and from the development of capital markets. Hilferding reiterated and advanced the latter factor when analyzing the early 20<sup>th</sup> Century economy. During the Great Depression of the 1930s, the concerns about monopoly power increasingly reached the mainstream. It also influenced Kalecki, who incorporated the degree of monopoly as a crucial variable in his Marxist-flavored version of Keynesianism. He reckoned that corporations operating under a high degree of monopoly can secure a disproportionate share of incomes through mark-up of prices over costs. Kalecki argued that the “degree of monopoly has a general tendency to increase in the long run and thus to depress the relative share of wages in income” (Kalecki 1969, p. 30).

Kalecki’s friend and colleague Steindl (1976) built on these ideas and argued that economies of scale existed not only in production and finance, but also in distribution and administration (Steindl 1976, pp. 1–42, and Bloch 2005, pp. 23–35). In line with monopoly theory, he argued that it is optimal for a monopoly to reduce output rather than prices in face of declining demand. This induces a tendency for excess capacity and output to be below capacity utilization, in turn negatively affecting investment and leading to stagnation. While he also acknowledged a negative impact of a lower

wage share on the propensity to consume, his focus was on the supply-side rather than the demand-side (Steindl 1976, pp. 245–246).

The contributions of Kalecki and Steindl had a strong influence on Baran and Sweezy ([1968]1989) in their analysis of monopoly capital in the 20<sup>th</sup> Century US. They equated the profit share with the economic surplus in society. Following Hilferding, they argued that capitalism had entered a new stage in the 20<sup>th</sup> Century, distinct from the type of capitalism characterized by competition which prevailed in the early 19<sup>th</sup> Century. This resulted in a tendency for the degree of monopoly to go up, with a depressing effect on investment, according to Baran and Sweezy. They argued that three exogenous outlets emerged to the rescue of capitalism in the USA from the turn of the 19<sup>th</sup> Century to the early 1960s: the sales effort (including sales and marketing, but also finance and real estate), increasing arms spending (militarism/imperialism), and a growing civilian government sector.

Baran and Sweezy are the originators of the Neo-Marxist school associated with *The Monthly Review*. Present-day theorists of this school of thought believe that capitalists (corporations and individuals) have poured their excess surplus into financial and real estate markets for speculative purposes when they could not find an outlet in the real economy (Foster and McChesney 2009, p. 67). Greater assets have in turn been mirrored by greater liabilities. Assets have provided collateral for loans, but there has also been a reversed causality where debt has financed speculative investment, which has raised asset values further. This notion represents a synthesis of underconsumption theory and the Keynesian-Minskian emphasis on financial instability.

Keynes was not an underconsumptionist, although he associated wage income with consumption (Keynes [1936]1964, pp. 91–92), and like the underconsumptionists focused on aggregate demand rather than supply factors. Moreover, he perceived a possible mismatch in the monetary circuit of the capitalist economy, and the possibility of a persistent glut (Palley 2015), but highlighted group psychology rather than over-accumulation of surplus value. For him, money invested in production relied on expectations – which he famously referred to as “animal spirits”, since they were often guided by herd behavior. Keynes envisioned a worst-case scenario, during which extreme pessimism among investors could lead to money hoarding and cause disastrous consequences to output and employment. (Keynes [1936]1964, pp. 84–85). Like Malthus and Sismondi, Keynes refuted Say’s law. He argued that a market economy could get stuck in a long term state below full employment, and that money was non-neutral in the long run.

Fisher (1933), showed that it was possible to reach conclusions similar to those of Keynes, but from a neoclassical position. Fisher adhered to the QTM, and like Wicksell believed that money was neutral in the long run. Even so, he warned that drops in asset prices may deteriorate the balance sheets of investors, and spell an even larger increase in the debt to income ratio, creating a devastating and mutually enforcing feedback mechanism between debt and deflation. Along with Keynes, Fisher was an important inspiration to the Post-Keynesian Minsky. According to Minsky's FIH, capitalism goes through stages of increasingly risky finance. According to the FIH, profit expectations are fundamental for the risk appetite of both lenders and borrowers. This applies to asset markets in particular, which are prone to the irrational exuberance described by Keynes. A number of studies have corroborated the relation between asset prices, private debt and financial crises inherent to the FIH (e.g. Collins and Senhadji 2002; and Borio and White 2004).

In the long run profit expectations and share prices are determined by real profits. This means that the stock market wealth to GDP ratio is tied to the profit share in the long run. Normally, stock prices adjust rather well to corporate earnings (Brown 2013, pp. 63–69). The same goes for bank debt. According to Moore (2006, p. 220), banks set the credit line according to a detailed estimate of income, collateral (wealth), and credit history of the borrower. Likewise, Hein (2007, p. 92), argues that equity and retained earnings improve access to external finance in financial markets, because it allows firms to offer more collateral – or as Kalecki puts it: “The access of a firm to the capital market, or in other words the amount of rentier capital it may hope to attain, is determined to a large extent by the amount of its entrepreneurial capital” (Kalecki 1954, p. 95).

To some extent, this capacity for prediction is an embrace of ergodicity. Financial history, however, also shows that normal circumstances where rational expectations apply quickly can change into unknown terrain. During a stock market bubble, the risk appetite of investors grows along the lines described by Minsky. Over time stock prices can increasingly lose touch with underlying cash flows. No one knows what will trigger the crash before it is too late. According to Davidson (1996), bubble theories – and the related “sun spot” theories – often treat asset bubbles as temporary exceptions from the rule of ergodicity, but there are other interpretations as well. Minsky pictured asset bubbles as part of long run trends where investor behavior altered gradually. This is reiterated in financialization theories emphasizing long run change (see section 6.4).

Foster and Magdoff (2009, p. 67) and Foster and McChesney (2010; and 2012) have adopted an analysis where a rising profit share is associated with rising asset values and rising debt levels, creating a tendency for speculation and financialization. This process has in turn built a whole financial superstructure of the economy – a house of cards destined to fall.

In a Marxist setting, financial wealth is foremost an accumulation of surplus value in money form. Marx mainly saw the banks as intermediators through which capitalists could lend to each other. Simultaneously, he also acknowledged that money was non-neutral and that banks could create new deposits when they issued a loan on promise of repayment, without full backing in loanable funds already deposited (Bellofiore 2005, pp. 137–138). This endogenous money creation is particularly emphasized by post-Keynesian economists, and makes it impossible to distinguish between “primary” and “secondary” deposits. Marx himself however, believed that fictitious capital – his term for capital claims – was a fringe aspect of capitalism, unable to dominate over real capital accumulation (Hudson 2010). This applies to both deposits created by banks and to stock market wealth.

Later Marxists, such as Foster, Magdoff, and McChesney have acknowledged the pivotal importance of fictitious capital in late capitalism. Where Luxemburg and Hobson saw colonization as an escape route for capital in the late 19<sup>th</sup> Century, modern-day Neo-Marxists see financialization, or “colonization of the future” as referred to by Lysandou (2014), as a temporary escape route today. Since both stocks and credit are claims on future cash flows, the metaphor makes sense. This analysis is to a large extent shared by some scholars within other Marxist-inspired traditions, such as Kotz (2011), a SSA theorist, and Boyer (2000), a regulation school theorist. Post-Keynesians have also highlighted the need to supplement the Minskian FIH explanation with the predominantly Marxist notion of class conflict, in order to explain modern financialization (Palley 2010, Hein et al. 2014).

### *6.3. The present debate*

Today, both inequality and private debt are perceived as some of the most pressing economic issues among mainstream economists, and recently mainstream scholars have begun to see a historical connection between the two. The most common version states that increasing inequality between workers and capital owners has fueled a tendency toward depressed aggregate demand in industrialized countries from about 1980, due to workers’ higher propensity to consume out of income, compared to that of capital owners.

According to this analysis, the depressed demand has created a potential problem for capitalist expansion. If there is not enough consumption, there will not be enough outlets for capitalists to sell their products. The problem, it is argued, has been solved through higher levels of household debt. What workers lacked in wage-led purchasing power, they gained in access to credit markets.

This credit for wage substitution was not a sustainable development path though, the argument goes, since the increasing debt levels produced an asset bubble which was doomed to burst, and did so starting from 2007. This essentially underconsumptionist analysis is not shared by all, but has quickly gained in popularity. It is found, with some variety, among celebrity economists such as Piketty (2014), Stiglitz (2012), and Reich (2011), as well as with economists at the World Bank (Milanovic 2009) and the IMF (Kumhof and Rancière 2010). The same analysis is found with different heterodox strand of economic thought (e.g. Hein 2012; and Stockhammer 2013). The long run relationship running from inequality to debt is also supported by a number of empirical studies (e.g. Malinen 2013; and Klein 2015).

Post-Keynesian scholars in particular have provided a nuanced view, emphasizing different growth models for different countries since the early 1980s. On the one hand, they claim, there are countries with a growth-regime driven by consumer debt and current account deficits. Examples of countries with this type of growth regime are the USA, the UK, and Greece. Other countries, such as China, Germany and Sweden, have depended on growth led by exports. The latter group of countries has been able to realize production through current account surpluses to the former group, but in the end growth in all the industrialized countries relied on credit expansion, domestic or foreign, and all (or almost all) countries experienced rising rates of inequality (Hein 2012; and Hein and Mundt 2012).

The explanation referring to exports suggests that Sweden does not have a debt-driven growth regime, where credit substitutes wages. The fact that private consumption (and total consumption) declined in the era of financialization since 1980 in Sweden suggests that this description is correct. So if there is a connection between inequality and debt levels in Sweden in recent decades, an explanation has to be found elsewhere. The Neo-Marxist focus on the capitalists rather than on the workers offers such an explanation. In this explanation, financialization of the whole economy, rather than debt for wage substitution among the working class, is the engine of growth in the neoliberal era (Foster and McChesney 2012, p. 60). It includes debt finance, wealth effects and employments in finance, real estate and insurance (Foster

and Magdoff 2009, pp. 63-76), and can co-exist with both a debt-driven, and an export-driven, growth regime. Nevertheless, the emphasis on underconsumption in relation to financialization and crisis tendencies among both heterodox and mainstream economists today is an interesting phenomenon. Together, they represent an abandonment of Say's law and the ergodic axiom. This emphasis has also raised attention for the causes of functional inequality.

Baran and Sweezy saw the government sector as an outlets for the surplus produced, but as Foster and Magdoff (2009, p. 65) points out, civilian government spending may intrude on areas of private accumulation. A larger public sector relative to GDP per definition means a smaller private sector, and therefore a smaller profit share of incomes. Recent research shows that large government spending relative to GDP is detrimental to the profit share also in the private sector and correspondingly benign to the private wage share (e.g. ILO and OECD 2015; and Stockhammer 2017; and *article IV*).

One explanation to this relationship is that the government provides the function of an employer of last resort. If there always is a possibility to get a job in the public sector, the threat of unemployment is eliminated and the workers may be bolstered in their negotiations with private employers. Public works aiming to strengthen the position of workers was identified as a way to stave off underconsumption crisis already by Hobson and other early underconsumptionists (Allgoewer 2002, p. 7). Kalecki (1943) likewise observed that full unemployment policy would strengthen the bargaining position for workers versus capitalists, and this point was later reiterated by Baran and Sweezy ([1968]1989), p. 150). Even if this meant higher higher demand, higher economic growth and higher profits in absolute terms, Kalecki argued that it would be opposed by business leaders. He believed that the benefits were inferior to the pain of lost political power for the capitalists. Korpi (2002) argues along similar lines. Rather than a means towards a greater power for the working class however, he argues that full employment policy is an expression of this power struggle, as is the functional income distribution between labor and capital. He reason that such policy is the work of working class parties coming to power after World War Two, or of the influence of working class parties on other parties – a “contagion from the left” (Korpi 2002).

Besides the size of the government sector, some institutional variables particularly associated with the labor market such as union power, minimum

wage legislation and unemployment benefits and coverage, are sometimes found to be beneficial to the wage share (ILO and OECD 2015).

Technologic automation and globalization on the other hand, are often considered to do the detrimental to the wage share. Marx claimed that technologic advances led to a tendency toward more constant capital (expenses on machinery, structures, raw materials, etc.) in the composition of capital, at the expense of variable capital (labor), and eventually create an unemployed and growing reserve army of labor. This process is intimately tied to capital concentration in Marx's analysis (Marx ([1867]1990) pp. 78–794). The link between technology and capital concentration is equally strong in subsequent Marxist theories. Keynes too warned of the consequences of technological unemployment, although he was a lot more optimistic in his outlook (Keynes [1930]1963). In recent empirical research, technology is often shown to have a strong negative association from about 1980 (e.g. Karabarbounis and Neiman 2013; and Dao et al. 2017). Before that however, technology seems to have been beneficial to the wage share (e.g. McCallum 1985; and Guscina 2006). One explanation to this suggested by Davidson (1996) is that full employment policy can give incentives for entrepreneurs to innovate means of increasing productivity without the creation of a reserve army of unemployed. In line with Marx, Kalecki and Steindl, lately there have been studies showing that increasing monopoly power have had a negative impact on the labor share of incomes (e.g. Barkai 2017) and that this may indeed be linked to technological advances (e.g. Autor et al. 2017a; Autor et al. 2017b; and Zhu 2017).

The effect of globalization on the wage share can go through multiple channels, such as trade openness, foreign direct investment and outsourcing (e.g. Foster and McChesney 2012, pp 125–154; and Palley 2007). In the research globalization is generally found to have had a small negative impact on the wage share (e.g. Elsby et al. 2013; and ILO and OECD 2015). Shareholder value orientation among corporate managers may also decrease the wage share, since it may take resources from productive investment in real and human capital to excessive dividends and share buy-backs with the aim to raise stock prices (e.g. Stockhammer 2017; and Dünhaupt 2013). Debt levels may also depress the wage share, if they contribute to financial crises and higher unemployment. The same can be said about capital account liberalization (Furceri and Loungani 2017). In this dissertation, neither union power, technology, globalization, nor the bank debt to GDP ratio, are found to be significant dependent variables for the Swedish wage share in 1900-



2013. Share-holder value orientation and capital account liberalization has not been tested.

Many of the variables listed above are under the influence of economic policy, and several heterodox economists associate changes in them since the late 1970s with neoliberalism (e.g. Hein et al. 2014), which can be defined as laissez-faire, or free-market, oriented reforms (Boas and Gans-Morse 2009). Hence, functional income distribution has often been related to neoliberalism. The same applies to financialization. Kotz (2008) sees the strengthening of financial interests as a political outcome, and Duménil and Lévy (2011) argue that neoliberalism was launched by financial interests revolting against the oppression of the Keynesian welfare state.

Others have argued that the main conflict is not between finance and the rest, but between the classical Marxist antagonists of capital and labor. This is for instance the standpoint of Kalecki and Steindl, who argued that opposition of capitalists to full employment gives rise to a political cycle or trend. Steindl maintained that the most important factor behind the reversion to stagnation in the 1970s was because of such a revolt of the capitalists (Steindl 1979). Korpi agrees with this description. He claims that the policy shift away from full employment towards inflation targets was not caused by the oil shocks and the stagflation of the 1970s, but designed by capitalist interests aggravated by heightened political struggles in the late 1960s (Korpi 2002).

The results of the dissertation show an upward trend in the profit share during this period, and a matching increase in both stock market wealth and debt. Over the 1900-2013 period, the cointegration tests in *article III* indicate that the three variables are related in the way proposed by current Neo-Marxist theory. According to this theory, financialization is merely a result of an accumulation process which lacks other means of realization, and a way to escape low returns. Much like other heterodox economists though, Neo-Marxists see financialization as a dead end. Sooner or later the model will run out of steam and turn into a bust, followed by recession. In their view, mature capitalism is caught in a “stagnation-financialization trap”, with alternating periods of irrational exuberance and recession.

Where Post-Keynesians see possibilities of taming capitalism through regulation, Neo-Marxists are more pessimistic. They maintain that the rising profit share and the tendency toward stagnation are inherent attributes of modern capitalism, because of what Marx saw as the predisposition of capitalism to produce monopoly power. The results of this dissertation offer another possible solution however: The Swedish experience indicates that an



expansion of the welfare state may keep the profit share, and the financialization associated with it, in check.

#### *6.4. Stages in capitalism*

Lack of data on earlier periods makes a lot of the research short-sighted, and much of the literature on financialization discusses the post 1980-period. Sometimes, it is contrasted with the welfare state expansion that preceded it. Of course, recent decades of economic development hold many unique traits, but it can still be worthwhile to extend the vision further back in economic history. A number of theories have evolved from the notion that capitalism has gone through stages or waves in its development. The focal point is often economic growth and fixed capital accumulation, but the theories generally relate to financialization and class struggle as well. One such school of thought is the SSA approach. Apart from long-wave theory, it draws on both the Keynesian and the Marxist traditions (McDonough et al. 2010, p.2). The main focus is on the relationship between potentially unstable accumulation processes and the social institutions which seek to tame this instability. Unlike Marxist orthodoxy however, SSA theory emphasizes capitalism's ability to successfully reinvent itself. The process is not smooth at all, but goes through a series of phases where endogenous mechanisms ultimately destroy the previous SSA before a new SSA is born. The SSA literature identify at least four such phases of capitalism – SSAs – in the modern history of the USA: a competitive SSA characterized by *laissez-faire*, international trade and dominated by small and medium companies in the second half of the 19<sup>th</sup> Century; a monopoly SSA dominated by oligopolistic markets from the late 19<sup>th</sup> Century to the Great Depression; a regulated SSA characterized by a capital-labor accord and the Keynesian Welfare state from the end of the Second World War until the 1970s “Great Stagflation”; and the neoliberal SSA, with dominance of capital over labor, financialization and globalization as its hallmarks, after that (Hein et al. 2014).

A similar analysis is offered by the regulation school. Like the SSA school, it stipulates inevitable clashes of interests through which one accumulation regime transforms into a new one (Jessop 1997). This oscillation between instability and stability, emanating from the relation between market forces and institutions is also present in the “Double movement” of Polanyi (1985). Here movements towards *laissez-faire* and liberal reforms aiming to “disembed” the market from society are counteracted by attempts by society to “re-embed” the market through attempts to ease social tensions.

Polanyi traced this dualistic process of laissez-faire and government intervention from the early 19<sup>th</sup> Century until World War Two.

Kotz (2011) has a similar approach. Even though the SSA school has roots in long-wave theory, it is common in the SSA literature to see every SSA as unique, but he focuses on the commonalities instead. Kotz proposes that there are two types of SSAs – regulated and liberal. While the post-World War Two-regulated capitalist SSA experienced a profit squeeze stemming from the relationship between capital and labor during its structural crisis in the 1970s, the present liberal (or neoliberal) SSA stems from the large asset bubble that has been underpinning its expansion. Kotz observes that the conditions during the beginning of the 20<sup>th</sup> Century were very similar to that of the end. He suggests that the 1920s had many of the same features as the neoliberal SSA has. Duménil and Lévy (2011) refer to these two financially dominated SSAs as “The first and the second financial hegemonies”.

Likewise, Minsky’s FIH should not just be seen as a theory of the short run, but also as a theory of super-cycles. Minsky argued that the modern capitalist economy has an inherent tendency for speculative booms, and saw the “money-manager capitalism” of the end of the 20<sup>th</sup> Century as a return of “finance capital” to the position it had before the New Deal and the Great Depression of the 1930s. He saw the active government of the decades after post-World War Two as an antidote, albeit temporary, to the influence of this finance capital. He labeled this stage in history “paternalistic capitalism”, in reference to interventions such as welfare programs, financial regulation, and support for the housing mortgage market (Palley 2009; Wray 2009; and Hein et al. 2014). Vercelli (2013) share this view of financialization as an intrinsic trait of the market economy, checked only by collective forces for religious, ethical or political reasons, and let loose during periods of laissez-faire policy.

Another example of this observation is that of Fasianos et al. (2016). They compare different periods of financialization and definancialization in the USA since 1900, and divides their sample into four regimes, rather than the three found with the for instance the SSA school. The first financialization took place in the 1900-1933 period, they argue. The ending is dated to the New Deal, representing a paradigmatic shift in economic policy. The second period, 1933-1940, was one of transition to the third period, the prosperous definancialization of the “Golden Age” in 1945–1973. The fourth period, the present era of financialization, started after the collapse of the Bretton Woods in 1973, in the account of Fasianos et al. The comparison

between the different stages is done on several levels, both quantitatively and qualitatively. Most interesting for this dissertation is the similarity between the two phases of financialization, which both display high debt to GDP ratios, high stock market wealth to GDP ratios, high inequality, lack of commitment to full employment, low level of financial regulation and high inclination to financial crises. In comparison, the two periods in between, 1933–1940 and 1945–1973 display inverse conditions in all respects.

An even longer time-frame is presented by Arrighi (1996). In his view, western economies has experienced a long-wave movement between government regulation and crisis-prone financialization since the 15<sup>th</sup> Century (1996, pp. 291–325). In relation to the taxonomy of Kotz, each such “long century” would include one regulated and one liberal SSA. In Arrighi’s view, the financialization of the early 20<sup>th</sup> Century marked the death for the long (British) 19<sup>th</sup> Century, and the birth of the long (American) 20<sup>th</sup> Century.

Lastly, there have also been attempts to analyze the Swedish economic history in terms of long waves. Schön (2000, pp. 19–34) is the most prominent example. Like Schumpeter and others, he emphasized the role of innovations and creative destruction during phases of crisis, but he also touched on matters of central importance to this dissertation.

## 7. A history of financialization and definancialization

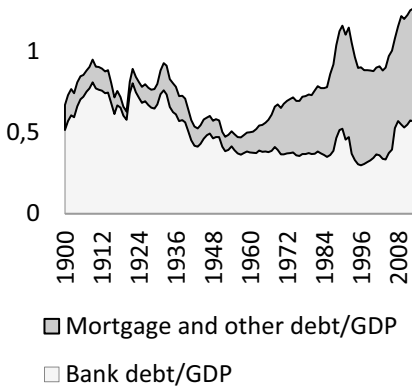
The time frame for the dissertation is motivated by pragmatic and historical reasons. The starting date at 1900 is chosen because of the dramatic institutional changes occurring around this time in Sweden, and also because of availability of data on credit – one of the core variables of the study. The ending date at 2013 is also set due to availability of data. The time frame is also convenient from a theoretical perspective, as it lends itself to periodization present in the “stages of capitalism” discussion. The fact that developments in the beginning of the 20<sup>th</sup> Century show so much resemblance to financialization tendencies today calls out for a comparison. Also interesting is the behavior of the variables in the middle of the period, which suggest the need to contrast the periods with each other. The conceptualization used by Fasianos et al. (2016) of phases of financialization and definancialization may be translated to a Swedish context.

Schön identified three long waves of accumulation with relevance to the investigated period: 1890–1930, 1930–1975, and 1975–2010. According to Schön, these waves could also be related to distributional class struggle,

political change and financial development. This makes him relevant also for marking transitions in Swedish financialization. The SSA school makes a similar periodization when analyzing the 20<sup>th</sup> Century history of USA, but sets the start of the second sub-period to the end of World War Two, and the beginning of the fourth period to the early 1980s (Hein et al. 2014). Since the interventionism of the Swedish state during World War Two was only partly repealed after the war, an appropriate shift from the first to the second sub-period may be dated to 1939–1940. Larsson and Söderberg (*forthcoming* 2016) argue that there has been two paradigmatic changes in the Swedish financial regime during the latest century – one around 1950 and one in the late 1970s. It is also possible to date the transition of the third sub-period to the 1980s, considering the extensive financial reforms taking place during this decade. The endogenous structural break test employed in *article IV* come up with 1940 and 1994 as the most important break dates. Even so, a quick glance on some of the key variables in this dissertation reveals a clear turning point around 1980. This is the case for the wage and profit shares, the development on the Swedish stock market, as well as for the aggregated welfare-related variables. Furthermore, most theorists set the turning point from one accumulation regime to another to 1980, with the change of government in the Anglo-Saxon world spreading financialization through the world system via the Washington Consensus (Westad 2005, p. 359). The year 1980 is often marked as the takeoff for modern-day financialization internationally.

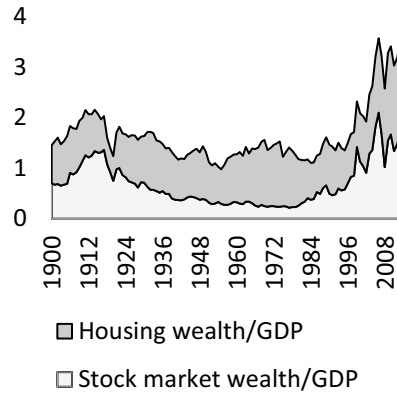
Altogether, this account produces the following periodization of the three sub-periods: The 1900–1939 period, the 1940–1979 period, and the 1980–2013 period. These are rough estimations of the turning points. Still, each of these phases can be interpreted in relation to financialization, and to the conscious and unconscious efforts to restrain financialization through economic involvement of the government. The following section provides a historical narrative together with a short analysis of each sub-period in relation to theory. With reference in the analysis, Figures 2.1 to 2.4 presents the core variables of the dissertation.

Figure 2.1: Debt, 1900–2013



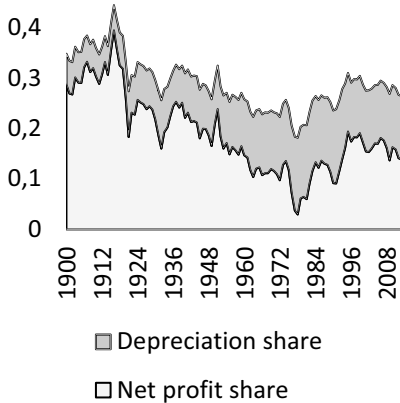
Sources: See *article I*.

Figure 2.2: Wealth, 1900–2013



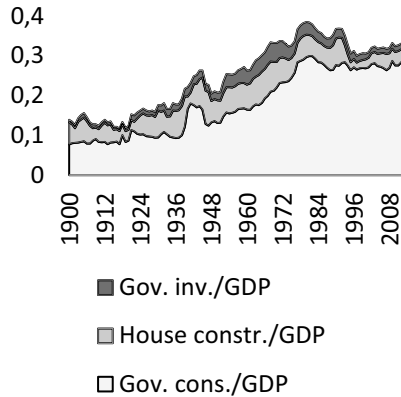
Sources: See *article III*.

Figure 2.3: Profit share, 1900–2013



Sources: See *article III*.

Figure 2.4: Welfare state, 1900–2013



Sources: See *article IV*.

### 7.1. 1900–1939: The first financialization and the interwar years

To say that the Swedish society went through substantial change in the end of the 19<sup>th</sup> Century is a modest statement. On the social and political level, class organization reached a breakthrough with the establishment of Sveriges Socialdemokratiska Arbetareparti (SAP) in 1889, the trade union confederation Landsorganisationen (LO) in 1898, and the employers union Sveriges

Verkstadsförening (VF) in 1896 and Sveriges Arbetsgivarförening (SAF) in 1902. This was an intense entrepreneurial age as well, with a number of the large Swedish 20<sup>th</sup> Century multinationals founded at the time. A new and modern company law was implemented 1897. Financial markets also went through a paradigmatic change. The second half of the 19<sup>th</sup> Century saw the breakthrough of commercial banking, the development of liquid securities markets, and growth in financial services (Ögren [ed.] 2010). The changes reached a peak around the turn of the century, with a massive credit expansion from 1895, a modernized bidding system at the Stockholm stock exchange in 1901 and, most importantly – the bank reform of 1904, where the modern division of labor between the central bank and the commercial banks was established.

The reformation of the financial system was an important prerequisite for the second industrialization in Sweden, and from this time on, the Swedish economy was characterized by a close connection between banking and industry. In the early years of the new century, this meant a close relationship between the banks and the stock market, for instance through bank loans with stocks as security. Soon, this relationship spiraled into excessive speculation. In 1907, the New York bank panic to spread Stockholm, and several banks perished. Even so, the crash did not produce the kind of credit losses seen in later financial crises, nor did it reach all corners of the still predominantly agrarian Swedish economy.

After 1910 the profit share rose again, and so did stock prices (Figures 2.2 and 2.3). The Swedish economy had become increasingly export-oriented from the turn of the Century to World War One (Bohlin 2007). World prices on strategic products such as iron ore and certain industrial products increased before and during the war, and Sweden was in an extremely favorable position. A new bank law in 1911 strengthened the ties between the banks and the stock market, which together with expanded liquidity due the savings rates before the war paved way for a heavy bank involvement in business life during the war. Loans collateralized by stocks again grew rapidly among the public (Figure 2.1). This time, trade was mostly in unlisted shares, brokered by banks outside of the Stockholm stock exchange (Larsson [ed.] 2016). The Swedish export industry effectively bypassed the restrictions which were imposed on imports during the war, and profits increased even more (Schön 2000, pp 273–280). This export success resulted in the highest profit share ever recorded in Sweden in 1916 (Figure 2.3). The stock markets also peaked (Figure 2.2) After that however, wealth in listed and unlisted shares declined for several years, relative to GDP. Due

to import restrictions, inflation continued to rise. Meantime, political tensions intensified, especially after the Russian revolution in 1917. Class struggle centered on general suffrage and the eight-hour workday, and the workers achieved both goals.

Since the latest financial panic in 1907, both industry and finance had increased their roles in the Swedish economy. By the time of the next financial crisis in 1921, the industrial sector was about as big as the agrarian sector. This meant a potentially larger impact from the swings of the industrial business cycles on the overall economy. When the government set out to stifle the inflation lingering on since the war, with a dramatic tightening of monetary policy, it triggered the worst (peace-time) economic crisis in the industrial history of Sweden (Edvinsson 2014; and Edvinsson 2015). Bank losses sky-rocketed, the stock market lost even more of its capitalization (Figure 2.2), and the profit share shrank fast until 1921 (Figure 2.3). The faltering financialization and the turn in the functional income distribution were no coincidences. The revolutionary tide in Europe and the political gains of the workers were other signs of the growing strength of the working class (Bohlin and Larsson 2007). The unions saw their power increase as well (Kjellberg (2017)). The 1920s also experienced a modest rise in government consumption and investment expenditures relative to GDP – and the embryo of the massive welfare state to come.

Though financial markets and the GDP recuperated during the remainder of the 1920s, already a decade later it was time for a new crisis. Once again, the impulse came from the other side of the Atlantic. In Sweden, the Wall Street crash of 1929 eventually brought the Kreuger empire to collapse. Through the sale of debentures and stock emissions, Kreuger had bought both industrial companies and real estate, both in Sweden and abroad. Yet, with the exception of Skandinaviska banken, house bank of the Kreuger empire, Swedish banks survived relatively well, as did the Swedish economy in general. Real estate wealth had increased a lot during the 1920s, and moved in tandem with debt levels in the 1920s and 1930s (Figures 2.1 and 2.2). Arguably, the sector was very much a part of the financial boom-bust cycle. Stock market wealth was so only to a limited extent. Though it grew in relation to GDP in 1928 and 1929, and declined fairly steeply in 1930–1932, the magnitude of both the increase and the decrease was nowhere near the volatility of the previous two decades (Figure 2.2). The profit share reached a new record-low in 1932 (Figure 2.3).

Meanwhile, the working class pushed forth its positions. The unions had seen their membership grow during the 1920s (Kjellberg 2017) and in

1932 SAP gained the government power. The party quickly adopted the new ideas on economic policy that were provoked by the global Great depression in the USA. In collaboration with the peasants party Bondeförbundet, SAP implemented public jobs programs in order to combat unemployment. Public infrastructure investment as well as housing investment encouraged through government policy increased throughout the 1930s. This policy did not have significant macroeconomic effects, but spelled a paradigmatic shift in economic policy (Jonung 2017). Another cornerstone in the foundation of the Swedish model, the historical agreement between the Swedish working class and the Swedish capital owners on labor relations and social policy, was also put in place by the treaty between LO and SAF at Saltsjöbaden in 1938. Even so, it would take another two decades before the Swedish welfare state really began to grow (Figure 2.4).

The division of each accumulation regime into two phases – one of prosperity and one of stagnation – has some empirical backing in an international context in the 1900-1939 period (Maddison 2007). In large, Sweden fits this pattern too. This backdrop can illuminate aspects of the first financialization era in Sweden. The entrepreneurial expansion before World War One was accompanied by a long lasting financial boom which turned into a bust during the second half of the war. It would however take a few more years before the situation evolved into a financial crisis, as the fragile private balance sheets collapsed under the burden of tight monetary policy. The volatility continued, with rising wealth and debt levels in the end of the 1920s, and a subsequent decline during the 1930s (Figures 2.1 and 2.2). The shift in inequality was even more dramatic. An already high profit share increased even more until the middle of the war, only to drop significantly for the second half of the 1900–1939 period (Figure 2.3).

## *7.2. 1940–1979: Definancialization and the rise of the welfare state*

The regulation school coined the term "the Fordist accumulation regime" for describing mainly the growth period after World War Two until the stagflation of the 1970s. The term has also been used in a Swedish context (e.g. Viktorov 2007). The regime is foremost characterized by mass production and mass consumption, enabled by a historical compromise between labor and capital (Boyer 2010) and the commitment to full employment and rising effective demand by the Keynesian welfare state (Jessop 1997).

The massive involvement in the economy by the Swedish state came however not after World War Two, but with its outbreak. The government



had learned from the mistakes of World War One, and adopted extraordinary measures. Extensive capital controls and a complete stop on wages and prices were introduced with the aim to secure the financial system and economic stability. Moreover, the mobilization meant large scale fiscal spending, financed through government debt (Jonung 2017). Things would not go back to business as usual after the war however. The capital controls remained, and though public expenditures relative to GDP declined, they stayed on a higher level when compared to the pre-war level (Figure 2.4). The opposite was true for unemployment among unionized workers. It dropped significantly, and stayed low for the rest of the Fordist era (Molinder 2012).

Sweden did not take part in the Bretton Woods conference in 1944, but the cautious attitude towards finance of the conference reached Sweden a few years later. While the spirit of Saltsjöbadsandan seems to have encompassed domestic finance in the 1930s (apart from a ban on bank trade in stocks in 1934), the attitude of the government was soon to become more authoritative. In the 1950s, a range of credit regulations were imposed in order to direct financial resources towards politically prioritized areas, such as construction of housing and infrastructure, and for the expansion of the welfare state (Larsson and Söderberg *forthcoming* 2016; and Nygren 1985, pp. 98-100). The regulatory policy continued in subsequent decades, in tandem with the social engineering of the Social Democrats and their effort to materialize the visionary ideas from the 1920s and 1930s. Part of this project was the construction of dwellings in order to eviscerate poverty and to build a new and modern society. Until now, housing mortgage had been a relatively small part of the credit market, dominated by semi-governmental bodies. But from the mid-1950s to the late 1960s, it grew at an unprecedented pace (Figure 2.1), leading to a vastly enhanced housing supply (see *article I*).

Government intervention was commonplace all over the capitalist world, and present at the international level as well. The fear of communism instigated the Marshall plan on the European continent. This induced an increased demand for Swedish export goods, and helped in providing funds for the post-war expansion. Trade was not the most prominent engine of growth though. In fact, trade actually declined somewhat in relation to GDP during the 1950s and 1960s. Instead, growth came from investment in infrastructure and housing and from the growth of the public sector (Figure 2.4). During this time, housing construction may actually be considered a semi-governmental sector, heavily subsidized and favored through regulation, and carried out to a large extent by the municipalities and non-profit cooperatives.

Women entered the workforce in large numbers when work was offered in the public sector. In industry Sweden had to invite thousands of workers from abroad in order to meet the labor demand. Unemployment was kept at a minimum, and the wage share continued to rise during the 1950s, 1960s, and 1970s (Figure 2.3). Financialization was held at bay. Bank credit to GDP was stagnant from the 1950s all the way up to 1980, and total private credit to GDP plateaued in the 1970s (Figure 2.1). The sharp rise in total private credit in the 1950s and 1960s was due to housing construction of mostly rental apartments, and was not part of a Minskian asset price boom. Household wealth in housing relative to GDP increased about 60 per cent from the early 1950s to the early 1970s (Figure 2.2), whereas housing mortgage relative to GDP increased over 300 per cent. Wealth in the stock market was more or less stagnant relative to GDP (Figure 2.2).

Economic policy was to a large extent guided by the Rehn-Meidner model, which combined the Keynesian belief in full employment with active labor market policy, a policy for wage bargaining coordination and low wage dispersion, and low profit margins in order to curb inflation and promote productivity and structural change (Erixson 2010). As long as economic growth provided “reasonable” profits for the private sector, the capital-labor accord peacefully persisted. In the 1960s though, there were signs of radicalization within the left. This scared officials at SAF, and when SAP engaged in increasingly progressive reforms, SAF launched a massive public relations campaign in favor of capital interests (Koch 1999, pp. 28–48; and Viktorov 2009). A similar development occurred in the USA and the UK.

In the academic debate, Keynes theory was criticized for being too obsessed with the short run. The biggest challenge came from monetarism, with Friedman as its greatest proponent. He argued for a return to QTM, and provided support for the view that monetary authorities should set a target for the monetary supply in order to control inflation rather than to focus on employment. Monetarism was an important part of a general attack on fiscal policy (Bain and Howells 2009, p. 92). The collapse of the Bretton Woods system, exacerbated by currency speculation via the offshore Eurodollar market and the two oil price shocks of 1973 and 1979, made economic policy a difficult business. The economic crisis highlighted the need for reform.

Korpi (2002) argues that the high inflation stemming from the Vietnam War and the oil shocks acted as a catalyst to the impending changes. Technological advances played a part as well. Mainly through the entry of computers, barriers and costs were lowered for both commodities trade and securities trade, further complicating the political efforts to tame the econo-

my. The inability of fiscal and monetary policy to cope with the situation opened up a breach in the belief in Keynes teachings, and the close association between Keynesianism and the welfare state spelled a critique for the latter as well. This guilt by association applied to Sweden too. The Swedish efforts to “over-bridge” the global downturn in the early 1970s were futile. The budget deficit worsened, inflation increased and the profit squeeze got worse.

Like the previous period, the 1940–1979 period displays the familiar pattern with a prosperous and expansionist first half, and a stagnating and crisis-prone second half. The SSA was however very different when compared to the previous era. The engine of growth was not entrepreneurial or financial this time, but social and run by a working class government through the expansion of the Swedish welfare state. Likewise, as suggested by the regulation and SSA schools, mechanisms inherent to that growth regime seem to have contributed to its own collapse. According to the regulation school, the breakdown of the Fordist accumulation regime was brought about by a slump in productivity growth in the late 1960s, due to slowdown in technological innovation and expressed in a structural crisis and intensified class struggle in the 1970s (Brenner and Glick 1991, p. 97). On the other hand, SSA theorists argue that it was a decline in profitability stemming from the diminishing effect of full employment on the power of capital, relative to labor that caused the regime to crumble (Hein et al. 2014, and Kotz 2011). This argument is reminiscent to Malthus notion of the golden mean, where the ideal is a high, but not “too high” wage share. This thought has been present elsewhere too, for instance in the Rehn-Meidner model (Erixon 2010). Erixon (1987, p 59) downplays this factor, and instead argues that the decrease in profitability was due to a rise in the degree of competition. Steindl, Korpi and Duménil and Lévy see the shift as a political revolution staged by capitalists. Thus, the regime change occurring around 1980 can be viewed either as a result of the exhaustion of processes inherent within the post-World War Two-Fordist regime, as resulting from the inability of the former regime to cope with new circumstances, or politically manufactured.

### *7.3. 1979–2013: The second financialization and the rise of neoliberalism*

By 1980 the Swedish public sector peaked relative to GDP, but the devaluations shortly thereafter invigorated the private sector and put a halt to the relative expansion of the government domain. The wage share, which had

reached an all-time high in the late 1970s, started on a descending trajectory and would not recover (Figure 2.3). Stock and capital markets were vitalized (Figure 2.2). Tabb (2010) argues that the new SSA was enabled by neoliberal policy, through cutbacks in public spending, the priority of inflation targets over full employment, privatization, deregulation, and lower capital taxation. A similar analysis is found with many other scholars, especially among heterodox economists (e.g. Palley 2007, Kotz 2008, and Hein et al. 2014). Both Keynesian policy and the Swedish Rehn-Meidner model had a hard time surviving in the new environment (Erixon 2010).

Internationally, the new policy was championed by President Reagan in the USA and Prime Minister Thatcher in the UK. In addition, between 1981 and 1983, the Reagan administration swiftly reoriented the IMF and the World Bank away from Keynesian theory and towards monetarism and free market ideology as a part of its Cold War strategy (Westad 2005, p. 359). “Supply-side economics” aimed at reducing the influence of government in the economy further. In Sweden, international pressure (Wohlin 1998) as well as loopholes in the credit regulations eroded the support for the financial regulatory regime (Jonung 1993, pp. 334–336). In 1983, the bank liquidity quotas were abolished, 1989 marked the end of the Swedish capital controls, and in 1993 all restrictions on foreign ownership of Swedish stocks were removed (Jacobsen and Wiberg 2014).

The deregulation of the credit market in 1985, later dubbed “The November Revolution”, was perhaps the most dramatic deregulation. The designers behind the reform seriously misjudged the situation (Wohlin 1998, p. 30). Shortly after the deregulation all categories of credit spiked in terms of private loans to GDP (Figure 2.1). The nature of credit also changed. The traditional and rigorous risk assessment, a legacy of the Kreuger-crash, was scrapped in favor of high-risk, high-yield, contracts (Larsson and Sjögren 1995, pp. 184–187). The main effect was the emergence of a twin real estate and stock market bubble in the end of the 1980s, and a subsequent bust in early 1990s due to the international downturn triggered by the Savings and Loans crisis in the USA. Having invested in a “hard currency” attitude towards the exchange rate, an extremely tight monetary policy exacerbated the bust.

The deep recession that followed meant a huge deleveraging of private debt, and more or less it stayed at the new low level until the early 2000s. The government budget took a heavy hit as well. Public debt acted as an air bag during the crash, and inflated as fast as private debt levels dropped. Even so, open unemployment five-folded in three years (Erixon 2010), and a large

chunk of the wage share disappeared as well. Real estate wealth moved in line with the development of debt, and saw a sharp and continuous decline between 1992 and 1996, but wealth in stocks only fell during 1990 and 1991 (Figure 2.2). After the devaluation in 1992, the stock market started on a rather steady journey upwards which lasted throughout the rest of the century. Inequality likewise increased. Both public infrastructure investment and the construction of houses went down relative to GDP.

In the second half of the 1990s the wealth effect from the devaluation of the Krona in 1992 reached the economy at large and towards the end of the decade, the US Dot.com bubble spread to Sweden. The equity boom took off in 1998 and 1999, but this bubble was not associated with a large increase in debt levels (Figure 2.1). The funding of the spark of the bubble is not easily discernable, but foreign ownership and attention from large US investment banks undoubtedly play an important role. Also, a big Swedish pension reform was implemented in 1999 and many fund managers saw great opportunities in marketing Dot.com shares towards the public. Not surprisingly, it was the US stock markets that (again) brought the saga to an end in 2000. Housing prices, which had joined stock prices in the upward moment in the middle of the 1990s, were unaffected by the crash (Figure 2.2). The low rate of residential construction fueled a housing shortage, which in turn helped keeping prices afloat. The following recession was relatively mild and it was not long until a new boom drove economic indicators and asset prices up globally and in Sweden.

When the crash went into a new banking panic in 2008, Sweden was ill-placed. Like elsewhere, both bank credit and housing mortgage had increased a lot more than GDP in the 2000s (Figure 2.1). Yet, the main culprit was the involvement of Swedish banks in the Baltic states and Ukraine. According to the finance minister of Sweden at the time, Anders Borg, two of the biggest Swedish banks were very close to bankruptcy in the summer of 2009 due to their heavy risk-taking abroad (Realtid.se 2011). Even so, the Swedish economy quickly returned to growth. Neither debt levels nor house prices experienced the deep decline seen in many other countries. The stock market dropped fast during 2007 and 2008 but rebounded quickly in the autumn of 2009 (Figure 2.2). The Euro crisis meant a new steep stock market drop in 2011, but remained on a course upwards for the remainder of the period. Overall, the first one and a half decade of the new century displayed a somewhat changed relationship between asset markets versus bank credit and housing mortgage. While real estate wealth continued upward on a more or less unbroken trend, stock market wealth experienced violent volatility.

Much like the profit share (Figure 2.3) though, it stagnated when averaged over the 1998-2014 period (Figure 2.2) – which covers three boom-bust cycles starting with the Dot.com bubble. Debt to GDP ratios on the other hand, remained stagnant until the rise of the global housing bubble from the middle of the 2000s (Figure 2.1).

Though financial markets experienced a “bumpy road” from the 1980s, the upward trend is clear no matter what variable one look at. Financialization has been very strong and palpable in Sweden during the 1980 to 2013 period. Total private debt levels were at a record level in 2013, matched only by record levels of wealth in the financial and real estate sectors (Figures 2.1 and 2.2). From a Minskian perspective, wealth in asset markets should not be seen as comforting, but rather as a source of concern. Also, the currency regulation introduced in 1939 insulated the Swedish credit market from international impulses, but after 1989 it became increasingly intermingled with the global financial system. This meant a larger exposure to international financial instability, as so clearly demonstrated in the early 1990s, after the Dot-com crash and during the Global financial crisis of 2008. The post-1980 period has also been marked by increasing inequality (Figure 2.3). The fact that earlier research and the studies of this dissertation shows a possible causality running from inequality between wage-earners and capital-owners to financialization should be regarded a cause for concern about macroeconomic stability as well.

## 8. Concluding discussion

This dissertation shows that financialization has been a recurrent phenomenon in the modern economic history of Sweden and that the early decades of the 20<sup>th</sup> Century display patterns similar to that of Sweden in recent decades. This is in line with the description of the stages of capitalism by a number of scholars, such as Arrighi, Vercelli, Minsky and Kotz – whether they emphasize regularly returning cycles of financialization or not.

Both the 1900–1939 and the 1980–2013 periods experienced a high or rising bank debt ratio (Figure 2.1), a high or rising stock market wealth ratio (Figure 2.2), high or rising inequality (Figure 2.3) and two severe financial crises each. The period in between, the 1940–1979 era, experienced a low degree of financialization, expressed by a low and declining bank debt ratio, a low and declining stock market wealth ratio, declining inequality, and no severe financial crises. Total private debt relative to GDP was also high in the first half of the first period, and declined after the Krueger crash. How-

ever, due to massive housing construction launched by SAP, it began to rise already in the second period.

The relationships between the bank debt ratio, the stock- and housing wealth ratios and inequality are outlined in *the articles* of the dissertation. *Article I* implies that changes in the debt level have been a significant cause to the Swedish banking crises in the 1920s, 1930s, 1990s and 2000s. This corresponds to the claims of the Minskian FIH, which are echoed by a number of financialization theorists. Also in line with Minsky, *article III* shows that the debt level is related to the development of asset prices in the long run. Additionally, *article III* shows that the Minskian process can be tied to the claims made by the Neo-Marxist economists, that the financialization process is deeply rooted in the distributional class struggle between labor and capital. According to this viewpoint, a higher profit share has created conditions conducive for the creation of bank credit. Since a higher profit share is associated with higher stock prices, it contributes to a higher stock market capitalization. This applies to total financial wealth as well (though not in all specifications). This has in turn created funds and collateral for larger bank loans. *Article II* shows that household income inequality mainly should be regarded as a by-product of functional income inequality.

*Article IV* shows that the combined effect of government consumption, government investment, and government-sponsored residential construction, can explain much of the ups and downs of the private wage share in Sweden in the 1900-2013 period. As argued by Kalecki, Korpi and others, this relationship indicates that the welfare state has been an employer of last resort in Sweden from the 1930s to the 1970s and as such improved the bargaining position of labor. It has not been possible to assess whether or not the expansion of the welfare state has been a check on the monopolization tendencies postulated by the Marxists. In light of the other articles of the dissertation, this does imply however, that the ability of the welfare state to restrain the profit share has been an effective hindrance to the financialization tendency in Sweden. Ironically, this was the case especially during the post-World War Two “Golden Age” of capitalism. This move by society to “tame” or “embed” capitalism described by Polanyi, but also by Minsky, Vercelli and Kotz. The interpretation offered by Arrighi, who saw the collective force of the government as an aid to capitalism and financialization as a sign of capitalistic fatigue, is another possible perspective.

Taken together, the articles fit the causal model described in Figure 1. It is of course possible, if not likely that there is strong endogeneity in the relationships found in the study. Feedback mechanisms between asset- and



credit markets are inherent traits of the financial market. It is also possible that debt levels resulting in a recession affects the wage share negatively, just as a high profit share raises profit expectations and asset prices, thereby creating conditions conducive for a credit expansion. Still, the impulse-response functions in *article II* are indications that the causal direction primarily follows the latter description.

The Swedish financialization processes since 1900 appears to have followed the phases of accumulation described by SSA and regulatonist theories to a high degree. In the 1900–1939 period, financialization experienced an expansion during the first two decades, in 1900–1919, and a contraction in the last two decades, in 1920–1939. During the latter part of the period, the working class improved its position in the distributional struggle. It increased its economic power in the labor market through stronger unions and increased its political power through universal suffrage. During the global stagnation phase of the 1930s, the working class managed to use this power not only to launch a new economic policy, but also to lay the foundation of the Swedish welfare state. The 1940–1979 period can also be divided into an expansion and a stagnation phase in terms of economic growth, but financialization remained suppressed. The increasing housing mortgage lending was not tied to price speculation, but financed the construction of houses. The size of the welfare state relative to GDP continued to grow until 1980s however, and inequality of household and functional incomes kept on declining. In the 1980s, it was time for another change. From now on, debt and wealth levels increased along with increasing inequality and a retrenchment of the Swedish welfare state.

In the international debate, transparency and stricter supervision and regulation of securities markets are often identified as crucial measures for increasing financial stability. Efforts to decrease inequality, perhaps through a larger role for the public sector in the economy, might be added in this quest. Though an analysis of growth and accumulation is beyond the studies of this dissertation, the simultaneous financialization and comparatively low growth since 1980 may be an indication that the financialization-stagnation trap proposed by the Neo-Marxists is not that far-fetched after all. That the present secular stagnation is a crisis for the neoliberal accumulation regime as such, as argued by scholars such as Duménil and Lévy (2011) or Kotz (2011) is also open for debate. Perhaps, these are questions for the economic historians of the future.

As argued by several scholars presented in this dissertation, the financialization process in the 20<sup>th</sup> and early 21<sup>th</sup> Centuries has been a recurring



phenomenon internationally, and this investigation shows that the Swedish society has been subject to this cycle as well. The development can be framed as a Polanyian Double movement, applied to financialization and definancialization. The market and the government have however been mere instruments in this struggle. The real combatants have been the wage-earners and the capital-owners. Actions and reactions, fear and utopian visions of socialism have characterized this grand struggle. Sometimes, the pendulum of power has shifted to the side of the capitalists, and sometimes it has sided with the working class.

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