

# Two Attacks on the Swedish Corporate Model: From Wage-Earner Funds to Corporatist Pension Funds\*

by

Magnus Henrekson<sup>1‡</sup> and Ulf Jakobsson<sup>2</sup>

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*Abstract:* We analyze the development of the Swedish ownership model after WWII. The controlling ownership in Swedish firms is typically concentrated to one or two dominating owners. Often, but not always the controlling owners are Swedish families. Thus, the model resembles the typical corporate control model of Continental Europe. A distinguishing feature of the Swedish model is, however, that control is typically based on a smaller capital base than in other European countries. This feature is a result of a seemingly paradoxical policy when it comes to private ownership. Tax policy has consistently disfavored the accumulation of private wealth, but at the same time corporate law has greatly facilitated the wielding of control based on a small equity base.

Our analysis shows that the large gap between ownership and control makes the Swedish corporate control model both politically and economically unstable.

The major political threat to date has been the proposal of the Swedish TUC and the Social Democratic Party to introduce a scheme that would result in the gradual takeover of the Swedish corporate sector by union-controlled wage-earner funds.

After the political defeat of this proposal economic policy was changed in a more market liberal direction. This policy change has uncovered the economic instability of the model. The weak financial base of the controlling owners makes it difficult for them to take an active part in the current international restructuring of the corporate sector. Two forces are now seen as the major threat to Swedish ownership model: A rapidly increasing foreign takeover of Swedish firms and the large state and corporatist pension funds. Their financial assets are far larger than those of today's dominant control owners and extensive mandatory and/or tax-favored systems for pensions saving ascertains that their relative financial strength will continue to grow sharply.

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‡Corresponding author

<sup>1</sup>Institute for Research in Economic History  
Stockholm School of Economics

Box 6501

SE-113 83 Stockholm

Phone: +46-8-736 92 02

Fax: +46-8-31 32 07

e-mail: [Magnus.Henrekson@hhs.se](mailto:Magnus.Henrekson@hhs.se)

<sup>2</sup>The Research Institute of Industrial  
Economics, IUI

Box 5501

SE-114 85 Stockholm

Phone: +46-8-665 45 02

Fax: +46-8-665 45 99

e-mail: [UlfJ@iui.se](mailto:UlfJ@iui.se)

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## 1. Introduction

There has been a dramatic change in the ownership structure in Swedish firms in the last few decades. The most obvious change is a strong increase in foreign ownership of Swedish firms. Naturally, this is part of a general trend towards globalization. As we shall see, foreign ownership has increased more quickly in Sweden than in any other developed industrial country. This situation has led to considerable changes in the ownership and operation of some of the largest and most important Swedish firms. This has also stirred a lively debate on the advantages and disadvantages of Swedish and foreign ownership, respectively, as well as the reasons for the swift increase in foreign ownership in Swedish business.

In this paper, we aim at throwing some light on these issues, while also taking a wider perspective on the issue of ownership. The rapid increase in foreign ownership in Swedish business is part of a profound change in the conditions for corporate governance in Sweden.

This change has been brought about by several different factors. In the literature in corporate governance, there is a strong tendency to focus on corporate law as a determining factor of the system of corporate governance in a country. The work of La Porta *et al.* (1998, 1999) has been very influential in this area. We think that this focus of the traditional literature is too narrow. The analysis in this paper will show that this is indeed the case for Sweden.

The focus of our analysis is on the "Swedish ownership model", which means that the controlling ownership in firms is typically concentrated to one or two strong owners. Often, but not always, these owners are Swedish families. When it comes to controlling ownership, the Swedish ownership model thus resembles the model for corporate governance, which is predominant on the European continent. Sweden differs from most countries in Continental Europe in a couple of respects, however. First, the entire ownership on the stock exchange is predominated by a couple of dominant controlling owners. In 1998, two owners altogether controlled 54 percent of the market value on the Stockholm Stock Exchange. Second, Swedish controlling ownership is based on a smaller capital base than that in other Continental European countries. No other industrial country has such a large gap between cash-flow rights and control rights as Sweden.

This is the result of an apparently paradoxical policy when it comes to private ownership or family ownership. On the one hand, the tax policy has consistently disfavored the accumulation of private wealth in the whole post-war period. On the other hand, corporate law has favored those wishing to obtain controlling ownership on the basis of a limited private capital.

Here, Sweden seems to have found a model combining the requirements for strong owners with an egalitarian wealth policy. But as we shall see, the large gap between ownership of capital and control creates considerable problems for the Swedish model. In the long run, this might mean that it is phased out in order to be partly or entirely replaced by other models for corporate governance.

On a very general level, it can be said that the weak supply of capital makes the Swedish model both politically and financially unstable. A current example of this political instability is the debate that is now being carried out in the OECD and the EU, which aims at eliminating or at least limiting the use of dual-class shares.

Besides this, the major political threat against the model has so far been the proposal from the early 1970s of the trade unions and the Social Democratic Party of introducing wage earner funds. These funds were to be controlled by the trade unions and they would gradually by virtue of privileged equity issues they would gradually gain control of the business sector. This proposal led to a deep-seated political conflict between the socialist parties and the trade unions and the non-socialist parties, entrepreneurs and owners of private capital. A diluted version of wage-earner funds was implemented in the early 1980s, but they were dismantled by the nonsocialist government in the early 1990s. In fact, the conflict about the funds did mark the end of the political ambitions of the labor movement to nationalize Swedish business.

The international renaissance of the market economy in the 1980s contributed to the policy change in a more liberal direction after the conflict about the wage earner funds. Capital and foreign exchange markets were deregulated and the tax system was reformed in the direction of an increased neutrality between different kinds of owners and different sources of finance. An important part of the deregulation was that the measures that hindered foreign ownership in Swedish business were gradually abolished.

Since the political threat against the Swedish ownership model had been averted, the new more liberal market order came to expose the economic instability of the Swedish ownership model. On an internationalized stock market with new large groupings of owners, for example in the shape of Swedish and foreign pension funds and large international firms, incumbent controlling owners are often condemned to a passive role in the comprehensive restructuring among listed companies. What now begins to emerge is a situation where Swedish ownership of firms is to an increasing extent dominated by Swedish and foreign funds as well as politically controlled Swedish pension funds. At the same time, the old Swedish control model loses in importance, in particular as concerns the control and operation of large firms. Sweden is thus on its way away from the Continental European model of corporate control. It might seem natural that Sweden should thus be on its way towards an Anglo-Saxon control model with dispersed ownership and management control. Speaking against a pure model of this kind, however, is the fact that the Swedish stock market is dominated by a few very large funds, where the largest ones have a strong political connection. This means that in part of the stock market, there might be a return to a socialist controlling ownership within the framework of a liberal market model.

The purpose of this paper is to analyze the development of the Swedish corporate ownership and control model in the postwar period and how it has been shaped by political decisions, mainly within the areas of taxation and corporate law.

### *1.1. Framework and outline*

In this paper, we mainly study the development of the ownership and control structure of firms on the Swedish stock exchange. We also try to explain what forces have driven the observed trend.

In this analysis, we distinguish between different categories of owners: families, private institutional owners, public or semi-public institutional owners and foreign owners. The last group of owners can be divided into the same categories as domestic owners. Generally, we treat them as one group, however.

A central issue is also whether the ownership in firms is concentrated or dispersed. The issue here is mainly whether one or a couple of owners can have a dominant influence in each firm. This is what we call ownership dominance. Moreover, a single agent may have an influence in several firms due to ownership dominance. In that case, one might speak of a high concentration of ownership control. Controlling a firm is based on the control of a large part of the votes related to the outstanding shares of the firm. Owning a share in a firm both means controlling a certain part of the votes at the general meeting of shareholders and that one has the right to a certain share of the total dividends of the firm. On the European continent, as well as in Sweden, it is common that shares have differential voting rights. Thus, the influence in a given firm need not be proportional to the capital invested. The possibility of pyramiding also works in this direction.

When studying ownership dominance, it is therefore important to distinguish between whether the dominance concerns cash-flow rights or voting rights, i.e., power in the firm. The aspects of ownership that we have now mentioned are summarized in *Figure 1*.

*Figure 1* Aspects of the Ownership of Swedish Firms

Enclosed

The major part of our analysis deals with the postwar period. Since the end of World War II, ownership related to cash-flow rights has undergone dramatic changes, while control ownership at the stock exchange has remained surprisingly constant. Behind this, there is, however, a hidden trend where the sharp increase in foreign ownership has resulted in the disappearance of several large independent firms from the Swedish Stock Exchange. Several firms have either become wholly-owned subsidiaries to foreign multinationals or they have merged with a foreign competitor, and the new larger firm has subsequently become domiciled elsewhere and the delisted from the Stockholm stock exchange.

At the beginning of the post-war period, ownership in Swedish firms quoted on the stock exchange was mainly private. There was a strong ownership dominance throughout the firms and furthermore, ownership was concentrated to a small number of families and groupings. This concentration was both based on a considerable concentration of the large private fortunes and the fact that there were different mechanisms separating the possibilities to

control from the number of shares owned. These mechanisms consist of differences in voting rights between different shares, pyramiding ownership and cross ownership.

The use of these mechanisms is not specific for Sweden. With time, their importance has, however, become larger in Sweden than in any other industrialized country. Therefore, one might talk about a typical Swedish ownership model, thereby meaning a dominant and concentrated ownership based on an, in an international perspective, small equity base. In the period studied, the gap between the distribution of ownership rights and the distribution of control rights has widened, as shown in the figure. How has this trend been financed? Since the capital share among controlling owners has continually been decreasing, the supply of capital must come from other sources. As we shall see, loan financing played an important part in the period until the 1980s. Subsequently, the stock exchange has increased in importance as a source of financing.

Apparently, the legislation in a country affects the kinds of management and financing allowed in that country. These relations have also been frequently analyzed in the literature. However, the empirical literature has largely concentrated on the relation between "corporate law" and "corporate governance". Seminal studies in this tradition are La Porta *et al.* (1998, 1999), who obtain their results in a cross-section analysis of a large number of countries. A general result is that the legal framework is of crucial importance for the system of "corporate governance" in a country and for the financing of the activities of the firm.

One problem with their results is that they give no explanations for the considerable changes over time in many countries in the variables to be explained. An example from Sweden is the trend of the stock market capitalization as a percentage of GDP. This variable plays a crucial role in the La Porta *et al.* analysis. At the point in time when their study was made, this value was relatively low, but as shown in *Figure 2*, it has undergone considerable changes over time, despite the fact that the explanatory variables used by La Porta *et al.* have changed only marginally.

*Figure 2* Stockmarket Capitilization on the Stockholm Stock Exchange as a Share of GDP, 1908–2000.

Enclosed

*Source:* Daniel Waldenström and Statistics Sweden.

In this article, we argue that when it comes to Sweden, the development of ownership structures and systems for corporate governance can be explained by several factors, of which "corporate law" is one. The factors analyzed in this article are:

- *Tax policy.* This affects the conditions for ownership in a number of areas. For Sweden, it has affected the distribution between private and institutional wealth formation. It has also been of considerable importance for the relative cost of different sources of finance. As we shall see, the tax policy has also affected the size distribution of firms. This, in turn, might be expected to affect the types of ownership and the structure of firm financing.
- *Financial market regulations.* In the first three decades after the war, Swedish financial markets were subject to strict regulations. As we document below, these regulations affected both the structure ownership and financing in a number of ways. Analogously, the deregulation of financial markets in the 1980s had dramatic effects on these variables.
- *Channeling of savings in the economy.* The channeling of savings did, to a large extent, affect the supply and demand for equity capital and credits. In the first part of the post-war period, large part of the savings in the Swedish economy took place in the public sector. Since none of these savings were invested in shares, the importance of the stock exchange as a source of finance dwindled. In the latter part of the period investigated, there were a number of changes in the channeling of savings, which contributed to an increase in the importance of the stock exchange.
- *Labor market policy.* The organization of the labor market is an important part of what is usually called "the Swedish model". However, in the area studied here to we only highlight the fact that this policy has favored large firms
- *Corporate law.* In the literature on corporate governance, the type of corporate law in a country is considered to be of crucial importance for its firm and ownership structure. No doubt, this legislation has been of considerable importance since the Companies Act allows dual-class shares and tax-favored investment companies quoted on the stock exchange. However, these rules have been virtually unchanged throughout the postwar

period, and hence they cannot explain the major changes in the ownership structure and the sharp increase in the importance of the stock exchange.

The policy on ownership of firms in Sweden can be divided into two periods, where the proposal for wage earners funds constitutes a natural endpoint for the first period, which was characterized by a long-term socialist vision. In the second period, this vision has disappeared from the political agenda. Instead, the policy stance has been largely market liberal, but the tax policy has discriminated against Swedish individual ownership. A stylized survey of the two periods of the policy is given in *Table 1*.

*Table 1* Stylized Outline of Ownership Policy and Structure in Sweden during the Postwar Period.

	Phase I (1945–1985)	Phase II (1985–)
Ideological superstructure	Long-run vision of a socialist economy; Marx, Schumpeter, Wigforss.	Ambiguous combination of market liberalism, adjustment to EU and anti-capitalism.
Policy in practice	Aimed at discouraging individual wealth accumulation, stimulating institutional ownership, favoring large companies, impeding small and new firms. Strong obstacles to foreign ownership.	Deregulation and greater market orientation. Removal of obstacles to foreign ownership. Fiscal discrimination of Swedish ownership.
Resulting ownership structure	Strong increase in institutional ownership and corresponding decline in individual ownership.	Strong increase in international ownership and corresponding decline in Swedish institutional ownership.
Corporate control	“Swedish Ownership Model”	“Swedish Ownership Model”

In the paper, we provide a detailed analysis of the policy and its effects on the various aspects of ownership structure mentioned above. The effect might be more or less certain. In many cases, we can draw on previous studies, while in other instances we have to rely on more scattered evidence and economic reasoning. A summary of our analysis is presented in *Table 2*. The table can also serve as an overview of the contents of the remainder of this paper.

*Table 2* Effects of Policy Design on Ownership, Firm Structure and Financing in the Business Sector in the Postwar Period, Phase I (1950–1985) and Phase II (1985–).

Enclosed

The next section gives a historical survey of the development of the ownership of firms since the beginning of the last century. Then, the policy and its effects during the period 1945–ca.

1985 are described. The ensuing section analyzes the turning point or the transition to the second periods. Then, we present the development after the turning point.

While there have been considerable changes in a number of the variables studied here, we have already established that what we call the Swedish ownership model has remained strikingly invariant in the long period we study. Thus, the Swedish trend might seem to be in line with traditional analysis of corporate governance in one important respect. An important conclusion of our analysis is, however, that the Swedish ownership model is not a stable equilibrium solution. The other major changes that have taken place as concerns ownership have undermined the Swedish ownership and control model and we argue that it is currently undermined at a rapid rate and it is likely to gradually disappear, at least in its traditional shape. We conclude by discussing likely ownership and control models in the future.

The major problem for the continued existence of the Swedish ownership model is the increasing gap between the value of ownership wealth and the exercise of ownership control in Swedish firms. There is no possibility for Swedish individual wealth to exercise controlling ownership only through equity capital to the same extent as is done today through differentiated voting rights and pyramiding. The first great threat to the model was in the shape of a 1970s program for nationalizing Swedish business. The material conditions paving the way for these proposals were partly due to the lack of legitimacy of private ownership created by the concentrated corporate control structure of the Swedish business sector. The present threat to the model instead comes from the market. In today's deregulated and globalized capital markets, it is no longer possible to base a dynamic and expansive ownership on the thin capital base which constitutes the basis for individual ownership and control in Sweden.

## **2. Historical background**

Beginning in the late 1860s the Swedish economy embarked on a long period of modernization and sustained economic growth. This was greatly facilitated by a number of economic reforms in the mid 1860s, notably, the freedom for any Swedish man or woman to start a business and the liberalization of foreign trade. In 1870 the Swedish productivity level was the second lowest in Europe, but from 1870 to 1913 Sweden experienced the highest rate of productivity growth of all countries for which comparable data are available (Maddison,

1982). A number of highly innovative entrepreneurs such as Gustaf de Laval, Alfred Nobel and L.-M. Ericsson were active at the time. Before WW I a number of new industries and important firms were created. In fact, 35 of the 50 largest Swedish firms in terms of sales in 2000 were established before 1914 (NUTEK and ALMI, 2001).

Foreigners had been banned from owning Swedish real estate and mines since the 19<sup>th</sup> century. Restrictions for foreign owners were further extended in 1916 when new legislation was passed that prevented foreign owners from having more than 20 percent of the voting rights in Swedish corporations owning natural resources. This law mainly hit firms in mining, forestry, pulp and paper, and iron and steel (Glete, 1981).<sup>1</sup> In 1934 legislation was passed that outlawed earlier methods to circumvent the restrictions on foreign ownership by means of using a Swedish citizen as a dummy.

Apart from a sharp but short-lived crisis in 1920–21, Swedish industry thrived in the 1920s; several of today's large corporations were formed, and towards the late 1920s many large export companies raised capital through equity issues on foreign markets (Lindgren, 1987, p. 172). These activities were severely curtailed as a result of the international stock market crash beginning in October 1929 and the entire Swedish market for corporate control was totally retailored in the years following the demise of the internationally renowned Kreuger empire after Ivar Kreuger's death in March 1932. Since 1911 banks had been allowed to acquire stocks as collateral for loans, and after the severe crises of the 1920s and 30s banks held large portfolios of stock. A new bank law in 1934 prohibited banks from buying new stock and existing portfolios had to be sold within four years if this could be done without incurring losses. The major banks solved this problem by creating new holding companies, constructed as closed-end investment funds, whose main assets were the stocks previously held by the bank. Ownership of the investment companies was distributed on a *pro rata* basis to the owners of the respective banks.<sup>2</sup> Since these investment companies were, and still are, organized as pyramid holding companies with dual-class shares they immediately became important instruments for corporate control.

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<sup>1</sup> In 1934 the law was made more restrictive in that foreign owners could not own more than 20 percent of the capital either.

<sup>2</sup> Stockholms Enskilda Bank (controlled by the Wallenberg family) started two such companies, Investor (originally founded in 1916 as an equity issuing company) and Providentia, Svenska Handelsbanken started Industrivärden and Skandinaviska Banken formed Custos.

Without going into details regarding what exactly happened in the aftermath of the Great Depression and the Kreuger crash, we may note that corporate control was highly concentrated at the beginning of the postwar period. This is clearly documented by Lindgren (1953) in a study based on the 1945 Swedish Census. He shows that 6–7 percent of shareholders controlled 65–70 percent of the stock-market value. His findings regarding ownership control in the largest companies (more than 500 employees) are of even greater interest in our context. In no less than 60 percent of the large firms, a single individual represented the majority of the votes at the shareholders' general meeting. In more than 90 percent of these firms, three or fewer owners constituted the majority at the shareholders' meeting. The concentration of control was almost as high in the public companies. In the regularly quoted firms a single individual represented the majority of the votes at the general meeting in 53 percent of the cases. In 85 percent of the regularly quoted firms the two largest owners represented more than 50 percent of the votes.

At the end of the 1940s households were still the dominant owner category. According to calculations in Spånt (1975), households then held 75 percent of all Swedish listed shares. These calculations apply to final owners, which implies that ownership by investment companies and other intermediate owners has been netted out. Spånt's final owner categories are households, institutions and foreigners.

Foreign owners became increasingly marginalized after WW II. Shortly after the onset of WW II foreign exchange controls were introduced. These controls entailed a number of measures that restricted foreign ownership of Swedish firms and property. The most important of these were: the acquisition of Swedish companies required central bank approval, no more than 20 percent of the votes or capital of a listed company could be owned by foreign investors (unrestricted shares), foreign banks were not allowed to establish branches in Sweden and foreign acquisition of real estate was subject to approval from the regional government. In practice, this legislation ruled out a substantial foreign ownership share of Swedish industry. The purpose of this legislation was openly protectionist, i.e., to ascertain that "Swedish firms remain controlled by Swedish interests" (SOU 1986:23, p. 143).

In 1938 a number of important changes in the tax code were introduced. Income tax rates were increased, all investment could be written off instantaneously, dividends were hit by double taxation for individual owners, but not for institutional owners. These changes

benefited incumbent firms and owners that were not individuals. Montgomery (1946, p. 335) notes that this “did not encourage the formation of new firms. And the 1938 reform was more characterized by an aspiration to facilitate the consolidation of already existing firms rather than promoting new ventures.”

In sum, by the late 1940s control of the Swedish corporate sector was highly concentrated, but households was still the dominant final owner category. As shown by Glete (1994) there were several large owner groups in Swedish industry.<sup>3</sup> However, already before the war, the first steps had been taken towards a tax system that favored institutional ownership and drew a wedge between the scope for wealth accumulation for firms and their final owners. At the same time, strict legislation was in place that prevented foreign investors and industrialist from becoming important players on the Swedish corporate scene.

### **3. The Swedish Corporate Control Model and Its Role in the Corporatist Model**

#### *3.1 Ideological background*

The Social Democrats have dominated the political scene and the policy discussion since the early 1930s until the present day. As a result, there is little doubt that its philosophy had a tremendous influence on political decisions impinging on entrepreneurs, firms, private versus collective ownership and the overall business climate. It is apparent that the most important Social Democratic thinkers have seen the large industrial corporation as the major unit of production. Ernst Wigforss, Minister of Finance in 1925–26 and 1932–49 and probably the most influential of all Social Democratic ideologues, is quite clear on this point. Wigforss (1956) argues that the then clear tendency in capitalist societies that economies of scale favored large firms (Schumpeter, 1942; Galbraith, 1956) would facilitate the collectivization or socialization of the productive capital stock, which was seen as the ultimate goal of the labor movement. He also maintained that in the long run the large industrial corporations had to be converted into “social enterprises without owners”. In this perspective a strong concentration of ownership could be seen as a natural and even desirable intermediate station on the road towards the ultimate goal.<sup>4</sup>

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<sup>3</sup> The Wallenberg family, which became increasingly dominant, only controlled four out of the 25 largest firms in 1945 (Glete, 1994, p. 288).

<sup>4</sup> This point is developed at greater length in Henrekson and Jakobsson (2001).

In the medium term a more pragmatic strategy was followed by the ruling Social Democrats. State ownership of industry was limited and the government, trade unions and bank-related business groups came to constitute an explicit tripartite negotiating culture, which was the main characteristic of the Swedish democratic corporatist model. This model presupposed the existence of a fairly small number of owners or ownership groups – i.e., an identifiable industrial elite, which acknowledged and accepted that by virtue of their political strength, the Social Democrats would use their political power to implement far-reaching welfare reforms, while the labor movement would abstain from socializing the industrial sector. It would have been very difficult to develop this culture of compromise and negotiations between different elites (Steinmo, 2003; Katzenstein, 1985) without the predominance of a few large firms and even fewer ownership groups (Reiter, 2003). Calling this arrangement an “historical compromise” (Korpi, 1982) is in our view a misnomer. Swenson (1991) argues in favor of the alternative interpretation that it is a case of coalition between an entrenched political leadership and Big Business to the detriment of the (educated) middle class. Roine (2000) points out one plausible explanation for this arrangement. He shows theoretically that if private wealth is very unequally distributed initially, a political coalition may arise between low-income earners and the rich. A prerequisite for this coalition is the introduction of safety valves/breaks in the tax system for those who are rich initially, so they can avoid being substantively affected by an increase in aggregate taxation.

### 3.2 *Reinforcing policies*

Now we turn to a review of the different policy instruments used to promote and underpin the model outlined above. The policy dealt with are: taxation, credit market and savings policies, labor market legislation and wage-setting arrangements.

A key policy instrument promoting a development towards the vision of capitalism without capitalists was *taxation*. A number of channels were used. First, until the late 1970s taxable wealth amounted to 100 percent of the net worth of unlisted companies and 100 percent of the market value of listed companies. The tax rate has typically been 1.5 percent of taxable wealth. In practice, these rules resulted in very high real rates of wealth taxation on individually owned corporate assets in the 1970s and 1980s. The wealth tax was not deductible at the company level, so that funds required to pay the wealth tax were first

subjected to the mandatory payroll tax and the relevant marginal income tax rate.<sup>5</sup> Second, dividends were subject to taxation both at the corporate and individual level, which normally gave rise to a total tax rate on the order of 90 percent (Norrman and McLure, 1997). Third, high inheritance and gift taxes made it extremely expensive to transfer ownership from one generation to the next.<sup>6</sup> As shown by Du Rietz (2002) the payment of the inheritance tax in the 1970s typically required a withdrawal from the inherited firm corresponding to 50–60 percent of the net worth of the company. This was often impracticable and a sellout was the only feasible alternative.

On the other hand, capital gains taxation was designed so that it became exceptionally advantageous for individual owners to sell their firms. Until 1976, the taxation of long-term (> 5 years) realized capital gains on shares and the sale of partnerships was negligible. Between 1976 and 1990, 60 percent of nominal capital gains were exempt from taxation for assets held more than two years.

To get a full understanding of how corporate taxation can be expected to affect corporate ownership and financing, one needs to calculate how real rates of taxation are influenced by how a venture is owned and financed. *Table 3* lists effective marginal tax rates for different combinations of ownership and sources of finance. Three categories of owners and sources of finance are identified, and the effective marginal tax rate was calculated assuming a pre-tax real rate of return of 10 percent. A negative number means that the real rate of return is greater after than before tax. Tax rules benefiting debt financing relative to equity financing and institutional relative to individual ownership, can be expected to favor large, real-capital-intensive, publicly traded and well-established firms. Obviously, this also encourages capital accumulation and investments in existing firms without creating conditions conducive to wealth formation at the individual level.

The table highlights four important aspects of the Swedish tax system during the postwar period through the 1980s. First, debt financing consistently received the most favorable treatment and new share issues the least. Second, retained earnings were consistently taxed at lower rates than newly issued equity, which favored incumbent firms relative to entrants.

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<sup>5</sup> Typically 7 kronor had to be withdrawn from the firm for every krona paid in wealth tax in the early 1980s.

<sup>6</sup> In the late 1970s every krona to be paid in inheritance tax entailed a payment of a total of roughly 10 kronor in taxes, if the heirs had to withdraw the necessary funds from the firm.

Third, the taxation of households as owners was much higher than for other categories, and their rate of taxation increased during the 1960s and 1970s, whereas the reverse occurred for insurance companies and tax-exempt institutions.<sup>7</sup> From some point in the 1960s until the 1991 tax reform, more than 100 percent of the real rate of return was taxed away for a household buying a newly issued share. Fourth, tax-exempt institutions benefit from a large tax advantage relative to the other two categories of owners, and this advantage increased strongly during the 1960s and 1970s.

*Table 3* Effective Marginal Tax Rates for Different Combinations of Owners and Sources of Finance, 1960, 1970, 1980 and 1985 (real pre-tax rate of return 10% at actual inflation rates).

	Debt	New share issues	Retained earnings
<b>1960</b>			
Households	27.2	92.7	48.2
Tax exempt institutions	-32.2	31.4	31.2
Insurance companies	-21.7	41.6	34.0
<b>1970</b>			
Households	51.3	122.1	57.1
Tax exempt institutions	-64.8	15.9	32.7
Insurance companies	-45.1	42.4	41.2
<b>1980</b>			
Households	58.2	136.6	51.9
Tax exempt institutions	-83.4	-11.6	11.2
Insurance companies	-54.9	38.4	28.7
<b>1985</b>			
Households	46.6	112.1	64.0
Tax exempt institutions	-46.8	6.8	28.7
Insurance companies	-26.5	32.2	36.3

*Note:* All calculations are based on the actual asset composition in manufacturing. The following inflation rates were used: 1960: 3%, 1970: 7%, 1980: 9.4%, 1985: 5%. The calculations conform to the general framework developed by King and Fullerton (1984). The average holding period is assumed to be 10 years. A negative tax rate implies that the rate of return after tax is greater than before tax. For instance, a tax rate of -83 percent for a debt-financed investment owned by a tax-exempt institution in 1980 tells us that a real rate of return of 10 percent before tax becomes 18.3 percent after tax.

*Source:* Södersten (1984).

A high aggregate savings and investment rate was an essential part of Swedish economic policy during the first decades of the postwar period (Bergström, 1982). But achieving a high rate of aggregate savings without strong economic incentives to private individual wealth

<sup>7</sup> Tax-exempt institutions by definition pay no tax on interest receipts, dividends or capital gains. This category includes charities, scientific and cultural foundations, foundations for employee recreation set up by companies,

accumulation was not possible without a number of additional measures such as large surpluses in the public sector and a highly regulated credit market. Throughout the postwar period until the mid 1980s, Swedish *credit market policy* was aimed at low interest rates for favored sectors of the economy. The credit volume to the industrial sector was generally subjected to quantitative restrictions and the rate of interest was also regulated, which resulted in a situation of virtually continuous credit rationing. This set of regulations clearly favored credit access by larger, older, firmly established firms and by real capital-intensive firms with ready sources of collateral (see Jonung, 1994). Moreover, well-established links to banks was a clear advantage, and the two major ownership spheres groups were (the Wallenberg group and Industrivärden) were both closely tied to a large bank.

The credit market policy necessitated a number of measures to ensure a sufficient level of *savings*. The mandatory national pension system (ATP) instituted in 1960 transformed the public sector into the most important supplier of credit. Large surpluses were accumulated in the national pension funds, the so-called AP funds. In the early 1970s, the AP funds accounted for 35 percent of total credit supply (Pontusson, 1992). The decision to accumulate savings to such a great extent in the AP funds led to a massive further institutionalization of savings, which can be expected to have benefited large, well-established firms with a good credit rating that could operate on a high debt-equity ratio.<sup>8</sup> The AP fund system also benefited incumbents through the so-called "lending back" system (*återlån*) based on the rule that employers were allowed to borrow up to half the amount they had paid in to the fund during the previous year. The potential for using this credit channel was therefore proportional to the wage bill of the firm. This type of lending was abolished in 1987.

The structure of the Swedish tax and pension system reduced incentives for individual wealth accumulation in general and not only in the form of corporate assets. As shown in *Table 4* Swedish household savings was exceptionally low by international comparison through the 1980s. Since the availability of equity financing is a critical factor for both start-ups and the expansion of incumbent firms equity (Blanchflower and Oswald, 1998; Lindh and Ohlsson, 1996; Holtz-Eakin, Joulfaian and Rosen, 1994), this can be expected to contribute to a low prevalence of startups and high-growth firms.

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pension funds for supplementary occupational pension schemes, and the National Pension Fund (the AP Fund).  
<sup>8</sup> The gradual introduction of mandatory supplementary pension schemes can be expected to have the same effect.

*Table 4* Household Net Saving as a Share of Disposable Income in Sweden, OECD and OECD Europe, 1960–89 (percent).

	1960–69	1970–79	1980–89
<i>Sweden</i>	6.1	4.0	1.1
OECD	9.7	12.1	11.2
OECD Europe	12.0	13.6	11.6

*Sources:* OECD, *Historical Statistics 1960–1980* and *1960–1995*.

*Labor market legislation* was changed in a number of respects in the first half of the 1970s. A number of legislative measures aiming at giving labor direct influence on corporate decision making. Prime examples are union representation on corporate boards of directors and the Codetermination Act of 1976 (see Pontusson, 1992). Moreover, The Employment Security Act (LAS) from 1974 gives employees extensive protection against dismissal. The only legal grounds for dismissal are gross misconduct and redundancies. In the latter case, LAS stipulates a "last in – first out principle".

Strict employment security provisions and formalized labor influence on managerial decisions are likely to be more harmful for smaller and potentially fast-growing employers. For many firms – and in particular for firms with a good growth potential in terms of productivity and employment – there is a great need for flexibility both to increase the number of employees in response to rising demand and likewise to be able to rapidly contract when demand falls short of expectations. The road from small to large for a gazelle is far from straight, since the activities of new firms in particular are subject to genuine uncertainty (Davis *et al.*, 1996; Brown and Medoff, 1989). If, under such circumstances, rules are imposed that reduce the firms' leeway to rapid adjustment, one should expect both a lower willingness to expand in general and that fewer firms, despite a good product or a viable idea, grow from small to large in a short period of time.<sup>9</sup> In addition, a strictly applied "last in – first out" principle in case of redundancies implies that tenure at the present employer becomes relatively more important for labor security than individual skill and productivity. This fact increases the individual's opportunity cost of changing employers or of leaving a secure salaried job to start a business.

<sup>9</sup> Davis and Henrekson (2000) discuss these issues more fully.

As documented in many studies – see, e.g., Edin and Topel (1997) and Davis and Henrekson (2000) – the Swedish *wage negotiation system* produced a very narrow wage dispersion and high relative wages for low productivity workers. At the same time, numerous studies show that the wage level increases with the size, age and capital intensity of the firm (e.g., Brown and Medoff, 1989). By implication, the Swedish wage negotiation system has in many cases raised labor costs above the free-market outcome in small, new and labor-intensive firms, and analogously lowered labor costs in large incumbent firms. This fact can be expected to lower the likelihood that small firms become large firms that eventually pay higher wages (Audretsch, 2002).

Finally, as already pointed out in section 2 there were comprehensive impediments to foreign ownership of Swedish firms and Swedish real estate. In practice, these rules precluded extensive foreign ownership of Swedish companies until the late 1980s.

Given this characterization of the Swedish policy package vis-à-vis firm ownership and financing, one should expect an increased role for large, capital-intensive firms and domestic institutional ownership.

### 3.3 *Resulting ownership and control structure*

We may thus note that the combined effect of taxation on capital gains, wealth, profits and dividends forcibly discouraged individuals from owning firms before the 1990/91 tax reform and from wealth accumulation in general. Moreover, the tax system encouraged debt financing, which can be expected to benefit large capital-intensive firms with close ties to specific financial institutions. We have also pointed to some other policies that are likely to be conducive to a development towards large-firm dominance and few and financially weak owners. Does reality square with these expectations?

*Figure 3* demonstrates that the expected change in ownership structure actually took place: during the postwar period, the household ownership share of listed stock fell sharply from 75 percent in 1950 to 18 percent in 1990, while the institutional share rose commensurately.

*Figure 3* The Distribution of Ownership of Swedish listed Shares across Ownership Categories, 1950–1990 (percent).

About Here (Enclosed)

*Sources:* Spånt (1975), Norrman and McLure (1997), Statistics Sweden and OM Stockholm Stock Exchange.

From the perspective of the individual household, the fact that the tax code enhanced the accumulation of retained earnings in firms implied that existing corporate wealth owned by households was locked into incumbent firms.<sup>10</sup> According to traditional financial theory, such within-firm saving should be translated into household wealth through appreciated stock-market values. In practice, matters did not turn out this way. Until the early 1980s, stock-market values were extremely depressed,<sup>11</sup> which in most cases implied that the net worth of Swedish companies greatly exceeded their stock-market value. Södersten (1984) calculates that *Tobin's q* (the stock-market value of the firms divided by their replacement value) was approximately unity in 1960 and that it fell to 60 percent in 1970 and further to 30 percent in 1980. When *Tobin's q* is below unity there is no incentive to finance investment through new share issues, since that implies wealth destruction. At the same time, there are strong incentives to use internally generated funds to finance investments in incumbents firms, when taxation is high on funds withdrawn from existing firms. As shown in *Figure 4*, new equity issues (including IPOs) fell to negligible levels during the postwar period up through the mid 1980s. Another indication of low market values is given by the price-earnings ratios for large Swedish companies. The P/E-ratios for firms like Ericsson, Electrolux and Volvo were typically around 2–4 in the 1970s. Since the regulatory and policy environment induced a development towards increased institutional ownership, the stock-market boom which began in 1979–80 did not fuel household wealth accumulation to any large extent.

*Figure 4* Total Volume of New Equity Issues on the Stockholm Stock Exchange as a Share of GDP, 1902–1998.

About Here (Enclosed)

*Note:* Concerns the sum of new issues by already listed firms and IPOs.

*Sources:* Own calculations based on data from Althaimer (1988), Annual reports from the OM Stockholm Stock Exchange and Statistics Sweden.

<sup>10</sup> Deferred tax payments (“hidden reserves”) were typically as large as total equity in listed companies in the 1980s (Josefsson, 1988).

<sup>11</sup> David and Mach (2002) report that stock market capitalization was only 3 percent of GDP in Sweden in 1975 compared to 12 percent for Germany, 30 percent for Switzerland and 48 percent for the US.

The combined effect of the tax code and credit market regulations also provided strong incentives to transfer ownership of closely held firms to institutionally owned investment companies closely connected to a bank. Credit availability was crucial, since debt financing was so heavily subsidized by the tax system.<sup>12</sup> As documented by Petersson (2001) a second wave of bank-connected investment companies were formed in the first half of the 1960s. He documents that the six largest of those investment companies made a total of 111 acquisitions in the period 1962–89, most of them took place in the 1960s. Likewise it became rational for traditional industrial companies to expand through purchases of closely held companies in their own line of business and to diversify into conglomerates by buying into new industries. The classical example is Volvo, which used profits from its automobile manufacturing to expand into industries such as pharmaceuticals, sports gear, oil drilling and commodity trading.

These tendencies were also reflected in the development of the industry structure and the size distribution of firms. First, the industry distribution of employment and output tilted towards industries that were characterized by large firms and establishments and a compressed wage distribution (Davis and Henrekson, 1997, 2000). Second, there is plenty of evidence indicating that the relative importance of large firms became greater in Sweden than in any other country. Henrekson and Johansson (1999) provide an evaluation of the available evidence.<sup>13</sup> The mirror image of this fact is of course that the rate of self-employment became low. Since the early 1970s until 1990, Sweden exhibited the lowest ratio of nonagricultural self-employment to civilian employment among all OECD countries (*OECD Employment Outlook*, July, 1992). The European Observatory for SMEs (1995) reports that Sweden had a lower self-employment rate in 1992 than any of the then 12 member countries of the European Community (EC). The Swedish self-employment rate was found to be less than one-half the EC average.

Finally, while available data are fragmentary, there is some evidence to suggest that Sweden experienced low rates of new firm formation until the mid to late 1980s. Braunerhjelm and Carlsson (1993) calculate annual entry rates from 1920 to 1991 of new manufacturing firms with more than one employee. Their series show that rates of new firm formation in the

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<sup>12</sup> From the mid 1960s to the mid 1980s the debt-equity ratio in listed firms increased from slightly more than unity to 4 (Josefsson, 1988).

<sup>13</sup> The share of employees in the private sector working in firms with at least 500 employees increased from 27 percent in 1964 (SOU 1967: 7) to 47 percent in 1993 (NUTEK, 1995).

Swedish manufacturing sector had become extremely low by the 1950s; it fell from approximately 4 to 2 percent from the 1920s to the 1950s. The annual entry rate fell further to 1.5 percent in the 1970s, and the average entry rate was even lower in the 1980s. Glete (1994) shows that in the period 1965–90 hardly any new industrialists who built their wealth on innovative industrial production or distribution emerged.

As expected given the legal impediments, the foreign ownership share also remained low: the foreign ownership share of listed stock never exceeded 8 percent through the 1980s and less than 5 percent of private sector employees worked in foreign-owned companies.

Hence, it is clear that the expected development of ownership, financing structure, size distribution of firms and industry distribution took place. However, the disincentives to private wealth accumulation and household ownership of corporate stock did not result in a control deficit or an increased tendency to managerial control à la Berle and Means (1932). The widely cited government commission on *Ownership and Influence in Private Industry* (SOU 1968: 7) identified 17 important ownership groups/families in 1963.<sup>14</sup> Within the next few years ownership concentration increased considerably and by 1967 the Wallenberg family alone controlled 10 of the 25 largest companies (Glete, 1994, p. 289). Still individual wealth was modest by current standards. Total privately held wealth among the members of the Wallenberg family in 1963 was estimated to be SEK 125 million (SOU 1968: 7), which corresponded to 0.14 percent of GDP. This can be compared to the estimated wealth of the Kamprad and Rausing families, founders of IKEA and TetraPak. Their respective wealth was on the order of 8 percent of Swedish GDP in 2001.<sup>15</sup>

So how could control be upheld and even reinforced given the tax code? This was achieved through a number of capital-saving control devices, notably, dual-class shares, pyramiding and cross-ownership. This will be explained in full in section 5 below. At any rate, in the late 1960s the Swedish corporatist model reached its apogee, and at the time a handful of ownership groups represented by identifiable individuals had crystallized. In fact,

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<sup>14</sup> The then leader of the Communist party C.-H. Hermansson had already coined the expression “the fifteen families” in his 1962 book *Monopol och storfinans* (Monopoly and Big Business). According to him these fifteen families controlled Swedish industry. The government commission also identified fifteen families and two bank-connected groups.

<sup>15</sup> These families left Sweden in the 1970s. Kamprad and one branch of the Rausing family are residents of Switzerland. In 2002 they were ranked 1<sup>st</sup> and 2<sup>nd</sup> in terms of individual wealth in Switzerland. The individual wealth of today’s richest family in Sweden, the Persson family (founders and controlling owner of H&M) is roughly 2 percent of GDP. Special legislation passed in the mid 1990s has exempted this and other super-rich families from wealth taxation.

concentrated ownership control was a necessary condition for the model to function, or in the words of Reiter (2003):

In much the same way as the close ties between MITI and the *keiretsu*-system have been at the centre of the Japanese development, the Swedish corporatist model was built on similar arrangements between the state, banks (their investment companies), and large-scale export-oriented enterprises. The importance of the Saltsjöbaden Agreement of 1938 between the representatives of employers and employees lie not with the contents of the agreement *per se*, but rather in the resulting creation of a central institutional arrangement for Swedish industrialisation. The emergence of a concentrated ownership structure has been an important, not to say absolutely necessary, element of the economic policy, since it gave the Social Democratic Party an identifiable counter-part in the country's process of export-oriented industrialisation and the construction of the welfare state.

This made the tripartite model function smoothly for a while. However, the truce was to be broken by more radical currents that gained strength in the labor movement around 1970.

#### 3.4 *The first attack on the model: The wage-earner funds proposal*

By the late 1960s there was thus already an unusual concentration of ownership control in Swedish industry, and industry was dominated by large firms. Schumpeter (1942) asserted that in an economy that is increasingly dominated by giant corporations and devoid of entrepreneurs, the defense of capitalism has no constituency. Instead, capitalism will have to confront increasing hostility. Eventually, a democratic and peaceful transformation of the economy to socialism would take place. It was indeed the case that the popular support for capitalism was extremely low in Sweden by the mid to late 1970s.<sup>16</sup>

Consistent with Schumpeter's thesis, the labor movement was strongly radicalized in the early 1970s. This was reflected in two ways: open demands for the socialization of control rights in the enterprise and a quest for increased influence by pressing for legislation in their favor (Stephens, 1979). During the 1970s, the blue-collar workers' trade union, LO, was very successful in inducing the government to take a number of legislative measures aiming at giving labor direct influence on corporate decision making.<sup>17</sup> Prime examples are union representation on corporate boards of directors and the Codetermination Act of 1976 (see

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<sup>16</sup> In 1978 only 30 percent of the respondents in a poll believed that it was important to encourage entrepreneurship and firm formation and only 37 percent of the respondents believed that business leaders/entrepreneurs were most efficient in running a firm (Henrekson and Jakobsson, 2001).

<sup>17</sup> In addition, labor strengthened its relative position during this period by legislation on job security, substantially increased power to the local trade union safety officer, extended rights for elected trade union officials to get paid time off from work for trade union activities etc.

Pontusson, 1992). The radicalization of the labor movement in the early 1970s also entailed explicit demands for increased collective ownership<sup>18</sup>. Such demands had from time to time surfaced within the labor movement even earlier on. Already in 1961 the LO Congress had before it a suggestion to introduce so-called branch equalization funds, where high-profit firms should be forced to set aside part of the pay increase from which they abstained as a result of solidarity bargaining. Such funds were seen as a means to avoiding the consequences for the wealth distribution following from a solidaristic wage policy (LO, 1961). A first important step towards increased collective ownership was taken in 1974 when a fourth National Pension Fund (AP Fund) was introduced with the aim of investing in the stock market. Until then the National Pension Funds had been totally banned from equity investments.

Explicit demands for increased collective ownership on a much grander scale were voiced at the 1976 LO Congress where Rudolf Meidner and his colleagues presented a plan for an inexorable transfer of ownership from private hands to collective "wage-earner funds" – see Meidner (1978). This can be interpreted as a concrete plan for materializing Wigforss original vision to convert the large corporations to "social enterprises without owners".

The wage-earner fund scheme entailed a gradual transfer of ownership of all firms with more than 50 employees to wage earners as a collective group. The firms should be obligated to issue new shares to the wage-earner funds corresponding to a value of 20 percent of the profits. Thus, the transfer of ownership would be more rapid, the more profitable the firm. Incidentally, assuming a rate of profit of 10 percent, it would take 35 years for the wage-earner funds to obtain a majority equity share in the individual company. The wage-earner equity thus acquired was intended to remain within the firm as working capital. The voting rights and other ownership prerogatives were to be exercised by the trade unions (including representatives of other interests in society).<sup>19</sup>

These explicit proposals to infringe on private ownership implied that the labor movement broke away from the compromise struck in the late 1930s. In due course therefore, the wage-

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<sup>18</sup> This also became the ideological line of the Social Democratic party. When the then party leader Olof Palme presented the new party platform in 1975, he explained that the Swedish labor movement was moving to the third stage of its long struggle to transform capitalist society. The first two stages were political democracy and co-determination, and the third stage was economic democracy.

earner fund proposals met unprecedented opposition from capital owners.<sup>20</sup> Leading Swedish capital owners literally took to the streets. On October 4, 1983 capital owners rallied across the country in defense of the right to retain ownership and control of their firms. Moreover, the original Meidner proposal never gained full acceptance within the Social Democratic Party and subsequent joint proposals from LO and the Social Democratic Party were less radical than the original plan. Politically, any proposals were blocked from being carried out until the Social Democrats returned to power in 1982. At this stage the public opinion had shifted against wage-earner funds, but under pressure from LO the government introduced a considerably watered-down version of wage-earner funds in 1984. The five wage-earner funds thus introduced were financed by a 0.2 percent pay-roll tax and a 20 percent tax on real profits above SEK 1 million. Most importantly, the build-up of the wage-earner funds was restricted to seven years. The funds were abolished in 1992.

A fundamental consequence of the wage-earner fund battle was a dismantling of the controversy on the ownership issue. There were no more serious demands for a collectivization of corporate control and ownership. On the other hand, the tax system was not reformed in order to facilitated the emergence of new individually held corporate wealth. And, as we will see in section 5 this led to further development along the same lines, and it is not until the late 1990s that we can detect a break in earlier trends.

#### **4. A New Regulatory Environment**

During the 1970s the major industrial countries witnessed a renaissance of the liberal market economy. It was precipitated by many factors, including disappointment at the results of extensive public intervention in the west and the failure of the planned economies in the east. These developments, along with the first signs of collapse of the socialist economies in the Eastern bloc, would have led to increasing isolation if Sweden had continued on a socialist course.

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<sup>19</sup> It is interesting to note that this form of socialization was in line with Schumpeter's (1942) prediction of "laborism" as the last stage of capitalism.

<sup>20</sup> The wage-earner funds were probably important also in that they provided the igniting spark for the mobilization among Swedish industrialists in defense of private ownership and entrepreneurship, see Blyth (2001) for a discussion.

The long period during which large firms had predominated while small firms had been increasingly marginalized came to an end in the late 1970s. Entrepreneurship experienced a global resurgence. The decrease in the average size of firms in the industrialized countries since the 1970s has been documented by, e.g., Brock and Evans (1986), Loveman and Sengenberger (1991) and Acs (1999). There are several reasons why this occurred. Some of them are: (i) technological change in recent decades has resulted in a dramatic reduction in transaction costs in the market, which has led to increased specialization across firms and sharper focus on each firm's core activity (Carlsson, 1999); (ii) there has been a sizeable shift towards service industries where establishments and firms tend to be smaller; (iii) small entrepreneurial firms can often act as crucial *agents of change* and if such firms are motivated to grow they are likely to play a particularly important role in the growth process (Acs, 1984; Audretsch, 2002). As a result, growth is often manifested by the expansion of small entrepreneurial firms with viable business concepts (Birch and Medoff, 1994).

These changes in the underlying structural and technological conditions thus dislodged the underpinnings of Schumpeter's theory and Wigforss' vision. And somewhat belatedly relative to the leading countries Sweden embarked on a comprehensive reform track. First, the capital markets were reformed in a number of steps. This is outlined in *Table 5*. Without going into details we may just note that domestic credit markets were fully deregulated by 1986 and the deregulation of capital markets, including restrictions on foreign ownership, was completed in 1993.

The earlier tax favoring of debt financing presupposed strictly regulated credit markets. However, the tax system remained virtually unchanged while credit markets were deregulated, creating an asset-price bubble in the latter half of the 1980s (Jonung, 1994; Norrman and McLure, 1997). The tax system was eventually reformed in 1990/91.<sup>21</sup> The corporate tax rate was cut in half in 1991 and is now 28 percent, which favors equity relative to debt financing. The introduction of a uniform 30 percent flat capital income tax rate and the abolition of wealth taxation on unlisted stock in 1992 have favored individual equity investments relative to the earlier situation. The highest marginal tax rate has been lowered from close to 90 percent around 1980 to roughly 55 percent in 2002.

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<sup>21</sup> Agell, Englund and Södersten (1998) provides a detailed examination of the tax reform.

*Table 5* The Major Steps in the Deregulation of Swedish Capital Markets

Permission for corporations and municipalities to borrow abroad	1974
Deregulation of banks' deposit rates	1978
Deregulation of interest rate on corporate bonds	1980
Deregulation of lending rates by insurance companies	1980
Banks granted permission to issue CD's	1980
Liquidity ratios for banks are abolished	1983
Deregulation of banks' lending rates	1985
Loan ceiling on bank lending lifted	1985
Marginal placement ratios for banks and insurance companies abolished	1986
Relaxation of foreign exchange controls on stock transactions	1986–88
Remaining foreign exchange controls lifted	1989
<i>Removal or annulment of:</i>	
Regulation of establishment of foreign banks' branches	1990
Regulation of foreign acquisition of shares in Swedish commercial banks, broker firms and finance companies	1990
Regulation of establishment of financial institutions other than banks	1991
The act on foreign acquisition of Swedish companies	1992
Trade permit requirement for foreigners	1992
Restrictions in the articles of associations regarding foreigners' right to acquire shares in Swedish companies	1993
The payments services act	1993

*Source:* Reiter (2003), Jonung (1994) and Henrekson (1992).

In a series of reforms between 1985 and 1994, the distortions in tax wedges across different owners and sources of finance were to a large extent evened out. After 1995, the differences in tax wedges increased once again, largely following the previous pattern. See *Table 6*.

But when the restrictions on foreign ownership were lifted, the focus shifted to the relative treatment of foreign and Swedish owners. The new system represented a significant step towards neutrality among Swedish owners. However, the tax burden on Swedish individual ownership remained heavier than the tax burden on individual ownership in most other countries.

The fact that the tax burden varies in accordance with the tax rules in the respective owner's home country has to be taken into account when analyzing the new situation. It is probably reasonable to assume that roughly the same tax wedges as in Sweden apply to tax-exempt institutions. *Table 7* reports a representative tax calculation for different owners using the 2002 tax code. The fact that individuals are disfavored relative to institutions is once again evident, and this also applies relative to foreign institutions. Moreover, it is clear from *Table 8* that a

large number of countries has a lower level of taxation of shareholdings for individuals than Sweden. Hence, it is evident that the Swedish tax system greatly favors foreign ownership relative to Swedish individual ownership. The more favorable tax situation of foreign owners implies that their pre-tax required rates of return can be lower than those of Swedish owners (except for Swedish tax-exempt institutions), i.e., that foreign owners, *ceteris paribus*, can pay a higher price for Swedish corporate assets than Swedish (rival) owners.

*Table 6* Effective Marginal Tax Rates for Different Combinations of Owners and Sources of Finance, 1980, 1994 and 2001 (10% real pre-tax rate of return at actual inflation rates).

	Debt	New share issues	Retained earnings
<i>1991</i>			
Households	31.7	61.8	54.2
Tax exempt institutions	-9.4	4.0	18.7
Insurance companies	14.4	33.3	31.6
<i>1994</i>			
Households	32.0/27.0†	28.3/18.3†	36.5/26.5†
Tax exempt institutions	-14.9	21.8	21.8
Insurance companies	0.7	32.3	33.8
<i>2001</i>			
Households	29.7/24.7†	61.0/51.0†	44.1/34.1†
Tax exempt institutions	-1.4	23.6	23.6
Insurance companies	19.6	47.2	44.7

†Excluding wealth tax; the wealth tax on unlisted shares was abolished in 1992.

*Notes:* The calculations conform to the general framework developed in King and Fullerton (1984). The average holding period is assumed to be 10 years.

*Source:* Calculations provided by Jan Södersten; see Södersten (1993).

Certain deregulatory measures on the labor market have also been taken. In 1997 a new type of employment contract was allowed, so-called prearranged temporary employment, which gives every firm an *unconditional* right to employ up to five persons for a maximum of one year. Another 1997 change made it possible to sign *local* collective agreements that replace the regulations in the law. This makes it possible, through local agreements, to annul tenure-based orders of priority in case of dismissal and to annul the right to reemployment for dismissed workers, and to extend the duration of temporary employment beyond 12 months. In 2001 firms with no more than 10 employees were allowed to except two employees from the “last-in – first-out” rule in case of redundancies. In practice, this gives some more room for flexibility than before. A law passed in 1993 paved the way for an expansion of temporary work businesses and staffing services. These firms expand at a rapid rate and already employ close to one percent of the workforce in the private sector.

*Table 7* Taxation of Dividends for Different Owner Categories according to the 2002 Tax Code – Investment of SEK 10,000 and 10% Return Paid as a Dividend.

	Swedish household	Swedish pension fund	Swedish foundation	Foreign investment fund
Corporate tax	280	280	280	280
Income tax	216	90	0	0
Wealth tax	120	0	0	0
Net return	384	630	720	720
Tax rate (%)	62	37	28	28

*Notes:* The household is assumed to pay full wealth tax (on 80% of the market value) on its shareholdings. An individual foreign owner has the same tax burden as a foreign investment fund in those countries where there is no wealth tax on shareholdings and where dividends are taxed at the firm level only; cf. Table 4.

*Table 8* Some Important Aspects of the Taxation of Shareholders in Selected Industrialized Countries, 2000.

No taxation of dividends at the owner level	No wealth tax	Low wealth tax/large exemptions and/or low/no taxation of dividends	No capital gains tax on long-term holdings	Capital gains tax > 0 but ≤ 20% on long-term holdings
Finland	Austria	Finland	Austria	Ireland
France	Australia*	France	Belgium	Italy
Germany	Belgium	Luxembourg	Denmark	Japan
Greece	Canada	Portugal	Germany	Luxembourg‡
Italy	Denmark	Spain	Greece	Norway
Luxembourg	Germany	Switzerland	Korea*	Poland
New Zealand*	Greece		Luxembourg	Spain
Norway	Ireland		Mexico*	U.S.A.
Spain	Italy		Netherlands	
U.K.	Japan		Poland	
	Netherlands†		Portugal	
	New Zealand		U.K.#	
	Poland			
	Portugal			
	U.K.			
	U.S.A.			

*Notes:* #Large exemption. †Effective as of 2001. ‡50% of the income tax rate, i.e., a maximum rate of 23%. \*Pertains to 1999. The definition of "long-term holdings" varies between 3 months and 5 years. In some instances the situation refers to a representative case.

*Sources:* The Federation of Swedish Industries, Institutet för Utländsk Rätt and *European Tax Handbook* (published by KPMG).

Several previously regulated product markets have also been deregulated, e.g., telecommunications (1993), electricity (1996), domestic airlines (1992), the financial sector (1993) and postal services (1993). In addition, EU membership in 1994 and the generally increased integration of product and capital markets have contributed to the undermining of the old corporatist model.

## **5. Effects on Ownership and Control through the late 1990s**

We noted in section 3.3 that the Swedish corporatist model reached its apogee in the late 1960s. Industry was dominated by a number of identifiable actors and agreements could be struck between elites. Although one outcome of the wage-earner fund battle was a broad acceptance of private ownership of the industrial sector, policies with respect to taxation, credit markets, savings and labor legislation continued to promote a development towards institutionalized ownership, increased predominance of large capital-intensive firms and higher debt-equity ratios.

However, as we will document in some detail shortly the concentration of control rights continued to increase in firms listed on the Stockholm Stock Exchange until the late 1990s. The most important control mechanisms used are or have been dual-class shares, pyramiding and cross or circular ownership. The use of dual-class shares to ensure concentrated control increased strongly after the mid 1960s – see *Table 9*. During the quarter century from 1968 to 1992 the percentage of listed companies using dual class shares increased from 32 to 87 percent. By far the most common voting right differential is one to ten – roughly 95 percent of all firms with dual class shares in 1998 had a one to ten voting differential (Agnblad *et al.*, 2001). Historically, a voting differential of one to thousand was allowed. In 2002, Ericsson is the only company still having such a large differential (no other listed firms had a differential exceeding one to ten in 2002).<sup>22</sup>

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<sup>22</sup> The possibility of issuing shares with a one to thousand voting differential was abolished in 1944, but the companies who already enjoyed this extreme voting differential were allowed to keep the old system.

*Table 9* The Percentage of Listed Companies on the Stockholm Stock Exchange with Dual Class Shares, Selected Years 1968–1998.

Year	Share	No. of firms	Year	Share	No. of firms
1968	32	146	1986	74	217
1972	36	134	1992	87	202
1977	44	130	1998	63	304
1981	54	128			

*Source:* Bergström and Rydqvist (1988), Isaksson and Skog (1994) and Agnblad *et al.* (2001).

The most important means for wielding control of the largest firms have been (and in many cases still are) closed-end investment funds organized as pyramid holding companies. These so-called investment companies enjoy a privileged tax status. Capital gains and dividends on their holdings are tax exempt. The only tax levied is a flat tax on the net worth of total holdings at year's end.<sup>23</sup> This is currently 1.5 percent, but new legislation in 2003 will make investment companies wholly tax exempt as long as the voting rights in their respective holdings exceed 10 percent. As already noted the most important of these investment companies were started in the aftermath of the Kreuger crash and as a result of new legislation that prohibited banks from owning stock. As shown by Petersson (2001) a second wave of new investment companies were formed in the first half of the 1960s. They all had close ties to specific banks and in a detailed analysis of six of them Petersson documents a total of 111 acquisitions of mostly medium-sized family-owned firms in the 1962–89 period. In some cases also large firms were acquired; 19 of the acquisitions were firms with more than 500 employees. In 1971 there were as many as 19 investment companies listed on the stock exchange (Lindgren, 1994b). This development was inevitable given the extent to which the tax system penalized individual ownership of firms. During this period a great many entrepreneurs sold their firms to investment companies or to other large firms and emigrated.<sup>24</sup>

The deregulation of domestic credit markets in the 1980s (see *Table 5*) provided ample opportunities for new actors on the ownership market – the unique position of bank-connected ownership groups was quickly undermined. Requisite capital could be mobilized for (sometimes hostile) takeovers, asset-stripping *et cetera*, and new fortunes could all of a

<sup>23</sup> This tax can be avoided in full if the investment company pays dividends to its owner that are at least as large as the sum of the dividends received and the flat tax.

<sup>24</sup> Lindkvist (1990) finds that 30,000 Swedes that emigrated in the 1965–89 period were granted permission by the Swedish central bank to export capital from Sweden.

sudden be created in other sectors and subsequently be used as a basis for value-creating stock-market activities. During the 1980s there was also an explosion of takeover activity. In the 1950s there was roughly one corporate takeover per year in the Swedish stock market. This increased to an annual average of three in the 1960s, and four in the 1970s (Isaksson and Skog, 1994). In the period 1980 to 1992 there were 253 takeover bids among firms where both the bidder and the target were listed on the Stockholm stock exchange, and 212 of those bids were successful (Agnblad *et al.*, 2001).

In order to fend off these new threats cross-holding arrangements emerged. Cross-holdings hardly existed in the 1970s, but rapidly gained in importance: In 1988 there were 26 cases among listed companies of cross- or circular ownership, where the companies involved held at least two percent of each other's voting rights (Isaksson and Skog, 1994). In particular Volvo was involved in intricate cross-holding arrangements with several investment companies but also including the leading construction company Skanska and the steel and engineering firm Sandvik.

Despite deregulation of credit markets in the 1980s the use of dual-class shares, pyramiding and the numerous takeovers led to a substantial increase in the concentration of ownership control – the average voting power of the largest single owner in listed companies increased by roughly 15 percentage points from the late 1970s until 1991. In the 165 firms with voting-right differentials of 1 to 10 in 1991, the largest owner on average held a voting share of 53 percent (Isaksson and Skog, 1994).<sup>25</sup>

Following the removal of all foreign exchange controls and all barriers to foreign ownership of Swedish firms and real-estate, a number of further changes ensued. First, the foreign ownership share of listed shares began to increase rapidly. As shown in *Figure 5* the foreign ownership share went from 7 percent in 1989 when foreign exchange controls were lifted to 40 percent ten years later. Domestic institutions lowered their share almost as much when they were given the opportunity to diversify their portfolios internationally.

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<sup>25</sup> The capital ownership share averaged 35 percent.

*Figure 5* The Distribution of Ownership of Swedish listed Shares across Ownership Categories, 1988–2000 (percent).

About Here (Enclosed)

*Sources:* Spånt (1975), Norrman and McLure (1997), Statistics Sweden and OM Stockholm Stock Exchange.

Even more importantly, as shown in *Figure 6*, the number of employees in wholly foreign-owned companies (in most cases wholly-owned subsidiaries or branches to foreign multinationals) has grown rapidly in Sweden over the last two decades. In 1980, approximately 113,000 Swedes were employed in foreign firms. By 2001, this figure had risen to 520,000 and more than one out of five employees in the business sector (21 percent) worked for a foreign firm (ITPS 2002).<sup>26</sup> Until the late 1980s, foreigners established and expanded their own activities in Sweden. But after ASEA merged with Brown Boveri in 1987, to become a Swiss-based company, many – often very large – Swedish firms have been acquired by foreign owners.<sup>27</sup>

*Figure 6* Number of Employees in Foreign-Owned Firms in Sweden and Their Share of All Employees in the Swedish Business Sector, 1980–2001.

About Here (Enclosed)

*Sources:* Strandell (2000) and ITPS (2002).

Thus, foreign owners have strengthened their control of the Swedish corporate sector considerably through the acquisition of Swedish firms. In terms of total activity most of this increase concerns acquisition of firms listed on the Stockholm Stock Exchange controlled by Swedish owners.<sup>28</sup> However, the control of the listed firms became even more concentrated at least until the late 1990s. Agnblad *et al.* (2001) provide a detailed analysis of the control situation among the 304 listed firms in late 1998. At that point the largest shareholder on average controlled 38 percent of the voting rights, in 34 percent of the firms the controlling owner has more than 50 percent of the votes and 82 percent of the firms had a well-defined

<sup>26</sup> The trend is similar in all industrialized countries, but much more pronounced in Sweden. From the mid-1990s, inward FDIs are very large in Sweden both in an absolute sense and compared to other countries. On average, they corresponded to 55 percent of total gross investment. This figure may be compared to a corresponding level of 31 percent in Ireland, the country which is usually mentioned in this context (UNCTAD, *World Investment Report* and OECD, *Employment Outlook*).

<sup>27</sup> The predominance of foreign ownership is particularly evident in the pharmaceutical industry, with an ownership share of 86 percent.

owner with more than 25 percent of the votes, which in practice implied operational control of the firm. Hence, the typical firm has *one* clearly identified controlling owner. In most cases the controlling owner was a family or a single individual (62 percent of all listed firms).

IPO activity also gradually became very intense in Sweden, beginning in the early 1980s. Holmén and Högfeltdt (2002) report 352 new listings on the Stockholm Stock Exchange between 1979 and 1997. The number of new listings in the years 1998–2001 were 35, 54, 62 and 24, respectively. Hence, there was a virtual explosion of IPOs in the late 1990s. This activity came to an almost complete standstill after the burst of the IT-bubble and in 2002 the number of IPOs was just 10. Among the 352 IPOs examined by Holmén and Högfeltdt, 69 percent of the firms were family or individually controlled. The private owners in control normally retained all shares with high-voting power (A-shares), and on average they kept 68.5 percent of the voting rights after the IPO. If the firm remained intact after five years and if it had not suffered severe financial problems, the original owners still retained 2/3 of the votes five years after the IPO. If sold, control blocks are always sold wholesale in a block transfer or at the time of takeover in order to protect control rents (Bebchuk *et al.*, 1999).

Considering the control of the market value rather than firms, it becomes important to focus on the largest firms. Here investment companies organized as pyramid holding companies become important vehicles for control. Following the profound changes in the tax system in the early 1990s most of the investment companies were gradually dismantled. However, two of them, Investor and Industrivärden gradually strengthened their control even further. Investor is privately controlled by the Wallenberg and Industrivärden is institutionally controlled by a management team closely tied to Handelsbanken. Agnblad *et al.* (2001) report that in 1998 Investor, i.e., the Wallenberg sphere, controlled 14 large listed firms with a market value making up 42 percent of the total market capitalization at the Stockholm Stock Exchange. With an ownership share of 19.4 percent (41.3 percent of the votes) the Wallenberg foundations had total control of Investor. Investor's share of the total market capitalization was in turn 4.6 percent. Hence, the Wallenberg foundation's ownership of approximately 1 percent of the total market value of the stock exchange was sufficient to control 42 percent of the total market value (see *Figure 7*). Similarly, the Handelsbanken sphere, through Industrivärden, controlled 11 listed companies, which constituted 12 percent of the total

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<sup>28</sup> Henrekson and Jakobsson (2002) document that roughly 30 listed companies were sold to foreign owners from the ASEA-Brown Boveri deal in 1987 until the end of 2000.

market capitalization. Jointly the two ownership spheres thus controlled 54 percent of the total market value, using two closed-end funds with a combined market value of 6.2 percent of the stock exchange.

*Figure 7* The Wallenberg Control of Swedish Firms through Investor AB, 1999.

About Here (Enclosed)

*Sources:* Investor AB, *Annual Report 1999*.

In summary, in the late 1990s the Stockholm stock exchange was characterized by an extreme separation of ownership and control as a result of the combined effect of dual-class shares and shallow pyramiding. In particular, it is evident that the Wallenbergs were much more proficient than other well-established families in taking advantage of the ownership vacuum brought about by far-reaching institutionalization of ownership during the postwar period (Lindgren 1994a, b). Moreover, it is evident that founders of firms that go public with few exceptions manage to retain full control of their firms, and, consequently, external investors have been willing to acquire sizable ownership rights without demanding any influence.

This extreme division of ownership and control is explained by an apparent contradiction between the way tax policy on the one hand and corporate law on the other hand, have been treating owners of individual wealth. The main objective of tax policies in this area have been to curtail the accumulation of individual wealth, while corporate law has provided ample opportunities for entrepreneurial individuals or families to base the control of a firm on a relatively small amount of capital.

It has often been said that the Swedish Social Democrats have been trying to create a system of “capitalism without capitalists”. Considering the effects corporate law a more adequate description would be “capitalism without rich capitalists”. The structure of incentives has gone against private wealth formation while concentrated control has been promoted. Interestingly enough, it seems as these incentives have had a profound impact on the norms of Swedish capitalists and entrepreneurs. In this section we have seen that the most powerful Swedish capitalists to a considerable extent are prepared to forego wealth in order to gain control. In the next section we shall see that this pattern also is prevalent among smaller Swedish entrepreneurs.

## 6. The Swedish Ownership Model at the Crossroads

In the previous section we have documented that the Swedish corporate sector is characterized by tight control – typically one owner or family controls the company and this tends to persist long after the firm has gone public. In fact, this pattern is just a manifestation of strong revealed preferences for control among Swedish entrepreneurs/business owners in general. The seminal study here is Davidsson (1989). In a study of 400 firms with 2–20 employees in four industries he finds that when growth is expected to lead to loss of control for the founder, this has a strong growth-detering effect. Wiklund, Davidsson and Delmar (2002) follow up on this study by looking at a larger sample of firms in the mid 1990s (1248 firms with 5–49 employees). The old pattern is repeated: In order to give priority to growth the entrepreneur finds it important not to lose control and independence to other stakeholders. In both these studies entrepreneurs emphasize the importance of the well-being of their employees for the decision to expand.<sup>29</sup>

Cressy and Olofsson (1996) study 285 Swedish firms in 1993 with 5–199 employees. They hypothesize that problems with equity financing of growing firms may not just be a supply problem, it could just as well be a *demand* problem in that the entrepreneurs may be reluctant to cede control in exchange for requisite equity financing even if this leads to considerably improved growth prospects. Strong support for this hypothesis is found. In all size classes retained earnings is preferred to other equity financing, and hence firms become highly dependent on profitability in order to be able to grow. Moreover, 44 percent of the entrepreneurs say that they would prefer to sell the whole company rather than sharing control with new co-owners. The authors conclude (p. 63) that "the firms themselves are aware that relinquishing some control would improve performance. However, it seems that the returns in growth, profits and survival are not sufficient to ensure that the needed transfer of shares takes place." Berggren, Lindström and Olofsson (2001) follow up on the earlier study by Cressy and Olofsson. In a study of 279 Swedish firms the previous pattern is repeated. Retained earnings is considered the most important source of finance and the reluctance to cede some control to outside investors makes it very difficult to grow for firms with little current profits. Furthermore, those firms where the founder and his/her family has a lower ownership share

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<sup>29</sup> Saemundsson (1999) looks specifically at university spinoffs, where he finds a similar pattern. These firms are often unwilling to grow if that results in a loss of control and independence.

are more likely to grow rapidly, and the larger the number of ownership categories in the firm, the more likely the firm is to grow rapidly.<sup>30</sup>

In a similar vein, Holmén and Högfeltdt (2002) find that family owned firms with large growth potential tend to be undercapitalized relative to comparable firms with a different control structure. As a result, the family-controlled firms invest less than the comparable firms, since the equity requirements would reduce family control of the firm.<sup>31</sup>

This revealed preference for control relative to growth is quite consistent with an institutional environment that makes it very risky to aim at rapid growth, and, moreover, with a regulatory package penalizing individual wealth accumulation, the opportunity cost for foregoing growth is lowered.

There are many indications that the observed “control culture” is detrimental to growth and economic dynamism in the corporate sector. It is illuminating to compare this culture with the one that seems to be dominating in successful clusters in the US economy. A typical feature of US venture capitalism is that the entrepreneur that has started up a firm is bought out by the venture capitalist at an early stage of the life-cycle of a firm. While the entrepreneur loses control he or she often gets very wealthy through the buyout and the selling of his remaining stock when both the venture capitalist and the entrepreneur exits in an IPO (Gompers and Lerner, 2001). The entrepreneur as well as the venture capitalist typically use their acquired wealth in new projects. Obviously, this is a model that could be expected to be more conducive to start ups and new firm growth than the Swedish model where the entrepreneur often clings to the control of his start up throughout his entrepreneurial career.

There are empirical observations that clearly confirm this expectation. Not a single one of the 50 largest firms in Sweden in 2000 was founded after 1969 (*Figure 8*). This may be compared to the very different situation in the US in recent decades, where new and fast-growing firms are generating not just most of the jobs but also the new industries (Audretsch and Thurik, 2000). In 2002 roughly 40 percent of the 50 largest firms were founded no later than 1970.

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<sup>30</sup> This is in line with studies from other countries, see Storey (1994).

<sup>31</sup> This is consistent with the findings by Morck *et al.* (2000) on Canadian data. They find that firms where control has been inherited grow more slowly than comparable firms with a dispersed ownership structure.

*Figure 8* Sweden's 50 Largest Private Corporations (Turnover) in 2000 – Period of Establishment.

Enclosed

*Source:* NUTEK and ALMI (2001).

Let us now turn to the current and likely development of the control structure in the large-firm sector. The Wallenbergs are currently waning in importance. In 1998 Investor controlled 14 large listed firms (Agnblad *et al.*, 2001). In late 2002 Investor retained a voting share exceeding 20 percent in just seven listed firms (Ericsson, Saab, WM-Data, Atlas Copco, Electrolux, Gambro and SEB) and they had a voting share of 15 percent in Scania and 17 percent in OM. Except for Investor and Industrivärden (and to a lesser extent Kinnevik) the numerous investment companies have either vanished completely through asset-stripping or been downsized through share redemption schemes or a transfer of the shares in individual companies directly to the share holders of the investment company on a *pro rata* basis. As a result, investment companies are losing in importance as control vehicles on the Swedish stock market.

There are several reasons for this development. First, the shares of investment companies trade at a significant discount relative to the net portfolio value of its assets. This is no recent phenomenon. As shown in *Figure 9* Investor has always traded at a discount relative to the net value of its assets. At times this discount has been as high as 40 percent. Although the discount has seldom been this high for other investment companies, the average discount over longer time periods has been roughly 20 percent (Högfeldt and Synnerstad, 1999). The discount implies that there is a negative valuation of the management services provided by the investment company, since the portfolio itself has a higher value without these services.

As long as the investment companies trade at a discount, they cannot issue new equity. Given that the overall stock market is growing it is therefore virtually impossible for them to expand their resources in tandem with the growth of the aggregate market. Second, their control is often based on historical holdings of A-shares with great voting power. A-shares in other firms are often hard to come by, and when barred from the issuance of new equity the best an investment company can do is to retain control of its historical holdings. Third, investment companies are not fully tax exempt; a flat tax of 1.5 percent of its net asset value at year end is levied. This tax can be avoided if the investment company pays large dividends to its

shareholders, but that weakens its potential for retaining control even more. Fourth, the companies controlled by means of a high-voting share and small capital share have suffered from low valuation. In two spectacular cases (Electrolux and SKF), this has already forced Investor to voluntarily reduce the voting rights of the A-shares from 1000 to 10 (Reiter, 2003). The only firm on the exchange that still has a voting share differential of 1:1000 is Ericsson.<sup>32</sup>

*Figure 9* Discount on Investor AB's Share Price Relative to Net Asset Value, Investor 1930–2002 (%).

About Here (Enclosed)

*Sources:* Lindgren (1994b) and Investor AB.

In many cases and in the case of the Wallenbergs in particular, the power is tied to share holdings by a family foundation at the top of the pyramid. The family foundations are tax exempt, but as a prerequisite for tax exemption, family foundations are obligated to donate 80 percent of their dividend income to charity. This not only diminishes their financial strength, but it is also suspiciously similar to a tax – except that the foundation is able to determine how the “tax” will be used. Apart from being fully tax exempt on capital gains, family foundations are also financially strained by this obligation to, and hence they can hardly generate means to expand as rapidly as the overall stock market. Furthermore, the system generates incentive problems. When dynastic ambitions cease to serve as a sufficiently strong incentive, family foundations would no longer be able to maintain their competence as owners to the same degree as those who can freely dispose of their returns.

Globalization of asset markets tend to penalize firms with a large wedge between control rights and cash flow rights more than before when the Swedish stock market was mainly an affair for domestic investors (Giannetti and Simonov, 2002; Denis and McConnell, 2003). When the stock market was largely domestic dual-class shares enabling highly reputed owners to exercise active ownership with less capital was often seen as an efficient means to protect shareholders against X-inefficiency that could follow from more managerial discretion (Bergstrom and Rydqvist, 1990).

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<sup>32</sup> In the case of Electrolux this measure reduced the voting share of the Wallenberg sphere from 94 to 25 percent. In 2002 the chairman of Ericsson established a group, consisting of representatives from the main shareholders, that until the first half of 2003 shall work out the details on the transition from A-shares with a voting right of 1000 to the standard differentiated voting rights of 1:10.

When the playing field is levelled across investors and sources of finance, the tax incentives for low dividends and financing through retained earnings go down. This spurs the valuation of firms and it once again becomes attractive to finance expansion by issuing new stock. The choice for the old owners now becomes very difficult: they either have to refrain from rapid expansion, thereby foregoing business opportunities and/or risking takeover bid, or they have to dilute their own ownership share and control rights.

## **7. The Future Ownership Model: Obstacles and Challenges**

From the analysis in the previous two sections it is quite clear that the traditional Swedish ownership and control model is currently under attack. First, a progressively larger share of saving is channeled to institutions, which is the result of a number of factors: a larger proportion of the pension system is funded and voluntary pensions saving schemes are greatly favored by the tax system. Second, the central government has stopped selling out its stock holding and it has emerged as the largest owner on the Stockholm stock exchange with more than 8 percent of total holdings (Feb. 2002).<sup>33</sup> Investment companies cannot raise capital through equity issues, and hence they are doomed to decrease in relative importance over time. Fourth, institutional investors become increasingly unwilling to accept dual-class shares, thereby putting pressure on listed firms to reduce the differential between cash-flow and control rights.

In *Appendix 1* we list total assets of state and corporatist pension funds as of mid 2002. It is clear that their assets are very large relative to the total stock market; their total assets exceeded 50 percent of the total market capitalization of the Stockholm stock exchange, and given the all-encompassing pensions saving schemes, these funds are bound to increase in importance as a source of finance relative to other sources.

So what is the likely future ownership and control model under current circumstances? It is hard to see that any one model will supersede the traditional control model. Instead a number of new ownership models are likely to gain in importance at the expense of the old model:

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<sup>33</sup> In fact, the current Minister of Industry, Mr Leif Pagrotsky (TT interview, Nov. 2, 2002), argues in favor of a larger state ownership share in order to compensate for what he considers to be inferior ownership competence and short-termism among private actors in recent years.

1. *Foreign ownership.* In this case Swedish firms become subsidiaries to foreign-owned firms, typically large multinationals.
2. *Dispersed ownership.* In this case the firm may have both Swedish and foreign owners, where no owners can exercise substantial control. This is likely to lead to management control.
3. *Corporatist or state pension funds as control owners.* This is a likely model in a number of cases in the future, since these funds together with the government are the largest owners on the stock exchange.
4. *Ownership entrepreneur backed by corporatist funds or the government.* This model is a highly likely variant of model No. 3. In particular, in a time of crisis for a particular firm it is easy to conceive of situations where government and corporatist money lines up with trusted individual investors or a private group.

Thus, the ownership and control of large firms is currently facing a number of challenges. At the same time, there are still large impediments to rapid growth among small firms. In particular, the new “pension-fund capitalism” that is emerging presupposes that the tax system makes room for the emergence of tax-efficient performance contracts that induce, entrepreneurs, portfolio managers and venture capitalists to behave as though they invested their own private money. However, the use of stock options to encourage and reward entrepreneurial behavior among employees is highly penalized by the tax system, since gains on options are taxed as wage income when the stock options are tied to employment. Thus, they are subjected both to mandatory social security (33 percent) and the marginal tax rate. Since the marginal tax rate is roughly 57 percent this entails a total tax rate of 68 percent (2002).<sup>34</sup> In practice, stock options can therefore not be used as a means to reward entrepreneurial behavior among wealth-constrained individuals. Neither can they be used efficiently to reward venture capitalists or portfolio managers who invest in venture capital firms. Venture capital firms can play a crucial role in the development of a small

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<sup>34</sup> This stands in stark contrast to the US where an employee who accepts stock options can defer the tax liability to the time when the stocks were sold rather than when the options were exercised. In general, there are (i) no tax consequences to the employee upon the grant or the exercise of the option; (ii) the employee is taxed at capital gains rates when the stock acquired upon the exercise of the option is sold after a specified holding period; and (iii) there is no deduction available to the employer. This change in the law shifted the tax risk in the options back to the government, and thus accomplished two things: it increased the potential profit from the stock options and it allowed budget-constrained individuals to sell stocks whenever they chose to do so (Misher, 1984).

entrepreneurial venture by converting high-risk opportunities to a more acceptable risk level through portfolio diversification, and adding key competencies that the firm may be lacking. This is achieved by means of developing arrangements that align the incentives of the three agents – investors, venture capitalists and entrepreneurs (Zider, 1998; Gompers and Lerner, 2001). However, the above-described tax schedules apply to this industry as well, which means that a highly competent venture capital industry domiciled in Sweden where high-powered incentives can be used to reward investment managers cannot develop.<sup>35</sup>

## 8. Conclusion

In this study we have documented that corporate control in Sweden has been highly concentrated; even among listed companies most firms have been controlled by a single individual or a single family. Given an overall policy disfavoring private wealth accumulation and new firm formation this appears paradoxical at first glance. However, this model was an integral part of a Swedish corporatist structure that presupposed a highly concentrated control structure in the business sector and given the overall policy this necessitated a growing disparity between control rights and cash-flow rights for the dominant owners. A number of devices have been used to achieve this, the most important of which have been dual-class shares and pyramiding with tax-favored closed-end investment funds as the prime control vehicle.

Thus, the Swedish corporatist model shows a number of similarities with corporatist models on the European continent, but there are also traits that are unique for Sweden. First, the concentration of corporate control in Sweden became higher than in other European countries. Second, the equity on which the control is based is thinner in Sweden than in other corporatist European economies (Agnblad *et al.*, 2001). This latter trait makes the Swedish model of control especially vulnerable to the threats posed by globalization and the increasing dominance of pension funds on global stock markets

A major threat to the Swedish model emerged in the late 1970s, when the proposals to introduce wage-earner funds gained considerable popular support. According to the most far-reaching proposals this would have led to a complete, albeit gradual, trade-union takeover of

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<sup>35</sup> See Henrekson and Rosenberg (2001) for a fuller exposition of this issue.

the whole Swedish business sector excepting the very smallest firms. In reality, the ideological battle that ensued marked the endpoint of the socialist vision that had been so important in Swedish politics for several decades. Following the dismantling of the wage-earner funds, numerous policy reforms were implemented and demands for socialization of the private sector was removed from the Social-Democratic political agenda.

However, in the long run the new more market-liberal order undermined the traditional Swedish corporate control model. This is due the fact that Sweden may once more be facing a situation where the control of the private sector is collectivised. During the liberal period since the mid 1980s politically or trade-union governed funds have grown very rapidly and their financial resources will soon be extremely large relative to other ownership groups. Moreover, the total international openness of the market for corporate control makes it increasingly difficult for traditional control owners to retain control based on a tenuous capital base. The loss of control will for the most part take either of two forms: sale of entire firms mostly to foreign owners and the voluntary reduction of control rights as a response to pressure from minority investors who are increasingly unwilling to accept large differentials between control and cash-flow rights.

So, are there any ways out of the "ownership control vacuum" that is becoming apparent in Sweden, and for that matter in many other countries, when savings are progressively channelled to large pension funds and when the public pension systems become increasingly funded rather than just pay-as-you-go? No, doubt there is an inherent problem involved, but a number of things can still be done.

First, savings can be "deinstitutionalized" so that large part of the pension wealth becomes available for equity investments in entrepreneurial firms. Second, the total tax burden on individuals can be equalized. That would remove the current discrimination of individual ownership, which is likely to increase the supply of firms in which pension funds and other financial institutions can invest.<sup>36</sup> Third, large closed-end funds of fixed duration may be formed with the express purpose of buying a controlling share in listed companies that are poorly managed. The managers/partners of these funds are then paid on a performance basis. Various arrangements of this kind are beginning to emerge in order to make up for the control

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<sup>36</sup> As emphasized by Gompers and Lerner (2001), the factor limiting growth of entrepreneurial firms is seldom lack of capital, but the limited supply of potential candidates for venture capital financing.

deficit that results when ownership becomes increasingly institutionalized. Similarly, it is easy to conceive of the emergence of ownership specialists who, based on contract, exercise the voting rights of the stock holdings of a number of funds in a specific company for a specified period of time. In this way, a single actor may achieve enough control rights to be able to carry out value-enhancing actions.

Still, we find it unlikely that a capitalist system can preserve its dynamism without forceful individual entrepreneurs and the continual creation of new large family fortunes. Later in life, these entrepreneurs are likely to be instrumental in the provision of angel capital.

The longer the 1990s progressed, the larger the number of observers who claimed that the US corporate governance model with dispersed ownership, strong minority protection in the sense of La Porta *et al.* (1999), and performance-based contracts for top management was superior to other models in solving the ubiquitous principal-agent problems in large firms. However, recent developments have called this view into question. In fact, the very principle of maximizing shareholder value has been questioned, and many claim that it leads to short-termism and speculation. But the problem is probably not the focus on shareholder value *per se*, rather that it has been seen in an insufficiently long perspective. Drucker (1996, p. 218) maintains that the objective is to "maximize the wealth-producing capacity of the enterprise." One has to find the "objective that integrates short-term and long-term results and that ties the operational dimensions of business performance – market standing, innovation, productivity, and people and their development – with financial needs and financial results." This is of course a formidable task, and it is likely to require active owners with a great deal of tenacity.

Public and collective pension funds may very well take a long-term view of their stock-holdings in particular firms. However, there is a palpable risk, in particular if each fund is very large relative to the whole economy, that a fund as a result of political pressure may have other objectives than just the long-run maximization of the firm's wealth-producing capacity. At any rate, since large pension funds are here to stay and it is inevitable that they will be a major source of corporate financing in the foreseeable future, it is necessary to have a tax code that makes it efficient to write contracts that induces portfolio managers to behave as though they were capitalists. Among other things, this requires major changes in the taxation of stock options so that capital gains on stock options are treated in a way that is equivalent to capital gains on the underlying asset.

To wrap up, we have shown that the traditional Swedish ownership and control model is about to lose its dominant position and that a number of different control paths are likely to be followed. None of them is without its problems. The current quandary is not unique for Sweden, however. Similar problems plague most of Continental Europe. A major challenge for the near future is to find new ways of ascertaining the existence of actors that can assume the ownership role in the corporate sector.

*Appendix 1* Assets and Domestic Stock Market Investments by State and Corporatist Pension Funds, Sweden 2001–2002.

Fund	Investments on the Swedish stock exchange Billions of SEK Dec. 30, 2001	Total assets State and corporatist funds Billions of SEK June 30, 2002
AFA Försäkring*	22.8	161.5
Alecta*	70.5	300.9
AMF Pension*	44.3	185.9
Andra AP-fonden*	23.8	124.3
Banco Fonder	8.2	
Fjärde AP-fonden*	27.8	121.8
Folksam Försäkring	7.2	
Första AP-fonden*	15.8	123.7
KP Pension och försäkring*	7.5	43.4
Länsförsäkringar	12.2	
Länsförsäkringar fonder	6.5	
Nordea fonder	44.1	
Robur fonder	74.3	
SEB fonder	41.3	
SEB-Trygg försäkring	18.6	
SHB fonder	33.0	
Sjätte AP-fonden*	8.8	15.4
Skandia	41.6	
Skandia Carlson fonder	9.0	
SPP livförsäkring	10.5	
Tredje AP-fonden*	20.5	126.6
Sjunde AP-fonden*		21.9
FSO		13.5
Total domestic funds	548.3	
Total stock market capitalization	2511.0	
Ownership share domestic funds %	21.8	
Total assets state and corporatist funds, June 30, 2002		1238.9
Investment capacity of state and corporatist funds as a share of total stock market capitalization, June 30, 2002		more than 50%

\*Denotes a state or corporatist pension fund.

Source: Sundin and Sundqvist (2002, p. 32).

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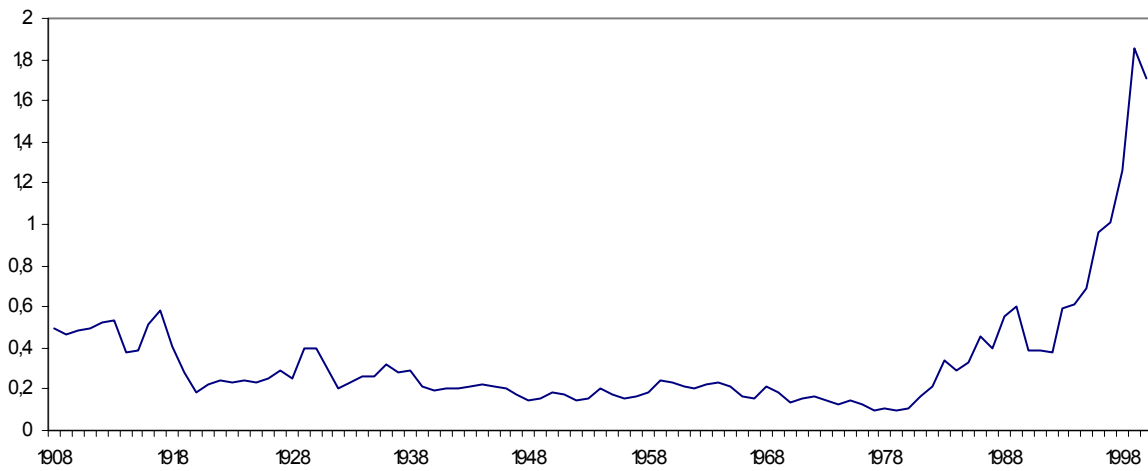
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Figure 1 Aspects of the Ownership of Swedish Firms.

Type of owner		Family	Institutional		Foreign
Distribution			private	public	
Votes	Ownership dominance	Swedish ownership model 1945 1980 2000			
	Dispersed ownership				
Dividends	Ownership dominance	Ownership 1945			
	Dispersed ownership		1980	2000	2000

Figure 2 Stockmarket Capitalization on the Stockholm Stock Exchange as a Share of GDP, 1908–2000



*Table 2* Effects of Policy Design on Ownership, Firm Structure and Financing in the Swedish Business Sector in the Postwar Period, Phase I (1950–1985) and Phase II (1985–)

Firm-related variables Policy area	Form of ownership						Firms				Financing							
	Individual ownership		Institutional ownership		Foreign ownership		Ownership dominance		Ownership concentration		Large vs. small firms		Stock exchange		Loans		Appropriated surplus	
	I	II	I	II	I	II	I	II	I	II	I	II	I	II	I	II	I	II
Tax policy	—	—	++	+		++	+	0	+	0	++	+	—	0	++	0	+	0
Regulation of financial markets	—	0	++	0	—	0	++	0	++	0	++	0	—	+	+-	0	00	00
Channeling of savings	—	0	++	+		0	+	0	+	0	+	0	—	++	++	0	+	0
Labor market policy	00	0	00	0		0	0	0	0	0	+	+	0	0	0	0	0	0
Corporate law	+	+	?	?		0	++	++	+	+	0	0	—	—	0		0	0

++ (—) strongly positive (negative) effect  
+ (–) positive (negative) effect  
+ – counteracting effects

**Figure 3** The Distribution of Ownership of Swedish Listed Shares across Ownership Categories, 1950–1990 (percent)

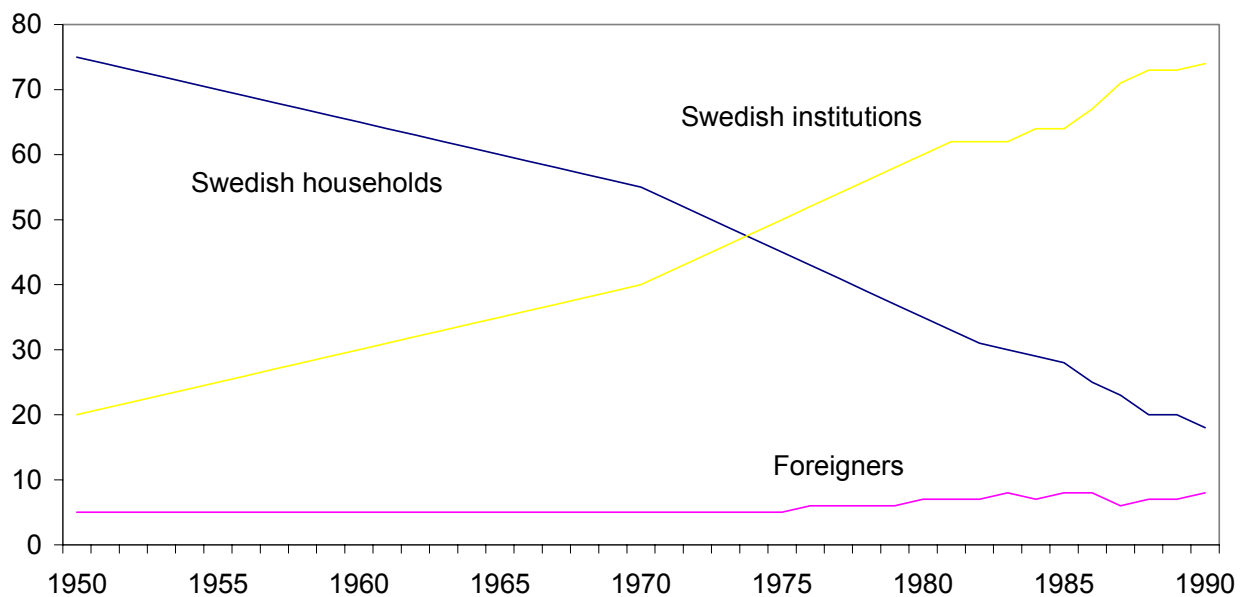


Figure 4 Total volume of New Equity Issues on the Stockholm Stock Exchange as a Share of GDP, 1902–1998

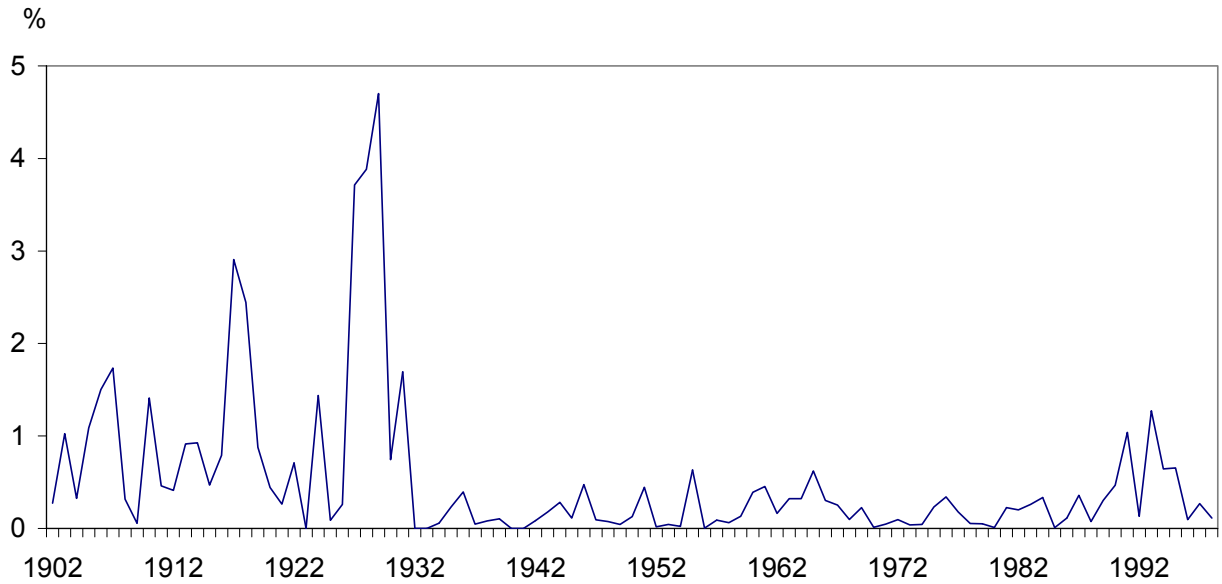


Figure 5 The Distribution of Ownership of Swedish Listed Shares across Ownership Categories, 1988-2000 (percent)

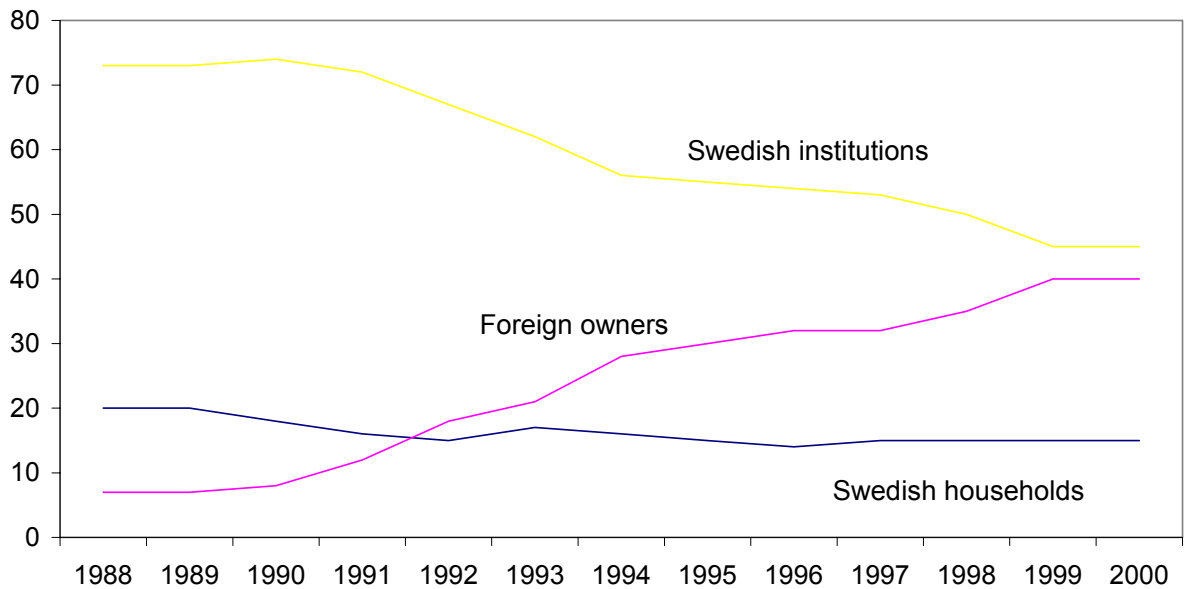
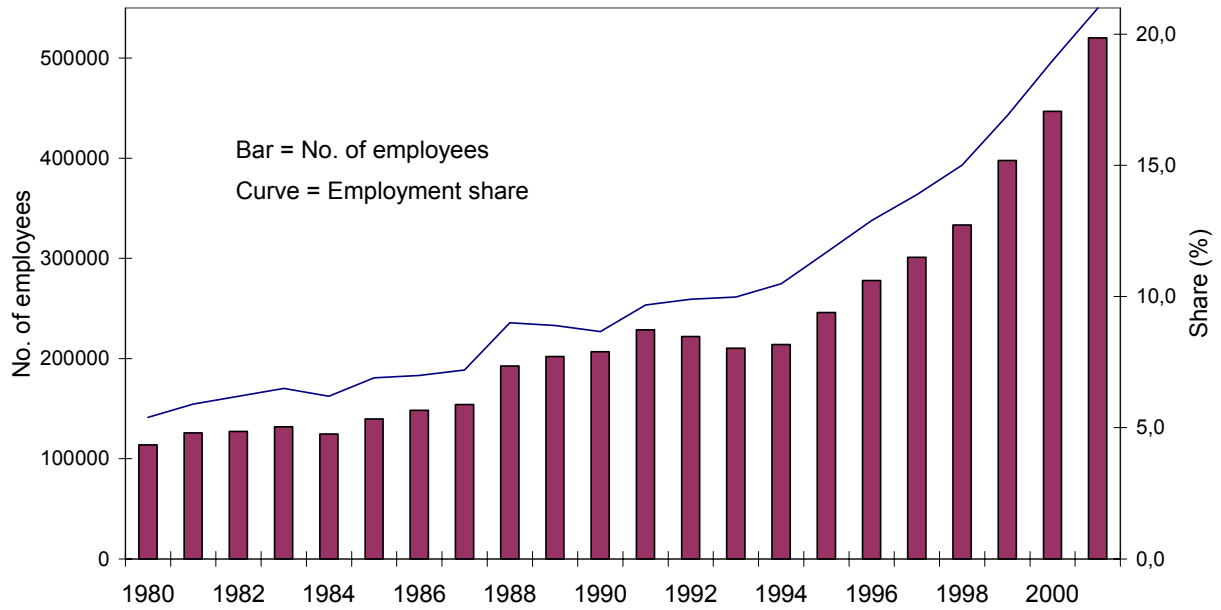
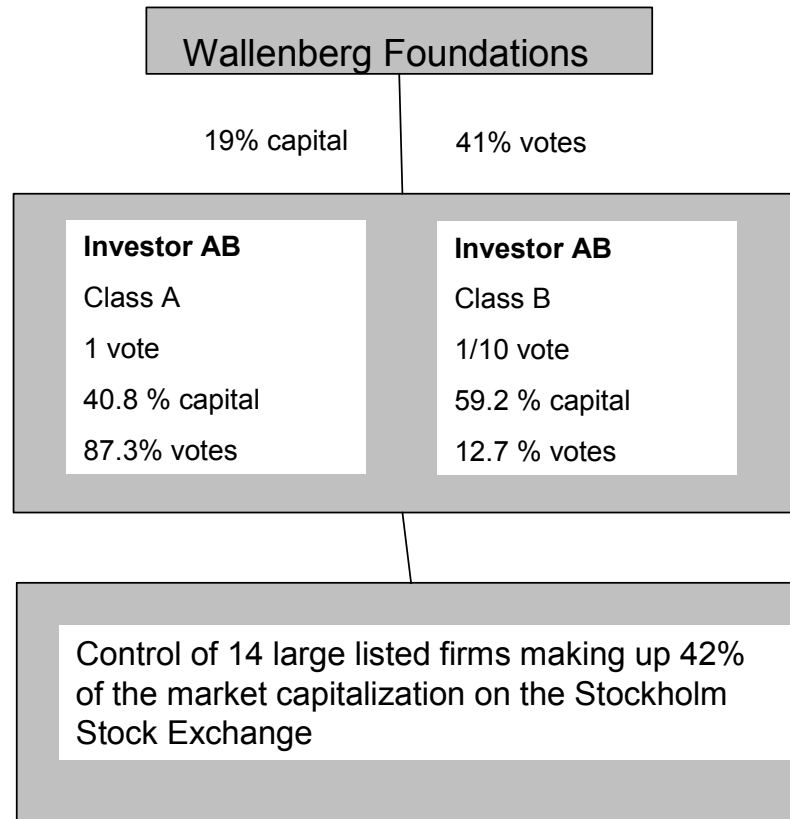


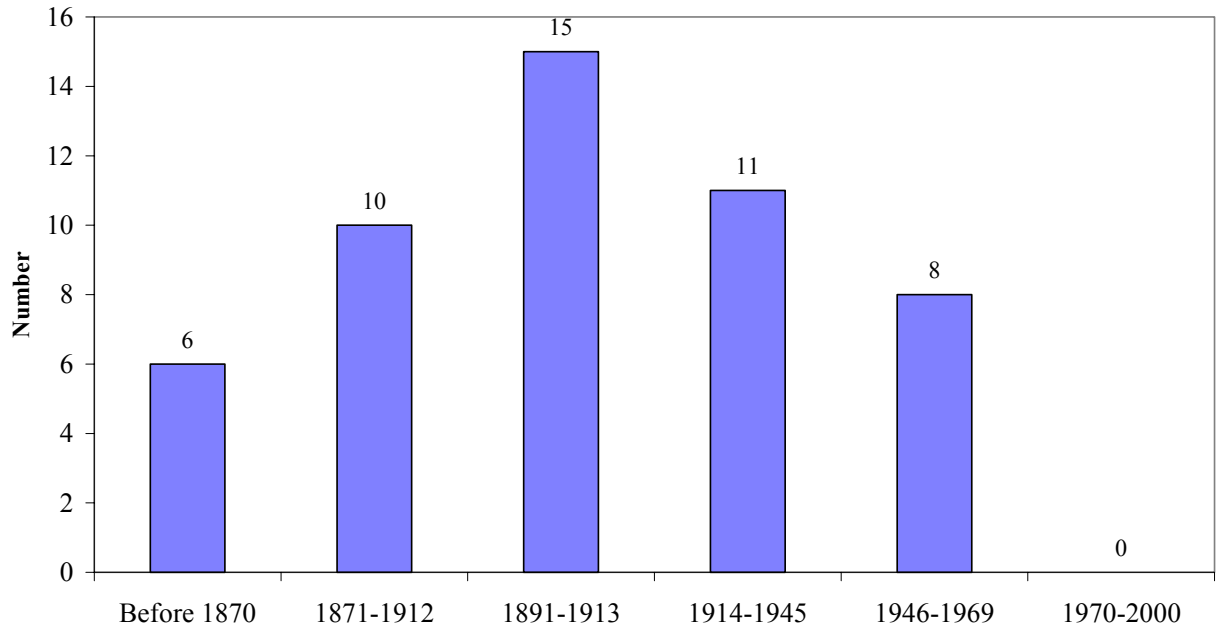
Figure 6 Employees in Foreign-Owned Firms in Sweden and Their Share of All Employees in the Swedish Private Sector, 1980–2001



*Figure 7* The Wallenberg Control of Swedish Firms through Investor AB, 1999



**Figure 8 Sweden's 50 Largest Private Corporations  
(Turnover) in 2000 -- Period of Establishment**



**Figure 9 Discount on Investor AB's Share Price Relative  
to Net Asset Value, Investor 1930–2002 (%)**

