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Independence within Government

A Comparative Perspective on Central Banking in Norway 1945-1970[*]

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Abstract

This article surveys the degree of central bank independence in Norway between 1945 and 1970. By comparing the developments in Norway with those of Sweden and the United Kingdom, it is shown that the Norwegian central bank had less room for maneuver than in the other countries. In spite of a high legal independence, the actual performance of central bank operations was almost completely subordinated the instructions given by the Ministry of Finance. A particular vivid, dirigiste environment followed the experiences of the 1930s and the war in Norway, curtailing any effort to make the central bank an independent institution in the machinery of state economic management that followed the return to peace.

JEL-codes: E58, F33, N44.

Keywords: central bank independence, monetary policy, institutional design.

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1. Introduction

Over the past decades, countries and regions around the globe have adopted reforms aimed at making their central banks more independent from government influences. Since the Reserve Bank in New Zealand implemented its price stability act in 1988, inflation targeting have become a widely accepted commitment device for most central bankers. The bulk of academic research has also supported this move by emphasizing the felicitous effects of *central bank independence* (CBI) on price stability and domestic economic output.[1] The contrast of this recent state of affairs with practice and consensus in the first quarter after the Second World War period is well-known. Many central banks functioned, as Alex Cukierman has stated, 'as departments of ministries of finance.' They were expected, by law, custom or policy instruction, to utilize their instruments to achieve a myriad of government objectives, ranging from full employment to stability in prices and exchange rates.[2]

It is convenient, for most countries during the period, to talk about the degree of *central bank independence within government* than any CBI per se. Even in the US, traditionally regarded as the steadfast defender of CBI along with Germany and Switzerland, the Employment Act of 1946 withdrew some of the Feds freedom of operations granted in the Banking Acts of 1933 and 1935.[3] At the other side of the independence scale, in countries like Sweden, Norway and the UK, central banks became to a varying degree an integral part of the public sector and made dependent on the will of the executive branch. They were not any longer 'insulated' from government pressures. In no country in 'Western Europe', maybe with the exception of Spain and Greece, were these moves expressed more clearly than in Norway.

Until recently, this has also been the conventional view about central banking in Norway. But in a PhD thesis published in 2008, Gunhild J. Ecklund of the Norwegian School of Management challenged the public knowledge. Rather than being reduced to a loyal servant of government guidelines, Ecklund argued that the Norwegian central bank (BoN) managed to enhance its role from marginalization to influential integration in the first decade after the

[1]For summaries of the literature: Eijffinger, S. C. W. and De Haan, J., The Political Economy of central bank independence, *Princeton Special Papers in International Economics*, Vol. 19, 1996. Berger, H., De Haan, J. and Eijffinger, S. C. W., Central bank independence: an update of theory and evidence, *Journal of Economic Surveys*, Vol. 15, 2001: 3-40.
[2] Cukierman, A., Central bank independence and monetary policymaking institutions – Past, present and future, *European Journal of Political Economy*, Vol. 24, 2008: 722-736.
[3] MacLaury, B. K., Perspectives on Federal Reserve Independence – A Changing Structure for Changing Times, Fed, *Annual Reports*, January 1976.

war. She traces the main causes of this development to the dispositions of the banks prominent governor until 1954, Gunnar Jahn. As a long-standing participant in Norwegian public life and a former finance minister from the liberal party Venstre, Jahn utilized both his political insights and the BoNs relative independent legal position to act as a traditional central banker, opposing the authorities publicly in cases of dissent. In spite of losing most of the struggles with the government, he managed to consolidate the Bank's position in exchange rate policies and moral suasion. The relative independent role was to last also under Jahns successor, Erik Brofoss, until the Credit Laws of 1965 again undermined the position of the Bank.[4]

This article takes a different point of departure. By comparing central banking in Norway with two of its closest accompanies along the independence scale, Riksbanken in Sweden (BoS) and the Bank of England (BoE), it is showed that the BoN had the least room for maneuver, in spite of the vigorous efforts by governor Jahn to keep the Bank as an autonomous organization. In fact, the comparative analysis suggests that the strategy of opposing government initiatives did not pay off. Policy makers reacted in manners which deprived the central bank of most of its 'instrument independence': interest rate decisions, bond issue regulations, open-market operations and the determination of private bank reserve requirements, were to be supervised by the Ministry of Finance, or abandoned as policy instruments. In moral suasion and exchange rate policy, the BoN had a bit more say. But viewing the establishments of the Foreign Exchange Council (FEC) in 1947, and the Joint Cooperation Council (JCC) in 1951, as bold attempts by governor Jahn to obtain key positions in currency policy and domestic credit regulation, as Ecklund tends to do, is to exaggerate the Bank's achievements during the period. Rather, the proposal of a JCC was an 'exit-solution' to avoid the Bank turning out to be a cashier's office in the Ministry and to gain at least some influence in directing private banks. Similarly, the real power of the FEC was rather bleak. Also in this policy area it was the Ministry which had the last word.

Accordingly, the institutional setting when Erik Brofoss entered the scene in 1954 was not one of a powerful BoN sparring with Ministry officials and actively participating in policy formulation and implementation. More truly, it was a central bank without much operational power left. Within these limits, the Bank was assigned some real influence in exchange rate

[4] Ecklund, G. J., Creating a new role for an old central bank: The Bank of Norway 1945-1954, BI Norwegian School of Management: *Series of Dissertations*, 2/2008, 230-233. Ecklund, G. J., Kredittpolitikken som redskap i den samfunnsøkonomiske styringen fra 1965 til 1980, *Master thesis in history,* Universitetet i Oslo 1995, 16-21.

policies (implementing currency regulations and managing reserves) and moral suasion (negotiating lending arrangements with the private banks under directions of the JCC). In most other policy areas, whether it came to determination of interest rates or targeting monetary objectives, the Bank's role was at best that of consulting and advising.

As a prominent member of the ruling Labor party, and former minister of both finance and trade, Erik Brofoss accepted the political subordination of the Bank and supported the establishments of corporate arrangements such as the JCC. The Bank he inherited was in such manner well suited to both his personality and political beliefs. By virtue of the Bank's expertise in monetary matters, and his broad platform of connections, Brofoss also managed to solidify the position of the JCC and to integrate it more closely to the economic policy making process. Additionally, in some fields not regarded to be core functions of a central bank, for instance industrial and regional policies, Brofoss created a new role for the Bank. Within these political boundaries, he followed his predecessors' style and opposed authorities publicly whenever it felt required. It was a central banks' most important task, he once expressed in the words of Montagu Norman, to defend its position 'up to the point of nagging'.[5] But with the introduction of the Credit Law in 1965, which statute most former monetary policy provisions under government jurisdiction and abolished corporate arrangements as the JCC, many of Brofoss' achievements lost ground. To the governor's great disappointment, the BoN was reduced to be the henchman in exertion of government policy in most areas.

There are many similarities in the the evolvement of central banking in Norway, Sweden and the UK. In all countries the central banks were rather marginalized in the immediate postwar period, reflecting the abundance of money in circulation and policy regimes favoring direct government control of credit and prices. But in their efforts to climb along the independence scale in the following decades, the BoN lagged behind. This article will try to sort out why and how this happened. It is structured in two parts. First part is quite quantitative in character and presents the method used and the results achieved. By focusing on developing usable definitions, a simple model is constructed to identify the determinants of CBI and discussing the possible relationships between them. In difference to similar models constructed to research CBI today, it is important that the determinants are historical applicable on the specific period which is investigated and on the sample of countries which is selected. Based

[5] Brofoss, E., Sentralbankens statsrettslige og forvaltningsrettslige stilling, *Statsøkonomisk tidsskrift*, Vol. 74, Aschehoug 1960, 1-31 (31). Montagu Norman was the powerful governor of the BoE until 1944.

on the determinants given in the model, four sub indexes embracing a total of 15 variables are presented. The multiple choices under each variable are structured from most weighty (high CBI) to less weighty (low CBI). Each country's position is placed in relationship to these choices. This enabled us to present quantitative judgments of the CBI for the nations involved. Some methodological reservations against the approach are also given in the section.[6]

Next part is more qualitative in character and presents an analysis with an historical bent. Each of the variables identified in the index construction is discussed and compared in relation to the historical context in each country. Inadequacies and problems connected to the outcome of the index series are identified and analyzed. This regards aspects as the deviations between legal and actual CBI, the influence of moral suasion on central banking, and the informal impact given by personal and cultural factors. The section ends with a comparative discussion.

2. Method and Results

Over fifty years ago, Oscar Morgenstern, one of the founders of game theory, warned against quantitative exercises ranging qualitative phenomena by weighting them by numbers. The possibility of random error would be overwhelming, making the factors involved to vary from one measurement to another. Additionally, the determination of appropriate weights given to the various variables would be more subject to individual preferences than to objective, scientific criteria. Creating index series based on adding the weights would bias the results even further.[7]

Still, such a method is applied in this article. Serious reservation against the approach must obviously be granted. Foremost, the weighting of the variables must be interpreted in a qualitative way, presented with a quantitative flowering. The construction of the index series,

[6] Approaches to measure CBI in this manner have been presented by Cukierman, A., Webb, S. B. and Neyapti, B., Measuring the independence of Central Banks and Its Effect on Policy Outcomes, *The World Bank Economic Review*, Vol 6. No. 3 1992: 353-398. Klomp, J. and de Haan, J., Central bank independence and financial instability, *Journal of Financial Stability*, Vol. 5. 2009: 321-338. Ahsan, A., Skully, M. and Wickramanayake, J., Determinants of Central Bank Independence and Governance: Problems and Policy Implications, *Journal of Administration and Governance*, Vol. 1. 2006: 1, 47-67.

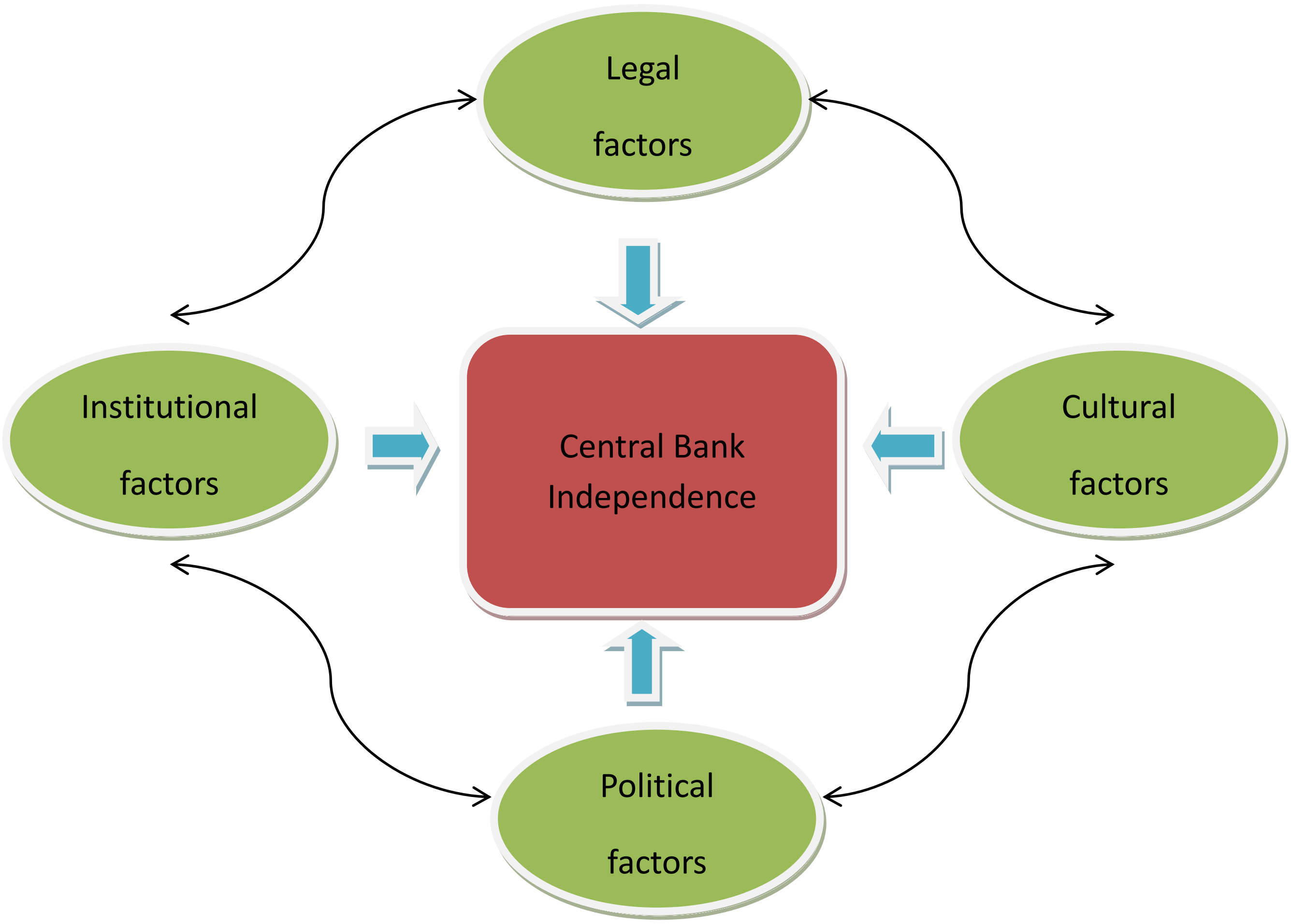
[7] Schotter, A. and Nadiri, M. I. (eds.), *Selected economic writings of Oscar Morgenstern*, New York University Press: New York 1977.

measuring CBI in the sample of countries, must neither be regarded as quantitative economics per se. Without the adhering historical analysis the quantitative sayings are quite insignificant.

2.1 Determinants of Independence

The basic difficulty in measuring CBI is that it is determined by a multitude of legal, political, institutional and cultural/personal factors. Either of these variables are easily quantifiable, particularly not when regarding the past. Any empirical ranking requires therefore at least some systematic indices. A simple model illustrating the determinants can be a start:

Model of CBI



Four main determinants of CBI appear in the model: legal proxies which mostly are deprived from the charter of the central banks, political factors as who is given the responsibility to determine interest rates and monetary objectives, institutional aspects covering the organization of moral suasion and reporting lines, and at last, cultural or personal factors judging the influence of the governor and his staff vis-à-vis the government and the public.

Under each of these headings we placed a set of variables. The ranking of central banks by their varying degree of independence are put in relation to numerical multiple choices, structured from most weighty (high CBI) to less weighty (low CBI).

Table 1 Legal aspects

	Variables	Coding	Country
1.	LEGAL		
a.	*Power to appoint Governor/CEO*		
	Board of the central bank (CB)	1,00	
	Parliament/Legislature	0,67	
	Board of the CB under direction from government	0,33	SWE
	Government/Executives	0,00	NOR/UK
b.	*Members of the management board of the CB*		
	Non-government persons	1,00	
	Parliament representatives	0,67	NOR
	Government appointments	0,33	UK
	Government Ministers/Secretaries of state	0,00	SWE
c.	*Terms of office of Governor/CEO*		
	Lifelong appointment	1,00	NOR/SWE
	5 years or more	0,67	UK
	4 years (reflecting the government election period)	0,33	
	Not mentioned	0,00	

Table 2 Political aspects

	Variables	Coding	Country
2.	POLITICAL		
a.	*Interest rates*		
	Managed by the CB	1,00	
	Managed by the CB in cooperation with the Ministry of Finance (MoF)	0,67	UK/SWE
	Managed by the MoF in cooperation with the CB	0,33	
	Managed by the MoF	0,00	NOR
b.	*State bank financing*		

	Managed by the CB	1,00	
	Managed by the CB in cooperation with the MoF	0,67	UK/SWE
	Managed by the MoF in cooperation with the CB	0,33	NOR
	Managed by the MoF	0,00	
c.	*Bond issue regulations*		
	Managed by the market (few restrictions on bond issues)	1,00	UK
	Managed by the CB	0,67	SWE
	Managed by the CB and MoF in cooperation	0,33	
	Managed by the MoF	0,00	NOR
d.	*Open-market operations*		
	Managed by the CB	1,00	UK
	Managed by the CB in cooperation with the MoF	0,67	
	Managed by the MoF	0,33	NOR/SWE
	None	0,00	
e.	*Who is responsible for monetary policy formulations*		
	Bank alone	1,00	
	Bank participate, but has little influence	0,67	UK/SWE
	Bank only advises government	0,33	NOR
	Bank has no say	0,00	
f.	*Who is responsible for exchange rate policy*		
	Bank alone	1,00	
	Bank participate, but has little influence	0,67	UK/SWE
	Bank only advises government	0,33	NOR
	Bank has no say	0,00	
g.	*Privat bank reserve requirements*		
	Bank alone	1,00	UK
	Bank participate, but has little influence	0,67	SWE
	Bank only advises government	0,33	NOR
	Bank has no say	0,00	

Table 3 Institutional aspects

	Variables	Coding	Country
3.	INSTITUTIONAL		
a.	*Moral suasion*		
	Organized by the CB	1,00	UK
	Organized by the CB and "sanctioned" by the MoF	0,67	SWE
	Organized both by the CB and MoF	0,33	NOR
	Organized by the MoF	0,00	

b.	*Communication strategy/reporting lines*		
	To parliament	1,00	
	To parliament via the MoF	0,67	UK/SWE
	Policy explanations provided for the general public	0,33	
	To MoF	0,00	NOR

Table 4 Cultural/personal aspects

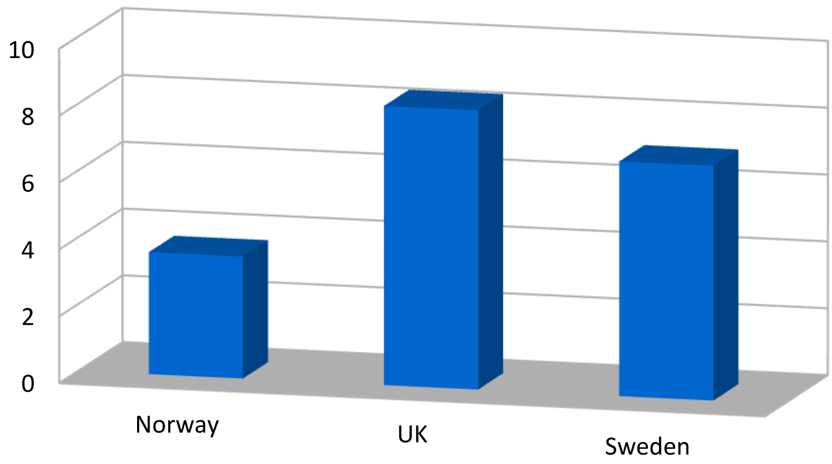
4.	CULTURAL/PERSONAL		
a.	The Governors influence		
	A prominent position, but partly influenced by government	1,00	UK
	A prominent position, but strongly influenced by government	0,67	NOR/SWE
	Predominantely representing the view of the MoF	0,33	
	Dominated by instructions from the MoF	0,00	
b.	The CB as an consulting agency		
	Widely consulted by the government	1,00	UK/SWE
	Partly consulted by the government	0,50	NOR
	Not consulted	0,00	

The definition of determinants, and the process of attaching variables to them, was not any straightforward process. Particularly, two problems acted to bias the statistical result. While a variable in one country could be regarded as legal aspects of independence, in others it was identified as political or institutional. The time-span of the research was also a problem. Some variables could change their position in course of the period. To keep the factors steady some subjective shortcuts had to be made. Additionally, in cases of uncertainty about the placement of the variables, Norway acted as the exemplar to follow for the other countries.

2.2 Presentation of results

In spite of the methodological deficiencies, the construction of the index series had a fairly broad empirical basis. The many variables put into work should be sufficient to smooth out the distortion of the statistical procedure. An overview of the overall result is given in figure 1:

Figure 1 Central Bank Independence



The figure illustrates the various degree of independence for the three central banks. While the result for the BoN is exceptionally low, the score for the BoE is surprisingly high. Taking into account nationalization and new statute law for the BoE in 1946, which gave the Treasury wide powers to instruct the Bank's operations, one should also expect a lower outcome on its part. In Norway, on the other hand, the legal position of the Bank was strong. In spite of nationalization in 1949, new statute law did not follow suit, giving the governor and the management board wide juridical independence in the decision-making process. Sweden took an intermediate position. A new statute law had been implemented in 1934, shrinking the power of the governor and making government representatives members of the board. In difference to the UK, however, the Swedish Finance Ministry did not have any instruction right set by law to determine the direction of the Bank.

Taking a closer look at the outcome of constructing the four sub-indices, a somewhat paradoxical pattern seemed to appear. Those central banks with high legal independence and a strong *de jure* position, scored inversely low when it came to political, institutional and cultural independence, i.e. their *de facto* independent position.

Figure 2 *De jure* independence

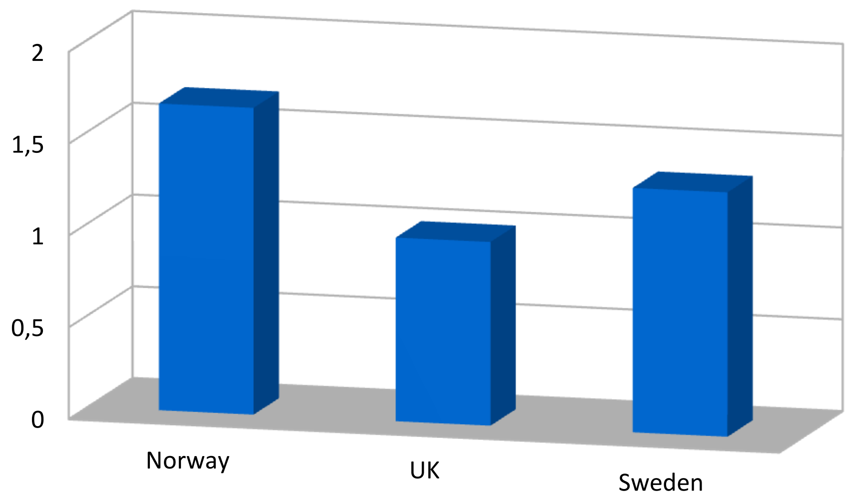
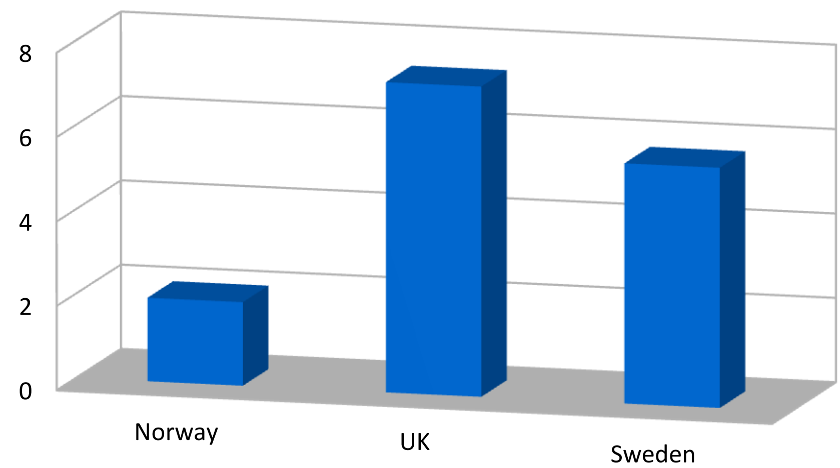


Figure 3 *De facto* independence



To conclude on these results, or to present a general hypothesis that a strong *de jure* position in the first postwar period led to low *de facto* independence, seems somewhat obscure. The sample of countries involved in the research is also far too narrow to make such a statement falsifiable. But it points to some external factors at work which undermined the power of the central banks, quite independent of their *de jure* positions. An obvious explanation is that the dominant politico-economic climate suppressed discretionary moves by the central banks. Nor were they allowed to follow freely those (non-discretionary) 'rules' which were recorded in statutory law. Whatever much governors and management boards stressed for independence in the public and vis-à-vis political authorities, their efforts went largely out in vain. In fact, it seems like the more confrontational the lines of arguments were, the less authority did the central bank retain. The historical analysis sets out to elaborate this issue further.

3. Historical Analysis and Comparisons

Governments were to entry several of capitalism's inner sanctums during the 1950s and 1960s. Monetary policies became an integrated part of short-term demand management, leaving little room for independent central bank maneuvers. But within these limits, the central banks achieved varying degrees of independence and managed to influence the policy process in various ways. Somewhat paradoxically, however, our preliminary quantitative research showed no connection between central banks *de jure* independence and their *de facto* power. A thoroughly qualitative and comparative analysis is accordingly needed to account for this unexpected result.

3.1 *De jure* versus *de facto* independence

The strong *de jure* position for the Norwegian central bank was specifically expressed in two ways: the composition of the management board (direksjonen) and the lifelong (unlimited in time) appointments of the governor and the deputy-governor. While three of the members of the five-strong management board were selected by parliament for a 6-years term, the remaining seats were held by the governor and the deputy-governor, who were appointed by the government. Taking into account the possible lifelong duty of these two last members, and given the fact that the governor was the chairman and possessed a tie breaking vote (extra vote) in the board, the opportunity of the government to influence the management of the Bank had some obvious limits. Additionally, the power of the executives was curtailed by the tradition that the parliamentary chosen members should reflect total composition of parliament, not only the majority as held by government parties. In some circumstances, as when the liberal politician Gunnar Jahn ruled the scene in the Bank, he could with support of the deputy-governor and parliamentary electives control the management board and, if he wanted, oppose labor government initiatives.[8]

In Sweden, the government had much larger opportunity to influence the management of the central bank. At first sight, though, it seems like the de *jure position* of the Riksbank was rather strong. The management board (bankofullmäktige) selected the governor. But the composition of the management board and the executive committee (bankoutsköttet) made political authorities highly influential in the governance of the Bank. While day-to-day operations in Norway were charged by the governor and his deputy, in Sweden a formal executive committee consisting of additional two members from the management board and one from the administration were responsible for the Bank's daily performance. Since all representatives of the management board except the chairman were parliamentary elected, it gave a clear political bias to its governing bodies. This was additionally strengthened by not admitting board seats to the governor and the deputy-governor, as was the case in Norway. In difference to for instance the US Banking Act of 1935, which removed the Secretary of the Treasury and his deputy from the Board of Governors (management board), the Swedish central bank charter of 1934 gave a prominent position to government representatives. After the war, it became custom that the deputy minister in the Ministry of Economic Affairs or Finance Ministry also held the chairman post in the management board. Dag Hammarskjöld, a leading politician from the social democratic party, possessed this position in the immediate postwar period. The central bank governor from 1929, Ivar Rooth, left office in 1948 after a dispute with Hammarskjöld and the government about 'instrument independence'. Rooth wanted, as Jahn in Norway, to use interest rates and open-market operations to control domestic credit and prices. But in difference to Jahn, Rooth did not gain much support for such an oppositional line internally in the Bank.[9]

The Bank of England Act of 1946 was both an act of nationalization and an act giving legal supremacy of the Treasury over the Bank in matters of policy. The Act authors, Herbert Brittain and Wilfrid Eady in the Finance Division of the Treasury, emphasised that changes in the bank rate could no longer take place without close consultation with the Chancellor of the

[8] NOU 1983: 39 *Lov om Norges Bank og pengevesenet*, 197ff.

[9] Jonung, L., Riksbankens politik 1945-90. En krönika, in Werin, L. (ed), *Från ränteglering till inflationsnorm. Det finansielle systemet och Riksbankens politik 1945-1990*, SNS Forlag: Stockholm 1993, 296. Wetterberg, G., *Pengarna & Makten. Riksbankens historia*, Sveriges Riksbank/Atlantis: Stockholm 2009, 335-38.

Exchequer. Clause 4 (1), the so-called 'power of direction', further empowered the Treasury with legal authority to instruct the Bank (instruksjonsrett). Another important and even more controversial provision, the 'power of direction of banks' (clause 4 (3)), gave the government the necessary legal foundation to control bank credit, both in general and selective ways. However, Lord Catto, succeeding Montagu Norman as governor in 1944, managed to obtain some important concessions in the exercise of these laws. The Treasury could not execute clause 4 (1) without prior consultation with the governor. As to clause 4 (3), the Bank managed to obtain a more general wording of the bill, ensuring that the established war-practice of implementing private banking regulations were shared among the two. But when it came to the appointment of composition of governing bodies, the supremacy of the Treasury was not questioned. The deputy governor and governor, the 12 Directors of the Bank and the management board (the Court), were all to be government appointments. The terms of office of the governor was set to five years, with possibility for re-election.[10] All in all, the subordinate *de jure* position of the BoE was extraordinarily strong compared to most other central banks in Europe and the Americas. But as we shall see, this was not the case when it came to the Bank's actual or *de facto* independence.

3.2 Independence in the UK

In his dispute with the Treasury, Lord Catto was well aware of one thing: if the Bank were to press its objections too far, the outcome could be that the Treasury itself took all the powers the Bank wanted to possess.[11] However, the general wording of clause 4 (3) gave some room for independent actions. The statutory law gave in fact no specific provision for as to who were to enforce the directives and confront private banks. Given the traditional strong role of the Bank towards financial institutions in the square mile (the City), the task of regulating private banking credit fell quite natural to already established custom. Several attempts by Treasury officials to interfere with these regulatory practices did not succeed. The Bank was in large left to get its way with the private banks by informal methods and unofficial request to control their lending and liquidity positions. An important exception was the 1955 measures, which along with interest rate increases also turned to a 'public request', or de facto directives, to curtail bank credit. But the somewhat half-way arrangement of the 1946 Act,

[10] Fforde, J., *The Bank of England and Public Policy*, Cambridge University Press: 1992, 665-79.
[11] Fforde, 665.

under which the Treasury itself had no power to instruct the commercial banks directly, enabled the Bank to find a role as a powerful intermediary between the government and the banks.

This is not to say that Bank actions were allowed to stray very far from the dominate demand-management regime and the macroeconomic objective of full employment. But still, and even under the heading of the cheap money policy, Lord Catto's successor from 1949, Cameron Cobbold, managed to defend the Bank's autonomy and opposed government initiatives of outweighing an expansionary fiscal stance by quantitative restrictions on private bank credit. Cobbold constantly reminded the Chancellors of the Exchequer that the 1946 Act had vested the Bank with the power to 'direct' commercial banks. He sided instead with the private banks in preferring higher interest rates and no quantitative restrictions. The Treasury conceded largely with his will. The bank rate was raised in several successive steps, from 2.5 percent in 1952 to as high as 7 percent in 1957, in many occasions despite government views.[12]

Any compulsory approach by the government against the private banking sector would also risk deteriorating the value of sterling in international currency markets. By the late 1950s, the adoption of dollar convertibility and the resurrection of London as an international financial centre meant that a public quarrel between the Bank and the Treasury could lead to distrust in sterling in financial markets. A most unwanted effect of such events would be a higher bank rate to stem disruptive flows in international currency and capital. The accepted 'rules' by which exchange rate policy was conducted during the Bretton-Woods era did not give the Bank much room for 'discretionary' actions. But it gave governor Cobbold the leverage to argue against the government and pinpoint to the dramatic effects of a policy turn to mandatory credit control, particular if it was implemented against the Bank's recommendations. Rather, as Cobbold stressed in his weekly meetings with the Chancellor or Treasury officials, the urgent need was to cut back government expenditure and to curtail the uncontrolled growth in capital spending by local authorities and nationalised industries.[13] Only by such measures could a cheap money policy be pursued successfully. In spite of the legal subordination to the government contained in the 1946 Act, the practical implementation of monetary policy thus gave some worthwhile degree of independence and authority to the

[12] Colling, M. and Baker, M., Bank of England Autonomy: A Retrospective, in Holtfrerich, C. L., Reis, J. and Toniolo, G. (eds.), *The Emergence of Modern Central Banking from 1918 to the Present*, Ashgate: Aldershot 1999, 17-19.
[13] Fforde, 670.

Bank. Cobbold had fought, in the words of David Kynaston, 'a long, hard, and successful fight on the City's behalf as well as the Bank's.'[14]

3.3 Political interference vs. 'interest rate coup' in Sweden

The evolvement of CBI in the UK is in some respect similar to the Swedish case. Both the Bank Act of 1946 and the Swedish Charter of 1934 assigned important roles to governments in appointing governors and members of the management boards. But the Swedes went a step further by authorizing politicians to direct the affairs of the Bank. For governor Rooth, belonging to the classical school of central banking, this was unreasonable interference by government in the Bank's inner affairs. Rooth had successfully managed to defend the Bank's independence during the 1930s and avoided to be replaced by the incoming social democratic government in 1932. Not surprisingly, during the boom years of 1947-48, the governor advocated a rise in interest rates to stem both the surge in imports and prices. He also urged for cuts in public expenditure and more freedom in open-market operations, so as not being forced to purchase government bonds at artificially high price (low interests). But Rooth met severe opposition, as mentioned above, and left his post in protest.[15]

By getting rid of a troublesome and traditional central banker, the door opened for the social democratic government to integrate the Bank in its planning apparatus. The importance of monetary policy was by no means reduced in the economic policy system which developed in Sweden and neighbouring countries during the 1950s. To stabilize a fluctuating business cycle monetary instruments played a key role. Simultaneously, monetary policy means was crucial for achieving allocative and distributional goals. To reconcile the many objectives, the system rested on rigid domestic credit control. Cheap money policy led to excess demand for credit, to which government regulated the supply. Traditional money and capital markets virtually ceased to exists. A massive socialisation of savings made their part. High tax rates squeezed disposable income, encouraged financial budget surplus and strong public sector savings. National pension funds, as the AP fund in Sweden, engaged large part of worker's savings at

[14] Kynaston, D., The Bank and the Government, in Roberts, R. and Kynaston, D. (eds.), *The Bank of England. Money, Power & Influence 1694 – 1994*, Clarendon Press: Oxford 1995, 50.

[15] The following sections are mostly based on Werin 1993. Haavisto, T. and Jonung, L., Central Banking in Sweden and Finland in the Twentieth Century, in Holtfrerich, C. L., Reis, J. and Toniolo, G. (eds.), *The Emergence of Modern Central Banking from 1918 to the Present*, Ashgate: Aldershot 1999. Trøite, R., Norges Banks uavhengighet i etterkrigstida, *Master thesis in history,* University of Oslo 2010.

the expense of private insurances. Additional capital was accumulated in state hands by requesting private banks to restrict lending, thus making them able to buy government bonds at low yields. A vivid state bank system and public housing cooperatives ensured that all these credits were canalized into investments in sectors of particular need (housing, export industries etc.), or to areas where stabilisation policy required them.

Some striking differences to the UK monetary policy system were apparent. The importance of sterling in international currency transactions and the significant role of the City in international finance, made domestic policies sensitive for cross-national movements of currency and capital. In Sweden and Norway, on the other hand, the rigid non-market approach rested on the existence of exchange and capital controls that financially isolated them from the outside world. While basically no functioning market for financial assets existed in either of the countries, the vitality of money and capital markets still prevailed in best vigour in London. Accordingly, the encompassing system of domestic credit regulations introduced in the Nordic countries was protected and supported by the exchange and capital controls allowed for under the Bretton Woods system. It gave political authorities the power to establish a structure of interest rates and a distribution of credit that was 'regulated' by plan, not price.

In Sweden, the role of administering the system fell on the central bank. In fact, the architect behind the whole arrangement of regulation and control was Mats Lemne, the deputy governor in the Bank under Klas Böök, who succeeded Ivar Rooth in 1948. As a prominent member of the social democratic party and former state secretary in the Finance Ministry, Lemne was trusted the task of reforming the system. The immediate challenge was to reconcile the policy of selective allocations of credit with the objective of keeping interest rates low. The answer Lemne gave to the challenge was two-sided. At one front private banks supply of credit should be curtailed by lending arrangements and so-called liquidity quotas. While a traditional deposit reserve requirement demanded the banks to keep part of their deposits with the central bank so as to keep liquidity and lending abilities under control, the liquidity quota plainly stated that a certain proportion of the reserve requirement should be met by buying government and housing bonds. In one go one thereby created a 'market' for public bonds without adding to total demand of credit and pushing interest rates upwards. At the other front were direct regulations of the bond market. No one could longer issue bonds without permission from the central bank. The size and interest rates of every 'market paper' had also to be approved. Thus, by rigid regulations of both the money and capital markets, total credit supply could be politically targeted and directed towards those areas of demand where policymakers had set priority without fear of rising interest rates.

In the fall of 1951, parliament passed a stand-by law encompassing all the new instruments requested by the central bank. The neat combinations of the regulatory tools were supported by an act allowing the central bank to directly determine the upper and lower level of private bank interest rates on a variety of loans. But Mats Lemne, who replaced Klas Böök as governor at about the same time, did never intend to carry through the new statutory provisions. Instead, he simply used the law as a hidden pressure - or as ‘a gun at the table’ in the words of the Swedish Banker’s Association - to bargain comprehensive ‘voluntary’ agreements with the commercial banks.[16] Formal agreements with the banks had been reached each year since 1947. But this form of moral suasion was something qualitatively new. It gave private bankers much less room for manoeuvre in their monthly meetings with the Riksbank. If the banks did not make sufficient concessions to curtail their credits, the central bank could command them to do so. But in no occasion was it necessary to go that far. It was sufficient for the governor to make *qualitative* bargains with the commercial bank managers in order to reach stated intentions. However, in some occasions, between 1955 and 1957, *quantitative* lending ceilings were introduced to check the growth in bank credits. Other quantitative controls were also used from time to time. But the corporate system was never exposed for any events that necessitated the full use of the law.

The new institutional role of the central bank under a regime of control and plan questions its real degree of independence. Did Mats Lemne and his staff just conscientiously and passively follow the policy guidelines emancipating from the Finance Ministry? Or did the Bank manage to sustain an independent role in a situation where traditional monetary instruments were regarded as obsolete? Undoubtedly, the Swedish case opened for direct political influence of central bank governance. But under prevailing conditions, it was equally important for the central bank to keep the initiative and to be heard among the politicians, thus avoiding to be overrun by the government and the planning bureaucrats in the Ministry. By making out a report and recommending a series of measures in support of planning regulations, the Bank adapted itself to a new situation and managed to keep in charge of the arsenal of monetary instruments.

[16] Quoted from Ecklund, 181.

Important events during the rule of Lemne's successor, Per Åsbrink, support this view. In 1957, the governor convinced the management board to raise the discount rate without asking for a prior approval from the government. It was a bold move that until then was unheard of in Swedish postwar politics. Popularly also labelled as the Bank's 'interest rate coup', it demonstrated a growing degree of independence for the central bank, and brings to mind similar actions carried out by the Bank of England. The reaction of the Finance Ministry was neither less than in the British Treasury. The chairman of the management board was forced to leave his post and replaced, in a typical Swedish manner, with a former finance minister from the social democratic party. Still, the event bear ground to the argument that the Bank claimed a relative independent position in spite of its close relations with the government.

3.4 Politically determined interest rate in Norway

In Norway, the situation was quite another. Any change in the discount rate was not for the central bank to decide. As with many other monetary instruments, the control and management of them did not adhere to the Bank, but went under the supervision of the Ministry of Finance. The bias in the institutional power of division may be traced to the outcome of a controversy between the Bank and the Ministry in 1950-51, just after the upheaval of the postwar price and production controls. Governor Jahn saw the new situation as a golden opportunity to introduce traditional monetary policies. He forwarded a draft law to the Ministry in February 1950, proposing the introduction of flexible deposit reserve requirements in order to control private bank liquidity and credit. The provision was intended as part of a wider set of marked-based policy instruments after model from the US.[17]

At first, Jahn's proposal obtained some support among planning economists as Ragnar Frisch and Petter Jakob Bjerve. The new provision did not challenge the cheap money policy in any particular manner. In its simplest form it was just a requirement that tied up bank liquidity. The statutory basis of the instrument also appealed to economists in search for efficient instruments to control private bank activities. But Jahns' references to the US system, and market-oriented policies more generally, surely also provoked. Olav Meisdalshagen, the finance minister, was not impressed. The proposal totally ignored the most pressing problem of the day: how to finance a growing state bank sector and obtain selective allocations of

[17] The following sections are mostly based on Ecklund 2008. Trøite 2010. Lie, E., *Ambisjon og tradisjon, Finansdepartementet 1945-65*, Universitetsforlaget: Oslo 1995.

credits without adding to interest rates pressures. Quite contrary, when taking into account the large amount of government bonds that needed sale to arrange such financing, an exclusive reliance on traditional deposit reserve requirement in monetary policies would only push for open market operations and higher yields on bonds (higher interest rates).

In the bill put forward by the Ministry in November 1950, the role model of the deposit requirements had also taken an abrupt change, from the US to Sweden. Similar to Mats Lemne's proposal for liquidity quotas, the Norwegian Ministry now suggested that the banks could meet the reserve requirements by keeping government securities and government-guaranteed bonds. Even worse, from the BoN's point of view, it was the Banking Inspectorate, organized directly under the Ministry, that was granted the authority to enforce the law, not the central bank.

This was a severe setback for governor Jahn. Like his colleagues in Sweden and the UK, Jahn fought boldly to keep the Bank's independence. But he fronted the political debate from a quite different perspective. His market oriented proposals for organising monetary policy undoubtedly provoked many politicians in the radical climate following the 1930s and the war. To launch a traditional deposit reserve requirement, without bringing forward any solution to the problem of state-bank financing, did not improve the case. It was more an act of confrontation than compromise. An openly distrustful atmosphere now also emerged between Jahn and minister Meisdalshagen. The bill would not only deprive the Bank of most of its political authority, it also completely undermined its position in the financial system. It was in fact turning the Bank into 'a cashier's office' at the Ministry.

Desperately seeking to avoid such an outcome, Jahn turned to the minister of commerce, Erik Brofoss, in search for a compromise solution. Brofoss, one of the main architects behind the planned economic system in Norway, supported Jahn in this matter. He recognised that the final control of monetary policy should be in the hands of the Ministry of Finance. But downgrading the Bank to a directorate under the Ministry, or solely viewing it as a regular state-owned bank, was an overreaction and would only lead to unnecessary loss of competence and the downfall of a valuable institution. When Jahn in late 1950 presented a second policy initiative - or the 'exit-solution' as we have chosen to label it - to formalize cooperation with the private banks under the heading of the JCC and with the central bank as a key participant, Brofoss welcomed this idea. Also among other labour politicians such thoughts had appeal. Corporatist cooperation had been a core element in Labour's economic policy programme right from the end of the war.

3.5 Voluntary agreements by force

The institutional responsibility of monetary policy now moved in a dual direction. At one side the JCC, headed by the central bank with Jahn as the chairman, was to negotiate over *qualitative* guidelines concerning lending volumes, credit allocations and liquidity positions with private banks on voluntary basis. The JCC also managed to temporarily delay the Parliament from passing an Act on the deposit reserve requirements. At the other side, the Ministry of Finance facing the bill put on hold, started on own behalf negotiations with private banks and insurance companies to sell government bonds in order to fund the state-owned banks. Although the JCC was involved in the negotiations in 1952, it was excluded in the following years. The Bank was not even informed about ongoing progress. The primary reason for this ignorance was that both the JCC and the Bank continued to put forward simple market-oriented arguments: the state-bank funding problem should be solved by restriction of their lending abilities and by raising interest rates on government bonds sold for that purpose. Obviously, such measures were incompatible with Labour's economic and political goals. Furthermore, the planning or Frischian economists, who dominated the bureaucracy of the Ministry, did not have much affection for a JCC that formalized cooperation without support of statutory provisions. Instructions were in principle preferable to negotiations. But as long as the JCC managed to curtail private bank lending in accordance with the private credit targets declared in the national budgets, the corporate arrangement did serve an important purpose. After all, somewhere the private banks had to put idle deposits and various cash items, and governments bonds gave at least some yield to their buyers.

In February 1952, the parliament passed a redesigned bill on the deposit reserve requirements. The Bank achieved a more pronounced position than in the original version, and the idea of using the reserve requirements to fund state-owned banks was annulled. However, the new bill was not effectuated until February 1955, and then with such low requirements that it had no practical functions. Equivalent, the provisions of the Interest Control Act that passed parliament in December 1953 was never carried out in practise, but served as a hidden threat ('gun at the table') to be effected if financial institutions did not comply with the demands of the Bank and the Ministry during negotiations. As in the Swedish case, the specific level of the various interest rates on loans and deposits should mainly be determined by moral suasion, though of course within the limits given by the regime of cheap money.

However, in one crucial respect the Norwegian bill diverged from the Swedish legislation. In Norway it was not the central bank, but the Ministry of Finance who where to initiate discount rate changes. In the first draft of the Interest Control Act, the position of the BoN was in fact not mentioned at all. After some revisions the Bank was granted the right to comment on proposals from the Ministry. But the downgrading of the central bank as an independent institution was indisputable.

Erik Brofoss shared many similarities with Mats Lemne, the Swedish governor. Both belonged to the social democratic regime, had former political experience and were ambitious on behalf of the role the central bank. But different timing of their appearance in the central banks may serve to explain why their roles as governors were quite different. While Lemne came to Riksbank already in 1948, before the forming of the postwar central bank had taken place, Brofoss entered the scene first in the aftermath of these events. This gave Lemne the opportunity to be the architect behind the new statutory provisions at the beginning of the decade, while in Norway it was primarily the Ministry of Finance which took that role. Gunnar Jahn had as governor of course also some impact, particular with regard to developing the corporate arrangements of moral suasion. But his political views and oppositional lines of arguments made the government not to trust him the task of reorganising the monetary system.

In difference to Norway, the institutional framework for formulation and implementation of monetary policy was rather simple in Sweden. The Bank was in charge for both formulating statutory provisions and implementing them through moral suasion. In the monthly meetings with the financial institutions a broad range of aspect were negotiated: reserve requirements, lending volumes, interest rates on loans/deposits and maybe most important, liquidity quotas and sales of government bonds. Additionally, the Bank was in charge of discount rate decisions and bond issue control. Turning to Norway, a more chaotic picture emerges. At one front, the Bank negotiated lending volumes, credit allocations and liquidity positions with the private banks under the JCC arrangement. At the other front, the Ministry of Finance was similarly committed to moral suasion and negotiated independently with financial institutions on reserve requirements and sales of government bonds to fund the state-owned banks. Since the Ministry also was responsible for formulating statutory provisions and was in charge of the discount rate changes, it got a key position. Monetary policy was both formulated and implemented by Ministry officials, leaving just a minor role to the Bank in controlling and monitoring bank credit and liquidity positions through the JCC.

Accordingly, for Brofoss, it was not much central bank independence left to defend. This situation was neither to be improved during Brofoss' governance. In 1956, bond issue control was handed over from the Bank to the Ministry. As we saw above, this instrument was of vital importance when it came to curtailing funding of private enterprises, thus liberating a room for state-controlled credit expansion. In 1965, most of the other monetary instruments became formalized in the Credit Law, with the government in charge for both formulation and implementation. The JCC as a corporate institution ceased to exist. Instead, some negotiating organs chaired by Ministry officials were set up, primarily with the aim of informing the financial institutions about changes in statutory provisions. Additionally, a range of new monetary instruments with statutory basis were introduced: restrictions on bank lending in foreign currencies in 1963, supplementary reserve requirements and bond investment obligations for private banks in 1965. To the governor's great disappointment, the BoN was reduced to be the henchman in exertion of government policy in most areas.

3.6 Comparative discussion

Neither the authorities in Sweden or the UK went as far as the Norwegian government in adopting monetary statutory provisions. In Sweden, the development turned rather opposite during the 1960s. After governor Åsbrink's famous 'coup' in 1957, pointedly characterized by Karin Kock as the 'renaissance of interest rate policy in Sweden', monetary instruments took a new and more prominent role, particular with regard to stabilisation policy.[18] Under cyclical upswings the whole arsenal of measures, with the discount rate in front, turned in contractive direction, and vice versa during economic slowdowns. The 1960s also saw a move towards more market conform policy means, as illustrated by the introduction of a penalty interest when private banks exceeded their borrowing facilities with the central bank. Only bond issue control remained as an active regulatory tool at the middle of the decade.[19] This made policy

[18] Wetterberg, 356.
[19] Jonung, 300.

more dependent on moral suasion. A successful outcome of negotiations with the private banks was a prerequisite for controlling total credit supply and avoiding an overheating of the economy.

In spite of a reversal of the 'liberalised' policy during the currency turmoil of 1969, some obvious differences occur in comparisons with the development in Norway. While a relative flexible Swedish discount rate policy allowed it to increase from 3 per cent in 1955 to 6 per cent in 1965, any movements in the bank rate in Norway was much less volatile (kept in the interval 2.5-3.5 per cent). Regarding moral suasion, the BoN lost power and position with the statutory laws of 1965. Not even when considering other typical monetary instruments, as bond issue control, reserve requirements and bond investment obligations by private banks, did the Norwegian central bank have much say. The decision making process and the ultimate authority lied with the Ministry of Finance. The Swedish case reminds us more about the performance of the Bank of England, where both the frequent use of the bank rate and moral suasion stood at more independent grounds.

In the UK, the system of moral suasion also changed during the 1960s. While governor Cobbold, in office until 1961, largely defended the City point of view against the Treasury, his successor, Baron O'Brien, distanced himself a bit from the square mile. This was not only due to his close associations with top officials at the Treasury. Also a general discontent with the practical implications of the BoE Act was at rise in Whitehall. As we saw in last section, the confusion over policy responsibilities in the 1946 Act had mostly come out at the Bank's advantage during the 1950s. But after the 1957 events, where governor Cobbold successfully advocated the interests of the City and managed to keep government regulations at hold, Chancellor Peter Thorneycroft reacted. A working party was set down to elaborate 'how to amend the law to give the Treasury power it thought it had already.'[20] His successor, Harold Macmillan, followed suit. By mid-1958, it was announced that a Committee of Enquiry into the monetary system would be appointed. A year later the Radcliffe Committee gave their report.[21]

This development did not only reflect that the Treasury began to get uneasy about the working of monetary policy. Officials and Ministers now also frequently criticised how the monetary system functioned and questioned the role of the Bank. Its close ties with the financial

[20] Kynaston, 49.
[21] Fforde, 612, 671-672.

community were not only an advantage. It made the Bank to favour a 'highly psychological and non-quantitative approach to monetary economics', as John Fforde has expressed it.[22] The normal practice of the City-Bank-Government relations was that the City went to the Bank with their complaints and troubles. A small and efficient Bank administration provided the governor with advice, whether the issue was of political or technical character. After making up his opinion on the case, the governor would argue the matter personally with the Chancellor or other Treasury officials. The practice gave, as we saw above, important authority to the Bank by monopolising all contact with financial institutions. But it also consigned, from the point of view of the Radcliffe Committee, a wrong focus of attention and was a hindrance for developing a structured economic and statistical service that was a prime requirement for a modern central bank. The Committee sought therefore to strengthen the administration of the Bank simultaneously as it became a typical arm of government. The point was to obtain an unconditional capitulation on behalf of the Bank's independence and to subordinate it to the Treasury and to the overall aims of discretionary management. This would enable the Treasury to use the service of the Bank more thoroughly and to involve it more closely in its own macroeconomic deliberations.

To some extent these targets were reached during the 1960s. The Bank started to participate in budget discussion and was more closely involved in preparation of official national income forecasts. In the field of balance of payments estimations, the Bank was already participating, but mainly because it produced much of the statistical information. Now it was brought in to the inner circles of government policy making, undoubtedly enhancing the role and prestige of the Bank. But did this come at the cost of a loss of the Bank's independence? Looking at the City-Bank-Government relations, there are reasons to doubt so. Even if Governor O'Brien not publicly objected direct Government-City contact, in practice there was not much of it. When Chancellor Denis Healy in the mid-1970s argued for closer contact with the financial institutions in the City, he at first had to break in some doors: 'Before I became Chancellor the Bank would not allow Chancellors to talk to people in the City because it regarded itself as God's appointed ambassador on earth from the City to the Treasury.'[23]

Denis Healey made his way. But any meetings with chief executives of financials firms were only 'allowed' on condition that a representative of the Bank always was present. Although

[22] Fforde, 612.
[23] Treasury and Civil Service Committee: The Role of the Bank of England, *Minutes of Evidence* (1993-4, HC 98-II, q 275). Quoted from Kynaston, 52.

the system of moral suasion in the UK in this way changed gravity, the special position and authority of the Bank gave it a status along the independence scale which was far out of reach for the central banks in Norway and Sweden.

4. Conclusions

The degree of central bank independence in the years after the Second World War till 1970 was marginal in Norway. In spite of a high legal independence, the Bank's actual power in policy matters was poor. Also the institutional independence of the Swedish central bank weakened during the period. But the governors of the Riksbank could implement independent policy if they had the desire to do so, and understood the rules of the political game. The ‘old central banker’ Ivar Rooth had the desire, but got played out in the game, while Böök and Lemne had neither of it. The case of governor Åsbrink and the ‘interest rate coup’ gave leverage to an independent central bank in times of strong governmental influence. Åsbrink played his cards well, indeed demonstrating who was in charge of the monetary policy arsenal.

Bank of England’s situation during the postwar era was the opposite of what we saw in Norway: a weak *de jure* position, but a strong *de facto* independence. The government would or could not interfere in the decision-making processes within the central bank. The private banking institutions had entrusted the Bank with the authority to negotiate on behalf of them with the government, while the Treasury had to send its requests to the private banks through the central bank. Bank of England also had its most important tools intact, such as the power to decide interest rates. It was undoubtedly under pressure from the government in a much larger scale than during the interwar period and today. But its independence within government was still a stronghold compared to central banking in Sweden and Norway.

In both of the Scandinavian cases, the central banks tried to recapture some of its lost power and influence. But the Swedish Bank succeeded in a larger scale than was the case in Norway. Gunnar Jahn’s opposition may have stressed the Bank’s independence towards the government too far, with the consequence that its most important policy instruments were deprived. In fact, during Brofoss’ time as governor, moral suasion was the only effective instrument the Bank possessed. With the Credit law in 1965, also this tool came under government control. It further undermined the policy role and position of the the Bank, making it the least independent central bank surveyed in this paper.

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