

Central Banking in Troubled Times – Norges Bank in London Exile

During the "London Moment", the central banks of the occupied countries were essential: on one hand, they helped the national governments-in-exile to achieve financial security, on the other, they facilitated the exchange of knowledge and ideas to plan post-war international economic and financial cooperation.

In this blog article, a short historical case study will be carried out, focusing specifically on the fate of one national bank during the German occupation: the Norges Bank (Central Bank of Norway). It will examine how Norges Bank established itself in exile and how it positioned itself vis-à-vis the part of the institution that remained at home, as well as the finance ministers and their advisors in exile. Norges Bank is particularly well suited for such an investigation, as its actions and activities are excellently documented in the Norwegian National Archives.¹ The problems faced by the Norges Bank board in exile can therefore be observed in detail: I argue that the constant differences between the board in London and the board that remained in Oslo, as well as the conflicts between the Norges Bank board in exile and the Norwegian government in exile, caused the entire institution to gradually lose prestige and autonomy.

Before the outbreak of the Second World War, Norges Bank had a high degree of autonomy. Its elected governors traditionally enjoyed great freedom of decision. As Harald Espeli, Senior Lecturer at the Norwegian Business School, aptly notes:

"Norges Bank had been organised as a private company since its establishment in 1816. The Act of Norges Bank of 1892 provided government and parliament with no legal powers to instruct the bank in its ordinary activities."²

By the time the German army invaded Denmark and Norway as part of Operation Weserübung on 9 April 1940, the economist Nicolai Rygg had been in the post of Norges Bank governor for almost 20 years and was thus closely associated with all the major decisions of the interwar period, including the management of the banking crisis in the early 1930s. This continuity ended abruptly with the German invasion.

Already on 22 April 1940, the Norwegian King had dismissed and replaced Nicolai Rygg and the rest of the board of Norges Bank with a provisional act. Together with the Norwegian government, the newly appointed board went into exile: first to Tromsø and, as the Germans advanced, to London.³ This measure stems from the accusation that Rygg and his fellow board

members had cooperated with the German occupiers. Espeli speaks in this context of "loyal cooperation with the Germans."⁴ After this far-reaching decision by King Haakon there were now two boards: one abroad and one in Oslo, both of whom insisted on legally representing the bank.

The new board, which consisted of the lawyer Arnold Ræstad, Jens Nørve and the economist Wilhelm Keilhau⁵ therefore strove to clearly distance themselves from the part of Norges Bank that remained in Oslo and to deteriorate its reputation. In a circular letter to other European and non-European central banks dated 23 July 1942, Ræstad and Keilhau declared:

"Norges Bank in Oslo is, from the point of view of the Norwegian law, a de facto institution working under the responsibility of the occupying power, and Norges Bank, London, accepts no responsibility for any of the actions or engagements of Norges Bank in Oslo. The Bank notes issued by this institution and other obligations incurred by it towards third parties have no validity as against Norges Bank, London."⁶

At the same time, the letter emphasised that debtors who repay their debts to the Norges Bank at its Oslo branch would do so without the Norges Bank London acknowledging this transfer. Furthermore, Ræstad and Keilhau stated that "the currency circulating in Norway is [due to German occupation] without national independence and thus the current exchange rates are without their normal significance."⁷ After the Norwegian Krone was pegged to the US dollar in 1939, the German occupiers pegged the Krone to the Reichsmark between 1940 and 1945. The London Exile Board did not want to accept this state of affairs. With the letter quoted, Keilhau and Ræstad denied the Norges Bank in Oslo its legitimacy and ability to act and thus tried to strengthen their own position of power.

As one can imagine, the circular letter did not only elicit positive reactions, but also a lot of resentment. Nicolai Rygg was outraged and tried to defend the legitimacy of Norges Bank in Oslo: he argued that it was providing for Norway's starving population by maintaining payments and that through its actions it could, for example, receive supplies of goods from free Sweden.⁸ The exiled government's finance minister, Paul Hartmann, was also at least puzzled by the letter quoted, as he had apparently not been informed.⁹ Under his pressure, Ræstad and Keilhau later had to retract their statements.¹⁰ The board of Norges Bank in London had thus not achieved its intended goal of demoting the board in Oslo. Much more, the relationship between the Norwegian government in exile and the three men now suffered from increasing dissonance.

Hartmann's opposition, however, was probably not only due to his lack of knowledge about the circulation of letters, but also to a heated dispute between Hartmann, his advisors and the London Norges Bank Board concerning the post-war economic order. In the context of the forthcoming Bretton Woods Conference in 1944, Hartmann and his team clearly sided with the Keynes Plan. This was one of the proposals for a post-war economic and financial order discussed in the run-up to the Bretton Woods Conference and included a multilateral Clearing Union. Balances of payments expressed in an international unit of account, the Bancor, were to be credited within certain limits, with sanctions against the build-up of excessive debtor and creditor positions.¹¹ Ræstad and Keilhau had reservations about the regulatory elements of the Keynes Plan arising from the traditional independence of the Norges Bank described earlier, while advocating the reintroduction of a fixed gold standard in Norway. In addition, the London board of the Norges Bank called for the use of a new Norwegian Krone, which would initially circulate in parallel with the old currency and have its exchange rate adjusted to pre-war levels.¹² This proposals met with reservations from Hartmann and his advisors: Sticking to a gold standard seemed outdated, the proposal of a dual circulating currency met with rejection from a practical point of view, and especially sticking to the exchange rate at pre-war levels without taking post-war realities into account was also seen as unrealistic and even dangerous. Einar Lie, Professor of Economic History at the University of Oslo, describes this dispute as a clash between the future and the past.¹³ While the Minister of Finance was enthusiastic about Keynes' progressive approaches, the directors of Norges Bank held more conservative economic views reminiscent of the post-World War I reforms. Nevertheless, Keilhau represented Norway, among others, at the Bretton Woods conference and was even eventually influenced by Keynes' ideas during the joint crossing from London to New York with the British delegation.¹⁴

Why Hartmann allowed the economist Keilhau to travel to the Bretton Woods negotiations on behalf of Norway despite all the turbulence is not conclusively clear. Einar Lie, however, points to an unusually detailed "written instruction" from the Ministry of Finance to the Norwegian delegation that was to be followed during the negotiations. It states that the delegation was not to make any statements or proposals that would in any way prejudice decisions about the future monetary system in Norway or diminish the status of Norges Bank in Oslo.¹⁵ Possibly due to staff shortages, Hartmann felt compelled to send Keilhau on the trip to Bretton Woods, but at the same time wanted to keep open the possibility of a post-war Norway according to his own ideas.

All in all, the board of the Norges Bank did not have an easy stance in London. Not only the dualism with the Oslo part of the bank, but also the dispute with the government in exile and the strongly conservative economic thinking caused problems for Keilhau and Ræstad. Einar Lie sees this as the beginning of the loss of Norges Bank's traditionally strong autonomy. He states:

"In 1945, Norges Bank's position was immediately and radically weakened. When in the spring of 1945 the jigsaw pieces were being put in place for a new and genuine division of power between Norges Bank and the transitional post-war government, the fractured and weakened central bank did not participate in any meaningful sense in the negotiations about its own future. The post-war regime left only nominal autonomy to the central bank and handed its traditional levers of power in terms of monetary, currency and credit policy to an assortment of government ministries, in particular the Norwegian Ministry of Finance."¹⁶

After the end of the war, the new monetary and economic system was ultimately set by the post-war Labour government.¹⁷ The Norges Bank had clearly lost prestige and independence due to the involuntary division of its board and the subsequent disputes. In addition to the difficulties mentioned, other factors, such as a general scepticism on the part of the Labour Party towards too much autonomy for central banks, naturally also played a central role. Nevertheless, the fate of the Norges Bank illustrates the potential problems that the exile could hold for a central bank during the Second World War and how these problematics could affect post-war decisions.

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- ¹ National Archives of Norway, RA/S-3946-Norges Bank, Londonarkivet.
- ² Espeli, Harald: Central banks under German rule during World War II: The case of Norway. In: Working papers fra Norges Bank, 02/12, p. 3.
- ³ Letter dated 9th July 1942, National Archives of Norway, S-3946/D/Da/L007.
- ⁴ Espeli, Harald: Central banks under German rule during World War II, p. 15.
- ⁵ Lie, Einar: Norges Bank 1816-2016. Oxford 2020, p. 169.
- ⁶ Letter dated 23 July 1942, National Archives of Norway, S-3946/D/Da/L007.
- ⁷ Ibid.
- ⁸ Lie, Einar: Losing autonomy: the Norwegian central bank during the Second World War. In: The Economic History Review, 72,4 (2019), pp. 1363–1383, p. 1374.
- ⁹ Ibid, p. 1374.
- ¹⁰ Ibid, p. 1375.
- ¹¹ Van Dormael, Armand: Bretton Woods. Birth of a Monetary System. London 1978, p. 7.
- ¹² Lie, Einar: Norges Bank 1816–2016, p. 172.
- ¹³ Lie, Einar: Losing autonomy: the Norwegian central bank during the Second World War, p. 1368.
- ¹⁴ Ibid, p. 1375.
- ¹⁵ Ibid.
- ¹⁶ Ibid, p. 1365.
- ¹⁷ Ibid, p. 1383.