Øystein Olsen: Guardian of the monetary system

Speech by Mr Øystein Olsen, Governor of Norges Bank (Central Bank of Norway), at the official event to mark the bicentenary of Norges Bank, Trondheim, 14 June 2016.

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Your Majesty, President of the Storting, Minister and honoured guests,

Exactly two hundred years ago today, the Act relating to the monetary system of Norway was signed into law by King Karl II of Norway. The Act was an important step in the restoration of Norway as an independent nation.

Two years earlier – at Eidsvoll – Christian Magnus Falsen, a key member of the 1814 Constituent Assembly, had asserted that no state can exist without a well-functioning monetary system. A national currency would be a symbol of Norway's sovereignty and freedom. And to secure independence, the country's economy had to be brought into order. With a monetary system in ruins, this was no easy task.

Norway's governing men – and no doubt Norway's women too – had long been aware that a country without its own bank was at a disadvantage. It was a long way to Copenhagen, where the nearest bank was located. With no easy access to a bank, people had to rely on friends and relatives or business acquaintances instead. Theatres were not only places of entertainment, but important meeting places where deals could be struck and money exchanged. And if the theatregoer was lucky, he might go home with a loan in his pocket.

With the king's signature on 14 June 1816, the foundations of the monetary system were laid. A new currency was issued – the *speciedaler*. And Norway's first bank was founded and named, not surprisingly, Norges Bank. Branches were established in the largest towns, and the Bank's first headquarters was located here in Trondheim, a twelve-day journey from the government in Christiania (now Oslo), and even farther from Stockholm[1]. This provided a geographical distance from king and government, in addition to the more important formal distance.

The people's elected representatives at Eidsvoll had taken responsibility for the monetary system, as stated in Article 75 c of the Constitution: "It devolves upon the Storting […] to supervise the monetary affairs of the Realm". The Storting, the Norwegian parliament, and not the king, would be Norges Bank's employer. The king would no longer have the authority to print money at will. Although bitter memories of the decline of the monetary system during the Napoleonic Wars lay behind this decision, it was also inspired by the ideas of Enlightenment philosophers. Absolute monarchy under the Danish king was to be replaced by the sovereignty of the people and the separation of powers. Institutions with clearly distinguished roles would foster confidence and prevent the arbitrary use of power.

To restore confidence in the monetary system, the promise of a stable monetary value had to be supported by concrete values. There could be no more empty promises. Confidence in the *speciedaler* would be based on a stock of silver in Norges Bank's vault. The promise to ensure that banknotes could be exchanged for the equivalent of their face value in silver was to be honoured.

But the stock of silver had to be procured first. Appeals to raise sufficient funds through share subscription on a voluntary basis were not successful and the government had to resort to coercive measures. Anyone with the means to do so had to contribute to finance the newly established bank. For many Norwegians, the silver tax – as it came to be known – was a

[1] In 1814, Norway entered into a personal union with Sweden under the Swedish king, who reigned from Stockholm.

heavy burden. Years of war and crop failures had set the economy back. 1816 is known as the year without a summer. In many cases, families were forced to relinquish their life savings or beautiful silver ornaments in order to pay the tax. Farmers from the Hallingdal and Valdres valleys marched on Christiania in protest. The finance minister, Count Herman Wedel Jarlsberg, chopped up the family silver himself and threw it onto the scales, with the heirlooms still wet from the tears shed by his wife, Karen, Prime Minister Anker's daughter, so the story goes.

Many years later, the poet Henrik Wergeland put words to the struggle – and the reward – brought by the silver tax. "The spirit of the people", said Wergeland, "demanded and created the bank … in the midst of hardship. It gave them the strength of the tired, who rouse themselves from their rest to soldier on and complete their task, and are rewarded by the sun's benevolent smile."[2]

With the silver tax, many Norwegian citizens involuntarily became shareholders of Norges Bank. However, holding shares in the Bank proved to be a sound investment, for the shareholders and for the country. Confidence in the monetary system was painstakingly restored. The Bank also extended loans to private individuals. Acquaintances or loan sharks were no longer the only sources of credit. The foundations had been laid to enable the economy to grow and to lift living standards.

In 1874, the stock of silver was exchanged for gold. The transition to a gold standard met little opposition. The proposed currency union with Denmark and Sweden, however, was difficult for many Norwegians to accept. Norway's own currency was an important symbol. The general aversion to government officials, who had proposed the union, also weighed heavily in the debate. And under the proposal, the currency itself would be changed. People were used to counting in *speciedaler*, divided into 120 *skilling*. Although the decimal system of *krone* and *øre* was in fact far simpler, many people found it unnecessarily complicated. The proposal fell at the first vote in the Storting.

One Norwegian who expressed pleasure at the apparent rescue of the *speciedaler* was cantor Olafsen from Romsdalen in the west of Norway. He exclaimed: "People here in the rural communities are shocked and astonished to hear that the Norwegian people were within a hair's breadth of losing their currency, after the enormous sacrifices they had made, and being given a new one instead with all the terrible disadvantages and problems that would inevitably have accompanied it …" [3]

The cantor's joy was to be short-lived. Norway joined the Scandinavian Monetary Union only a year later. The *speciedaler* was abandoned and the krone took over. The advantages of being able to use Norwegian money as legal tender in Denmark and Sweden trumped the symbolic value of the *speciedaler*. Looking back, Norway's participation in a monetary union reflected a nation that had become self-assured and that viewed itself as its Scandinavian relatives' equal.

In the 1800s, Norway's economy and monetary system underwent extensive changes. Increased trade and economic progress required a more advanced monetary system. A banking system developed, initially in the form of savings banks that extended credit based on their members' deposits, followed by the emergence of commercial banks. By the end of the 1800s, Norges Bank's role had changed: from being Norway's only bank, it was now the bankers' bank.

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[2] Henrik Wergeland (1834): Speech at Eidsvoll, "Til forfædrenes minde" [In memory of our ancestors], Samlede skrifter [Collected Works], Vol. 2: 1834–37.

[3] Kolbjørn Skaare (1995): Norges mynthistorie [A numismatic history of Norway] (p. 171), Vol 1. Oslo: Universitetsforlaget.

A new Norges Bank Act was adopted in 1892. Norges Bank's district branches lost their right to set the interest rate in their own district – Norway became one interest rate kingdom. And the stock of gold would no longer set an absolute limit on the supply of banknotes. A formal obstacle to the Bank's provision of emergency liquidity to private banks in a crisis had been removed – and, as it turned out, the need for emergency liquidity would soon arise.

A more complex banking system with a growing number of links to the international financial system had set the stage for financial turbulence. Just before the turn of the century, a speculative economy had developed in Christiania. Property prices soared and newly established banks willingly provided loans – often based on short-term foreign credit.

The ensuing crash was to claim many victims. One day in June 1899, a delegation from one of the banks, Discontobanken, marched into Norges Bank with some very bad news: one of the country's largest companies could not meet its payment obligations and Discontobanken was on the verge of collapse. If the bank fell, panic could ensue, triggering a domino effect in the banking system. Norges Bank, under the leadership of Governor Bomhoff, took immediate action to provide liquidity support. Credit was injected into the economy. Norges Bank soon had to take on the additional task of resolving speculative banks while at the same time protecting healthy banks from being caught in the undertow.

Norges Bank was later praised for its approach. During the Storting's deliberations on Norges Bank's activities, the following comment was made: "… Norges Bank had offered immediate support at a moment when it was less important to be the Bank's director and more important to keep a cool head and a warm heart." Norges Bank's heart beat for the monetary system. Cold reason dictated that if the turbulence in the banking system was allowed to spread, the country's economy would suffer a heavy blow.

The year 1905 is regarded as a milestone in Norway's history. But in the history of the monetary system, the year is almost a non-event, although Norges Bank noted some unrest through summer and autumn. There was a risk of war, and as the population braced for what might come, Norwegian banknotes, rather than gold, were in demand. In other words, the Norwegian currency was regarded as safe, reflecting the progress achieved in Norway in the shadow of the union with Sweden. When the union was dissolved, Norway stood on solid foundations with well-developed social institutions. Among these were a central bank of Norway and a monetary system that inspired confidence at home and abroad.

With the German occupation of Norway in 1940, disorder returned to the monetary system. The occupying power needed money and could in practice simply commandeer the banknote printing press to meet its needs. But one thing was not seized – Norway's gold reserves. It is said that a central bank must have foresight, so that it can take action in time and contribute to the stability of the economy. Foresight on a different level was demonstrated by Nicolai Rygg long before the invasion of Norway. Two years earlier, in 1938, Rygg had assigned a secret mission to the 21-year old Ivar Borg. Every morning for several months, the young man was locked into the Bank's vault to pack up the gold reserves. When German troops were approaching Oslo, the gold was ready to be quickly loaded onto pre-requisitioned lorries and, after a dramatic escape, was safely shipped out of the country. The gold reserves gave the government-in-exile in London the financial freedom to pursue its activities.

A central bank safeguards value. Norges Bank no longer guards the nation's gold. The gold was sold long ago. Today, the Bank manages the nation's income from the black gold beneath our seas. This will provide financial freedom of action for future generations.

A well-functioning monetary system with stability in the value of money is still at the core of Norges Bank's public mission, as it has been for the past two hundred years. Inadequate access to reliable means of payment affects trade in goods and services and can cause the economy to stall – now, as then. At the same time, the role of the central bank has evolved over time, requiring it to adapt to a constantly changing stage.

In the early stages of Norges Bank's history, lending to retail customers was an important part of the Bank's public mission. This task has since been transferred to other agents. This is a rational division of responsibility. At the same time, the Bank is true to its role as the bankers' bank, for better and for worse. When bank lending is impaired, the costs to society are considerable. A central bank cannot stand on the sidelines when banks' sources of credit are drying up, and we keep a vigilant eye on financial markets and offer advice on measures we regard as necessary. With the increased complexity of money and financial markets, this task has become more demanding, but also increasingly important.

Issuing banknotes is still the central bank's responsibility. People must be confident that the banknotes they hold in their hands are genuine. Thus, beneath their elaborate exterior lie increasingly advanced security features. Beautifully illustrated banknotes can also function as a calling card for Norway. We are looking forward to launching the new series of banknotes – which all embody the shared theme of "The Sea" – over the next couple of years.

But for a modern central bank, the responsibility for means of payment stretches far beyond banknotes and coins. We can use deposit money to make payments quickly and efficiently – as long as the payment system functions as it should. The core of Norway's electronic payment system is located in Norges Bank. It is a part of the Bank's public mission that is afforded little attention in everyday life. And that is how it should be. When interbank settlement is not something people talk about, we know it is working as it should. The uptime requirement cannot be lower than 100 percent.

Technological advances have not stopped at online banking, card terminals and the forms of contactless payment we are familiar with today. New means of payment are being created and new financial motorways are evolving. But stability and confidence will also be essential elements of future payment systems – not only for the individual user, but also to prevent a collapse of the financial infrastructure. A central hub is still needed to guarantee that the payment system is subject to the necessary control. That hub is the central bank.

Throughout the Bank's two hundred years of history, one of its most important tasks has been to ensure stability in the value of money. The Bank has performed this task with varying success. The pendulum swings back and forth. In some periods, price stability has admittedly been below par. In other periods, the Bank has been criticised for being too "one-eyed". And Norges Bank's room for manoeuvre in terms of keeping inflation in check has also, at times, been limited.

Today, this responsibility has been clearly and unequivocally delegated to Norges Bank. And this time, confidence in the value of money is not based on a quantity of precious metal, but on the Bank's ability to ensure that inflation remains low and stable – confidence that the Bank will keep its promise.

History has shown that it can be appropriate to delegate responsibility for price stability to a central bank, with its long-term perspective – even in times of turbulence. Another of the lessons learned over the past few years is that monetary policy cannot be put on autopilot. As the central bank, we have a responsibility for economic stability. Long-term objectives must often be weighed against short-term gains. Maintaining the balance can be demanding. A former Chair of the Federal Reserve[4] said that the role of the central bank is to order "the punch bowl removed just when the party [is] really warming up". This is a role Norges Bank must be prepared to take on. But not tonight.

The past year has also shown that the Bank can ease the burden in difficult times. Today's key policy rate is the lowest in the Bank's history. When inflation is firmly anchored, monetary

[4] William McChesney Martin, Jr., (1955): Address before the New York Group of the Investment Bankers Association of America.

policy can be used to stimulate output and employment and thereby to some extent facilitate the demanding restructuring facing the Norwegian economy today.

Since the Bank was established in 1816, its position has been regulated through specific legislation. But confidence will always be essential for true central bank independence. That confidence is only on loan. Changing circumstances require the ability to adapt and think differently, and the same applies to central banks. What matters is results, and how they are achieved.

Norges Bank’s first demanding objective – to restore confidence in the monetary system – was achieved and made an important contribution to the success of the nation building process of the 19th century. The Chair of the Bank’s first board of directors, Jacob Fredrik Oxholm, also enjoyed success in other arenas. He was an acclaimed amateur actor – right here in Trondheim.

The institution he directed – Norges Bank – is not looking for acclaim and enthusiastic cheering. The Bank has a more sober objective – to be a useful public institution and a dependable guardian of Norway’s monetary system.

But just tonight, we would not say no to a little applause. And let me wish Norges Bank many happy returns!