Jan F Qvigstad: Writing central bank and monetary history – what are the issues?

Welcome remarks by Mr Jan F Qvigstad, Deputy Governor of Norges Bank (Central Bank of Norway), at a workshop co-organised by The Graduate Institute, Geneva and Norges Bank, Oslo, 30 October 2008.

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Dear participants,

It is a great pleasure for me to welcome all of you to the first workshop in Norges Bank's Bicentenary Project. In particular I want to express a warm welcome to those of you who have travelled far. Norges Bank and the Graduate Institute here in Geneva are privileged to host a workshop with such a distinguished group of international experts in central bank and monetary history from academic institutions and from the central bank community all over Europe and from the US.

The financial crisis that was unleashed in the US more than a year ago went into uncharted waters on 15 September this year. Since then G7, IMF and governments all over the world have taken active policy measures that hopefully will steer the financial world into smoother water, although the real economy probably will be in dire straits the next year or two. It might seem strange, and a bit of an intellectual escapism in this situation, to gather here in Geneva to discuss economics in a hundred year perspective. However, while it may be necessary to take active policy measures in the short run to solve the crisis, it is equally important to learn from historical lessons of the past so we can be better prepared for the future.

Why are we here? Why has Norges Bank taken the initiative to this workshop? To answer this we have to turn the clock back to the time of the birth of Norges Bank right after the end of the Napoleonic wars in Europe. Six laws about the Norwegian monetary system, passed by the Norwegian Parliament in 1816, paved the way for the establishment of Norges Bank. The Norwegian Constitution of 17 May 1814 specified that the Parliament should oversee the monetary system but made no explicit reference to a central bank. The Constitution was modified in November 1814 after Sweden showed some military muscle to enforce the Treaty of Kiel. The revised Constitution was in place on 4 November 1814, and the main changes reflected the fact that Norway had entered a loose union with Sweden under a common King. A change, often overlooked, was that a new paragraph had been added which explicitly stated that Norway should keep its own bank and monetary system. Hence the Norwegian Parliament preserved an independent legal authority to decide on Norway's monetary system and institutions under the union with Sweden.

Norges Bank is thus celebrating its 200-year anniversary in 2016 and has announced ambitious targets for its Bicentenary Project. In 2016 we want to see that this project has produced three high quality books on The History of Norges Bank 1816-2016, The Monetary History of Norway 1816-2016 and on selected Topics in Central Banking in an international historical perspective.

The aim of the workshop is to bring together international experts from central banks and academia for informal discussions and an exchange on topics related to the writing of central bank and monetary history. We expect discussions to be active and lively and we want this workshop to kick-start research activities in these important areas. I want to thank the Graduate Institute here in Geneva and Professor Marc Flandreau in particular for their hospitality and for allowing us to spend almost two days discussing research in central bank and monetary history.

Previous books about the history of Norges Bank have been written in Norwegian, and predominantly by previous central bank governors. But "the times they are a-changin", to phrase Bob Dylan (Dylan, 1964),[1] and today we believe that best practice in writing central bank and monetary history is achieved by contributions from professional academic experts in relevant areas. The research should be brought up to international quality standards through the usual peer review process. And, once it is recognized that there is only one central bank in each country, it is also clear that a strong international perspective on central bank history and monetary history is needed in order to trace the origin of ideas and how monetary policy views and practices have developed over time as well as across different countries.

The key responsibilities of central banks are to promote price stability and financial stability. This fall, policy makers around the world have struggled to implement policy measures to bring the international financial markets back into a more normal mode of operation. In this pursuit we are constantly reminded of the importance of having a solid understanding of economic history and developments as a backdrop to designing the right policy for the current situation.

This fall, international experts like you are in greater demand than ever to help bring about this level of understanding, and many of you appear frequently in debates on these issues in policy workshops and conferences as well as in the media. Against this backdrop we see this workshop as one of many arenas where policy makers and academic experts can exchange ideas and views on what has been characterized as the most serious financial crisis since the Great Depression in the 1930s.

The escalation of the financial crisis on 15 September was a consequence of an abrupt loss of confidence and credibility in the financial markets. The banks' trust in other banks dropped to a level where interbank lending almost came to a complete halt. Confidence and credibility is the core in money and finance. What good is a 100 dollar note if there is no trust in its worth to buy 100 dollars of goods and service.

When confidence and credibility have been destroyed it may take a long time before they are restored. An example from Norwegian monetary history illustrates this. The example is from the time of the birth of Norges Bank. The successful establishment of Norges Bank in 1816 played a key role in stabilizing the external value of the Norwegian currency after the chaos following the Napoleonic wars in Europe. The previous joint currency with Denmark had collapsed and two attempts to restore the currency based on broad guarantees had failed, first from the Danish government in 1813 and second from the hastily called Constitutional Assembly in 1814.

The successful restoration of credibility in the Norwegian currency was finally brought about by the establishment of Norges Bank, but it took a long time. Norges Bank was in full operation already in 1818, but since the Parliament postponed the decision to reintroduce silver convertibility, the value of the notes continued to fall until the Parliament changed its strategy in 1822. In this year a course to reintroduce silver convertibility was set. Convertibility was introduced, first at poor (low) rates far from silver parity, but as confidence improved the convertibility rate was gradually moved closer to parity. This process took painstakingly long and it was not until 1842 that full convertibility at par values against silver was reintroduced after 85 years with a paper money standard. From the time when the strategy was laid in 1822 it took more than 20 years to build enough credibility to sustain full convertibility even after Norges Bank had been successfully established.

During the first century of its operations Norges Bank exercised a high degree of independence from the central government and built a reputation of credibility and confidence in defending first silver convertibility and thereafter gold convertibility. During the heydays of the classic gold standard in the four decades preceding WWI, recent research on

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[1] Dylan, Bob (1964), *The times they are a-changin*, Columbia studios.

monetary policy (Øksendal, 2008)[2] finds that credibility and confidence allowed Norges Bank more room for discretion than has previously been acknowledged. This room for discretion was used to take domestic considerations into account. This extra room for manoeuvring, however, was only available to the bank as long as its commitment to defend the gold standard was not called into question. Was this a preview of today's modern inflation targeting regime? As long as inflation expectations are well anchored, more weight can be given to developments in the real economy.

The independence of Norges Bank was de facto substantially reduced after WWII. The legitimacy of the bank and confidence in the bank had been seriously undermined during the interwar period and during WWII. The government tried on several occasions in the first decade after WWII to turn Norges Bank into a subordinated agency. If the history of Norges Bank was written in a vacuum with no international references, one might have thought that this was unique for Norway. Not so, similar developments were observed in many countries who previously subscribed to the gold standard. Political control over central banks was tightened in many countries with one notable exception, the Bundesbank in West Germany which was established as the most independent central bank in the post-WWII period (Sejersted, 1994).[3] Norges Bank was in fact not as dependent as believed. The truth may lie somewhere in between. Recent research on the role of Norges Bank during the first decade after WWII (Ecklund, 2008)[4] suggests that Norges Bank maintained a relatively high degree of operational independence in this period.

Norges Bank's independence was gradually restored. In 1986 Norges Bank was granted instrument autonomy and started to set short-term interest rates to sustain the prevailing fixed exchange rate regime. The current inflation targeting regime was introduced in March 2001 and Norges Bank now sets short-term interest rates aimed at keeping inflation around 2.5% over time. Greater independence demands adequate accountability. Along with greater degree of autonomy and independence Norges Bank has become more open and transparent in its monetary policy communication. Increased openness by Norges Bank is not only a way of achieving accountability to its constituents, but is also instrumental to enhance policy effectiveness. This stands in stark contrast with the mystique and opaqueness which characterized earlier central bank communication.

For a long time central banks have focused predominantly on their interest rate policy. Considerably less attention has been devoted to their liquidity policy which used to be carried out somewhere in the basement of the monetary policy temple, far away from the spotlight of the announcement of interest rate decisions. This year, liquidity policy has moved into the spotlight and has taken over the lead role at the forefront of the monetary policy scene. The current situation also highlights the close interaction between price stability and financial stability and that the focus of policy makers today is on crisis management. The challenge in the coming months and year is to pursue a dual approach consisting of short-term action and long-term solutions. We must constantly be on the alert to put out fires when and where they emerge, while studying the causes of the current crisis and finding the right long-term remedies in the form of new rules and systems so that we do not repeat the same mistakes. As the French saying goes, there is no point in putting a band-aid on a wooden leg.

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2 Ecklund, Gunhild (2008), *Creating a new role for an old central bank: The Bank of Norway 1945-1954*, Series of Dissertations No. 2-2008, BI Norwegian School of Management.

3 Sejersted, Francis (1994), *On the so-called "autonomy" or "independence" of central banks. Reflections on the Norwegian case of minimal formal authority*, TMV Working paper No. 75, Oslo: Center for Technology and Culture (TMV).

4 Øksendal, Lars Fredrik (2008), *Essays in Norwegian monetary history, 1869-1914*, PhD-dissertation, Norwegian School of Economics and Business Administration.