

Norwegian Policy Response to the International Economic Disintegration During the Inter-War Years

December 12, 2002

Discussion Paper 23/02

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Introduction

This work focuses on the disintegration of the world economy during the inter-war period and examines its effects on the Norwegian economic policies compared to other small European countries. Two very different patterns occur. In the 1920s several western European countries aimed their policy at restoring the pre-war economic regime. More precisely their goal was to re-establish a liberal economic order, viz. free trade, fair competition and the gold standard at par value. This type of policy was pursued by the United Kingdom, the Netherlands, Switzerland, Denmark, Sweden and Norway. In the 1930s most countries responded to the international economic disintegration by an inward-looking focus aimed at protecting their own industries, labour market, and current account balance. A major feature was the monetary reactions. After Britain suspended gold redemption on September 20th/21st 1931 several countries followed, dropping gold in favour of a floating currency. Protectionism, cartellisation and subsidies were other new instruments introduced in order to defend the domestic industries of most West European countries.

In 1920, Norway was a small open economy. In the following decade the Norwegian government, parliament and central bank fought to retain the pre-war system of a liberal economic order. In the 1930s this line was partly given up. Gold was suspended by the end of September 1931, and measures were taken to protect domestic industries, labour markets, and the current account balance.

In the 1930s a regime of moderate protectionism was introduced. The new order resembled a return to the mercantilistic system that prevailed till the 1840s, a century earlier. The new protectionism included both qualitative and quantitative measures. Import tariffs were reintroduced or raised. Even the old mercantilistic element of import quotas was reborn. The reintroduction of protectionism had mainly two purposes. Firstly, as an answer to foreign protectionism, the government sought to defend its home markets for its domestic industries. In particular the authorities protected agriculture and significant manufacturing industries, both facing severe competition from abroad. Secondly, the authorities sought to protect its exchange reserves. Despite this new orientation, one should bear in mind that Norway was still under a more liberal trade order than most countries in the Western world in the 1930s.

Cartellisation was also positively encouraged. It was an attempt to protect the supply side from over-production with its inevitable drop in prices and profits. A

negative consequence of this policy was the consumers' loss, as prices were kept "artificially" high. In addition to cartellisation subsidies were introduced in order to support some industries, in particular agriculture.

A semi-public campaign was also set on foot. The slogan was "Buy Norwegian". The aim was to stimulate the sale of Norwegian products in the domestic market and thus reduce the effect of economic slump among workers and producers.

In opposition Labour had initially agitated for inflationary fiscal policies. However, after having gained governmental power in 1935, they abstained from pursuing budget deficit expansion.

The deflationary monetary policy of the 1920s to restore, and after May 1928, to protect the pre-war gold parities, was given up in the early 1930s. Norway left gold, and a more successful inflationary monetary policy was conducted by the central bank. This change in monetary policy had two major effects. Domestic demand increased. Thus, production rose, and unemployment fell. Also, the depreciation of the krone made Norwegian industry more competitive against countries that still adhered to gold. Norwegian products became affordable abroad. They were also cheaper than foreign goods in the Norwegian domestic markets. Accordingly, a significant increase in both exports and imports substitution took place. Thus, a new monetary policy enabled Norway to recovery from the great depression quite rapidly.

Most measures against the crisis were introduced around 1930. The bulk of these became permanent, later even extended. On this basis, the paper argues that the shift from a mainly liberal economic regime to a mixed regulatory regime started around 1930. This is contrary to the conventional view, which holds that the turn around started in 1935, when Labour came into office.

Disintegration of the inter-war economy

The inter-war economy can best be characterised by its fluctuations between crises and spurts of growth. The international economy saw two major crises. The first, the post-war depression, was in the early 1920s. The second, The Great Depression, was in the first half of the 1930s. Both were characterised by steep falls in production and prices. The crisis of the 1930s was also accompanied by mass unemployment. In consequence of the collapse of the stock market on Wall Street from October 1929 onwards, American banks experienced heavy losses. In consequence, American private banks could no longer offer short-term credits to Germany and Austria. Thus,

Germany and Austria could not meet their obligations. International liquidity shrunk rapidly.

On the international arena the national governments met the crisis of the 1930s by various protectionistic measures. The first measures were in fact tried out already in the 1920s, when in particular the USA and France, despite significant trade surpluses and under-valued currencies, decided to increase their tariffs. In the 1930s all Western powers to some extent adopted some kind of protectionism. International trade fell rapidly.

The lack of international liquidity, the collapse of the gold standard, the reintroduction of protectionism and the rapid drop in international trade represent the disintegration or de-globalisation of the 1930s. This trend was not reversed until the post-World War II period. The collapse of the world economy forced the governments to embrace protectionism. In turn, international trade fell even more. This process of disintegration and de-globalisation is reflected in the work of Hein Klemann, Olle Krantz and Ivan Jakubec. On the other hand, in Margrit Müller's survey of the Swiss case, we note that Switzerland followed another course. In several areas they met the problems of the inter-war period by internationalisation of several industries. The Swiss case reminds us of the fact that there were significant differences in policy choice among European countries.

The Norwegian inter-war economy

In Norway the economy suffered three major setbacks during the twenty years between the world wars. The first, in the early 1920s, was due to the international post-war depression. However, it was amplified by the introduction of deflationary monetary policies aimed at restoring the pre-war gold parity of the Norwegian currency, the krone.¹ This recession hit Norway harder than most other countries, and GDP per capita fell by 11.1 per cent 1920-1921.² The fall in total production in the

¹ Knutsen, Sverre and Gunnhild Ecklund, *Vern mot kriser? Norsk finanstilsyn gjennom 100 år*, Fagbokforlaget, Bergen 2000, pp. 121-131 argue that the emphasis on deflationary monetary policy in Norway in the early 1920s has been exaggerated.

² NOS XII. 163, *National Accounts 1865-1960*, Statistics Norway, Oslo 1968, table 51, pp. 350-351.

United Kingdom and Sweden, our two most important trading partners at the time, was even bigger.³

A new recession hit the Norwegian economy in the middle of the 1920s. This second slump is basically explained by the persistent deflationary policy, and reflected domestic rather than international problems. GDP did not fall significantly. However, investments did, and unemployment reached peak levels.⁴ Denmark, and to some extent Britain that pursued a similar stubborn monetary policy, also experienced a slump in the mid-1920s.⁵ The two major setbacks in the 1920s resulted in high unemployment during most of that decade.

The third serious downturn came in the early 1930s, basically in consequence of the international depression. Norwegian GDP per capita fell by 8,4 per cent in 1931.⁶ This huge decline, however, was partly due to a massive labour conflict with lockouts and strikes that year. According to studies carried out by Professor Jan Tore Klovland, the "natural" trough during the depression can be dated to the last months of 1932, a few months later than most of Norway's foremost trading partners.⁷ At the same time unemployment reached peak levels. In 1933 one third of the insured labour union members were laid off. The peak rate of unemployment across the entire labour force was around eleven per cent that year. During the worst winter months 1932-1933 it probably touched 15 per cent.⁸ Also internationally unemployment met its peak level around 1933. This is noted by Anne-Lise Head König in her article on the labour markets during globalisation and disintegration 1880-1939 published in the present volume.

In the remaining years of the inter-war period significant economic growth took place. This was partly due to the adjustment introduced in response to the

³ Maddison, Angus, *Monitoring the World Economy 1820-1992*, OECD, Paris 1995, pp. 180-183 and 194-197.

⁴ Grytten, Ola Honningdal, "The Scale of Norwegian Interwar Unemployment in International Perspective", *Scandinavian Economic History Review*, No. 2, 1995, pp. 226-250.

⁵ Maddison, Angus, *op. cit.*, pp. 194-197.

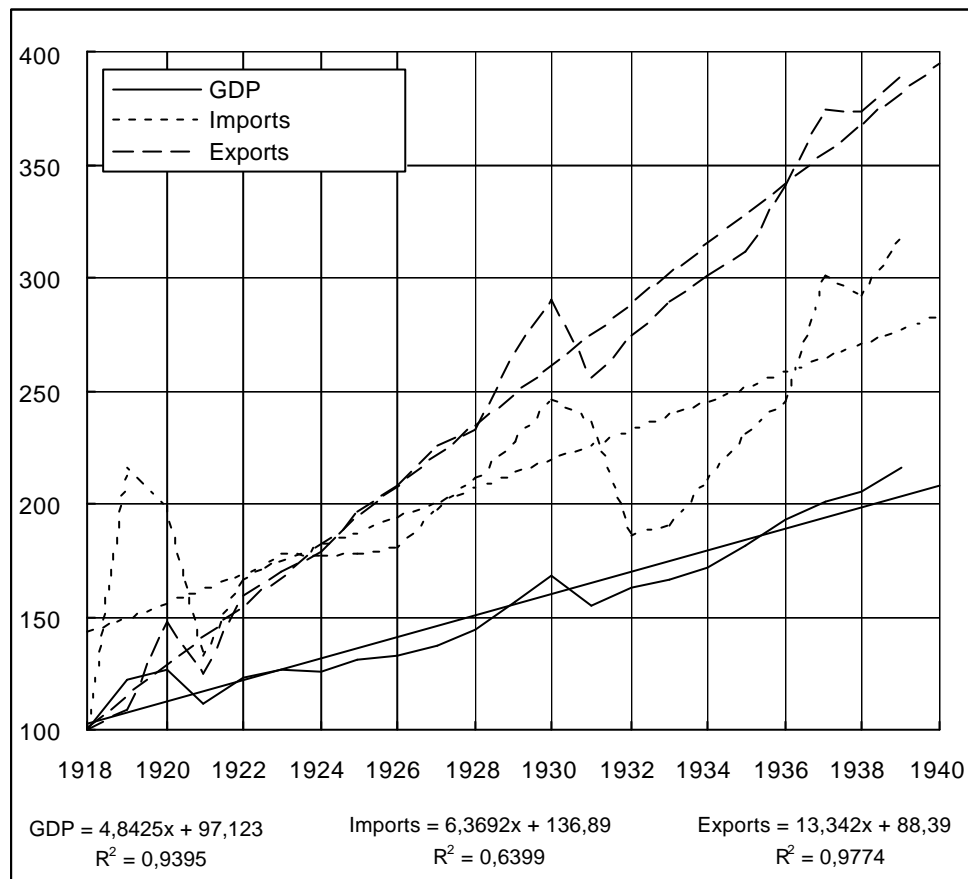
⁶ NOS XII. 163, *op. cit.*, table 51, pp. 350-351.

⁷ Klovland, Jan Tore, "Monetary policy and business cycles in the interwar years: The Scandinavian experience", *European Review of Economic History*, No. 2, 1998, pp. 309-344.

⁸ Grytten, Ola Honningdal and Camilla Brautaset, "Family Households and Unemployment in Norway during Years of Crises. New Estimates", *The History of The Family*, No. 1, 2000, pp. 36-37.

depressions. However, national accounts reveal that significant growth took place in the inter-war period as a whole. In Norway the annual rate of growth in GDP per capita was 2.2 per cent, 1919-1939.⁹ Prices fell almost constantly from the autumn of 1920 to 1934, and were reduced by about 50 per cent according to the consumer price index.¹⁰ Thus, the setbacks in the inter-war period certainly deserve to be titled depressions.

Chart 1. GDP, exports and imports for Norway 1918-1939 (1918=100).



Source, NOS XII. 163, *National Accounts 1865-1960*, table 51, pp. 350-351.

Following the disintegration of the international economy, the exports- and imports sectors suffered. Yet, despite years of serious setbacks, in terms of volumes the Norwegian export sector gained ground during the inter-war years. National account series for Norway report that annual growth in exports was 6.6 per cent in 1938-

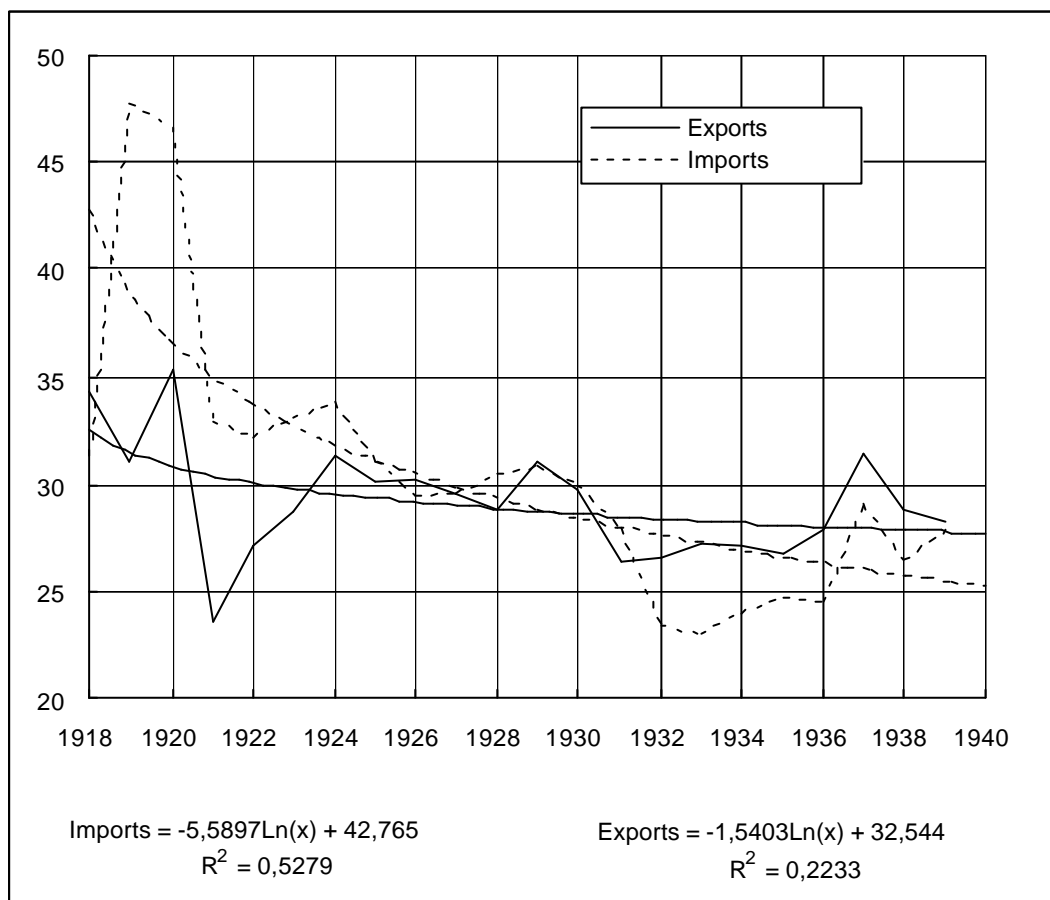
⁹ NOS XI. 143, *National Accounts 1900-1929*, Statistics Norway, Oslo 1953, table 14, pp. 128-129.

¹⁰ Printout of Statistics Norway's consumer price index (CPI) 1901-2000, Statistics Norway, Oslo 2001.

prices. The corresponding rate for imports was only 1.9 per cent.¹¹ However, the value of the volume figures is limited. Terms of trade fell, since import prices rose compared to export prices. At the same time prices on international goods fell relative to domestic prices.

Current figures offer a better picture of the importance of foreign trade in this matter.¹² It is clear from chart 2 that both exports and imports lost ground. The disintegration of the international economy obviously had a negative effect on Norwegian foreign trade.

Chart 2. Foreign trade in per cent of GDP for Norway 1915-1939.



Source, NOS XII. 163, *National Accounts 1865-1960*, table 50, pp. 346-347.

The Norwegian policy response in the 1920s

Like many Western governments, the Norwegian government responded to the crises in the 1920s by attempts to restore the institutional framework of the pre-World War I

¹¹ NOS XII. 163, *op. cit.*, table 51, p. 350-351.

¹² *Ibid*, table 50, pp. 346-347.

period, with a liberal trade order based on an international gold standard. The most visible action was the restoration of the old monetary system taken by several countries. For small, open economies, like the Norwegian, it was natural to follow the example of their most important trading partners. These were first and foremost the United Kingdom, and secondly Germany, and the neighbouring countries Sweden and Denmark.¹³ Norway followed the course taken by the United Kingdom, and so did Sweden and Denmark. With the exception of Finland, the Scandinavian countries pursued very similar economic policies both in the 1920s and in the 1930s, and, as we shall see, they were closely related to the British economic policy in the period.

Also Switzerland and the Netherlands chose to restore their pre-war gold parities. One aim was to regain confidence for their currencies and keep the financial markets open. This was particularly the case in Switzerland, as can be seen in Patrick Halbeisen's article published in this volume.

Monetary policy in the 1920s

Inflationary monetary policy in the period 1914-1920 and limited access to imported goods 1914-1918 fuelled inflation and currency depreciation in Europe. Table 1 reports inflation and currency depreciation in several Western countries 1914-1920.

In practice, the European countries followed three different paths in respect of monetary regimes and monetary policies in the 1920s. Most countries were unable to restore the pre-war parities. Some of these chose devaluation of their currencies, e.g. France, Italy, Belgium and Finland. Other countries chose to introduce new currencies, e.g. Germany, Poland, Austria, Hungary and the Soviet Union. The third alternative was to restore the old gold parities, as seen in the United Kingdom, the Netherlands, Switzerland, Sweden, Denmark and Norway. Of these latter countries Denmark and Norway had the longest way to go. In the case of Norway, the krone had depreciated more than 50 per cent from August 1914 to November 1920.¹⁴

¹³ Schön, Lennart, *En modern svensk ekonomisk historia: tillväxt och omvandling under två sekel*, SNS, Stockholm 2000, Johansen, Hans Christian, *The Danish Economy in the Twentieth Century*, Croom Helm, London and Sydney 1987, pp. 12-46 and Hodne, Fritz, *The Norwegian Economy 1920-1980*, Croom Helm and St. Martin's, London, Canberra, and New York 1983, pp. 12-99.

¹⁴ Bank of Norway, *Annual Report 1924*, Oslo 1925, p. 48.

Table 1. Inflation and exchange rates 1913-1920.

	Consumer prices (1914=100)	Whole-sale prices (1913=100)	Exchange rate (Par=100)
Germany	989	1485	5.5
Finland	911	-	11.5
Belgium	459	-	33.0
France	341	509	31.1
Italy	313	624	18.7
Norway	302	377	49.9
Sweden	270	347	71.5
Denmark	262	374	50.0
Switzerland	253	-	80.6
United Kingdom	252	283	70.4
Japan	223	268	101.9
USA	206	243	100.0
The Netherlands	210	281	75.1
Canada	190	246	89.1

Source, NOS, *Statistical Yearbook for Norway 1921*, pp. 281-284.

To obtain this goal a deflationary policy was introduced. The first measures were taken by the central bank during the autumn of 1920. Granting of new credits was restricted and the central bank's interest rates were increased. Arguably, the increase in interest rates was marginal, only one per cent. However, the measures were carried out at the same time as the international depression with rapid deflation hit the economy. Thus, real interest rates rose dramatically, from – 30 per cent pre-tax in 1916 and 1917 to + 30 per cent in 1921, and almost + 40 per cent in 1922.¹⁵

The post-war setback basically had three effects on the economy. In the first place, restricted credits and higher real interest rates caused a contraction in the money stock. This contraction was followed by reduced product demand, and thus, lower production, lower demand for labour and an increase in unemployment. Secondly, appreciation of the Norwegian krone from November 1920 through January 1921, and from October 1921 through November 1922, raised the price of Norwegian products in international markets. Thus, *cet. par.* demand for Norwegian products fell, so did production, whereas unemployment increased. Thirdly, significant deflation in the early 1920s made credits more expensive. This happened in two ways: real interest rates increased, and the real value of debts increased. As a result, a number of firms went bankrupt, and the banking sector took heavy losses. Both in 1923 and in

¹⁵ Grytten, Ola Honningdal, "Monetary Policy and Restructuring of the Norwegian Economy During Years of Crises, 1920-1939", Myllyntaus, Timo (ed.), *Economic Crises and Restructuring in History*, Scripta Mercaturae, St. Katharinen 1998, p. 112.

1925 Norwegian bank losses amounted to seven per cent of domestic GDP. More than a hundred Norwegian banks, about half of the existing commercial banks, went into liquidation during the 1920s.¹⁶

Economic crises, heavy bank-losses and mass unemployment forced the central bank to call a halt to the deflationary policy in 1923 and 1924. At that time the international post-war depression had also come to an end. Thus, the international business cycle pointed upwards. As a result of the pause in the deflationary monetary the krone depreciated from 70 to 50 per cent of its par value. A trade surplus was finally achieved in 1926. In turn, the krone started to appreciate in accordance with the trade surplus. The director of the Central Bank, Nicolai Rygg now grabbed the opportunity to resume a deflationary monetary policy.¹⁷ In 1926 a governmental commission proposed a formal devaluation of the krone by 25 per cent to the gold value. The suggestion, however, was approved neither by the government nor by the central bank. The healthy foreign trade and the continuance of a deflationary monetary policy, made speculation in Norwegian money attractive. In a remarkably short time the krone rose to par.¹⁸ In October 1926 it reached 95 per cent of par value. Finally, on the first of May 1928 gold redemption at par value was restored.¹⁹

A consequence of this second phase of deflationary policy was the onset of another slump. GDP however, only fell modestly. Investments and manufacturing output, dropped significantly, and unemployment reached peak levels.

Prices fell dramatically during the times of deflationary policy. Wages, on the other hand were sticky and not brought down to the same degree. Thus, real wages, and in particular product wages, i.e. nominal wages deflated by production costs, increased dramatically. In manufacturing they were almost four times higher in 1932 than in 1917. Labour intensive production became too costly, and declined. Capital-

¹⁶ Knutsen, Sverre, Even Lange, and Helge W. Nordvik, *Mellom næringsliv og politikk. Kredittkassen i vekst og kriser 1918-1998*, Universitetsforlaget, Oslo 1998, pp. 11-42.

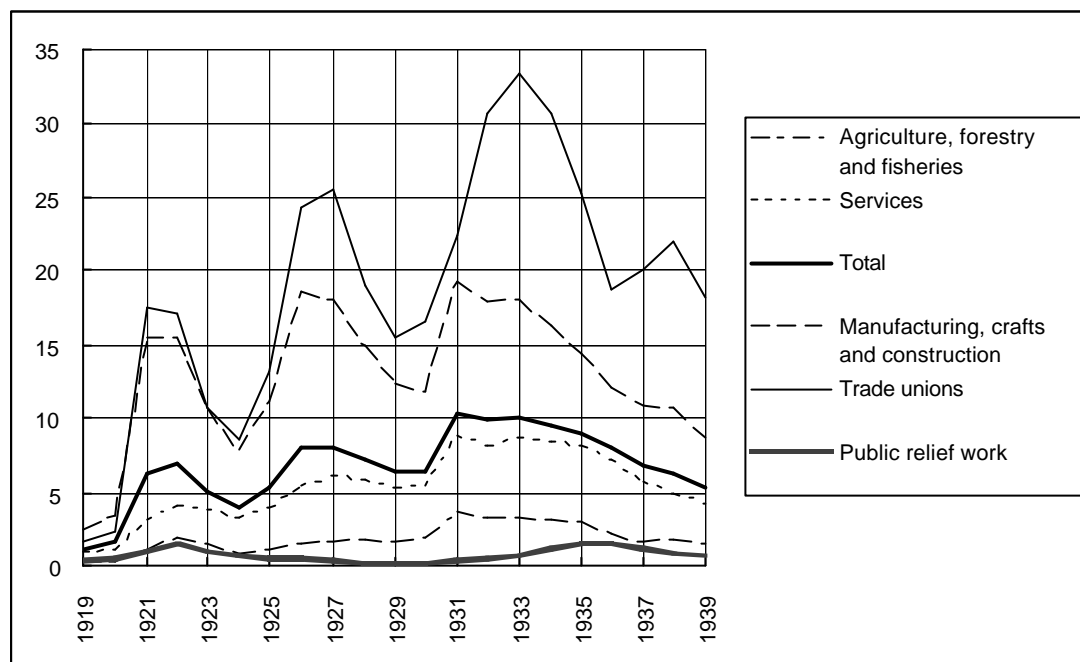
¹⁷ Hanisch, Tore Jørgen, "Om virkninger av paripolitikken", *Historisk tidsskrift*, No. 3, 1979, pp. 244-247.

¹⁸ Hanisch, Tore Jørgen, Espen Søylen, and Gunhild Ecklund, *Norsk økonomisk politikk i det 20. århundre. Verdivalg i en åpen økonomi*, Høyskoleforlaget, Kristiansand 1999, pp. 68-85.

¹⁹ Bank of Norway, *Annual Report 1927*, Oslo 1928, p. 45 and Keilhau, Wilhelm, *Den norske pengehistorie*, Aschehoug, Oslo 1952, pp. 158-199.

intensive production, however, increased in the 1920s.²⁰ Thus, the policy of "back to normal" in answer to the disintegration of the world economy resulted in mass unemployment. (Chart 3).

Chart 3. Unemployment in per cent of labour force.



Source, Grytten, Ola Honningdal, *An Empirical Analysis of the Norwegian Labour Market*, table 9.1, pp. 177-178.

International comparisons of the 1920s confirm that countries that pursued a deflationary policy were under-achievers in the fields of investments and production. They also had higher unemployment than those that adopted more inflationary policies.²¹ This view is corroborated in Patrick Halbeisen's article in this volume on monetary policy and international capital flows.

²⁰ Grytten, Ola Honningdal, *An Empirical Analysis of the Norwegian Labour Market, 1918-1939: Norwegian Interwar Unemployment in International Perspective*, Norwegian School of Economics and Business Administration, Bergen 1994, pp. 239-260.

²¹ Eichengreen, Barry, "Understanding 1921-1927: inflation and economic recovery in the 1920s", Eichengreen, Barry (ed.), *Elusive Stability. Essays in the History of International Finance*, Cambridge University Press, Cambridge NY 1990, pp. 24-56 and Grytten, Ola Honningdal, "Monetary Policy and Restructuring of the Norwegian Economy During Years of Crises, 1920-1939", pp. 93-124.

Competition laws

Another tool in the hands of the political authorities was the price, trust and cartel regulations. The new *Price Act* passed Parliament in 1920, the *Unfair Competition Act* in 1922, the *Act Controlling Trade Practices in Restraint of Trade*, commonly called the *Trust Law*, in 1926. When the ideas of these acts first were conceived the aim was to secure free competition and free market prices. The Trust Law was meant to be an anti-trust law. The act provided for a permanent trust control board, an executive director and a secretariat. Mr. Wilhelm Thagaard was appointed its first director. He held the position until 1960.²²

The political reactions to these laws differed significantly, and it was impossible to achieve a majority for any stand. Thus, the final law texts became quite general, and fell victims of their keepers' interpretations. Thagaard took the view that market regulations were necessary to overcome the problem of over-production and falling prices. He argued that public price control boards might replace competition. When the price authorities found competition negative, firms could be forced into trustification. By 1928 the number of cartels in Norway exceeded 100. By 1960 they exceeded 500.²³

The political authorities also had other tools to protect markets from overproduction, falling prices and bankruptcy. In the 1920s steps were taken to regulate both fisheries and agriculture. The measures were taken partly by the organisations representing the two industries and partly by the government and Parliament. However, these steps lacked efficiency. One important reason for lack of success was the problem of dealing with free riders. Thus, policy tools needed to be improved. That was basically carried through in the 1930s. In addition to the measures introduced in the 1920s, new and more powerful market regulations were brought into play in the last decade before the Great War.

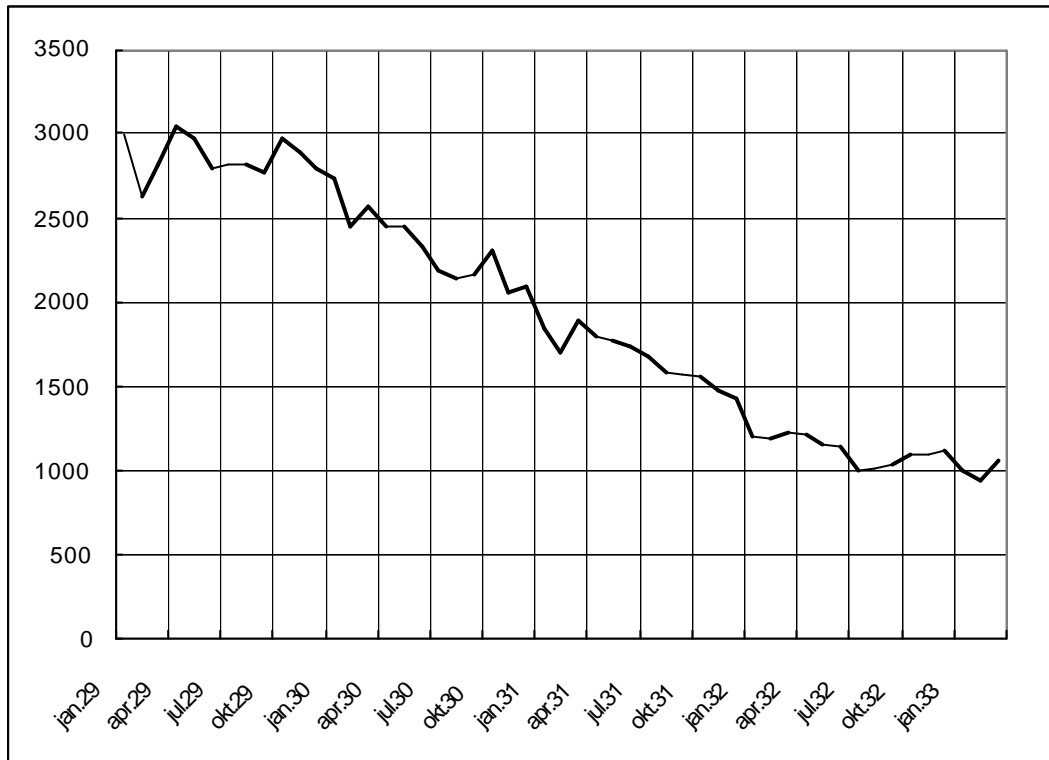
The Norwegian policy response in the 1930s

During the depression in the 1930s a serious breakdown in international relations took place. The monetary system failed, and the gold standard was in reality abandoned by almost every country by World War II. The rapid disintegration process is mirrored

²² Hanisch, Tore Jørgen et al, *op. cit.*, pp. 118-124.

in the fact that international trade diminished in the early 1930s, and barely regained pre-World War I levels before World War II.²⁴ (Chart 4).

Chart 4. Imports of 75 countries January 1929-March 1933 in million US gold dollars.



Source, League of Nations, *Monthly Bulletin of Statistics*, February 1934, p. 51.

The break down of international trade in the 1930s is also analysed in Hein Klemann's article in the present volume on international political development and international trade. The decade also saw a return to widespread protectionism, in the form of quantitative and qualitative measures aimed at reducing imports. To protect the interests of producers and employees, domestic and international cartels rapidly increased in number and size.²⁵ Again, the small open economies followed the great

²³ Hodne, Fritz, *op. cit.*, pp. 70-82.

²⁴ Kindleberger, Charles P., *The World in Depression 1929-1939*, Penguin Books, London 1987, p. 170 and League of Nations, *Monthly Bulletin of Statistics*, February 1934, p. 51.

²⁵ Kindleberger, Charles P., "Commercial policy between the wars", Matias, Peter and Sidney Pollard (eds.), *The Industrial Economies: The Development of Economic and Social Policies*, The Cambridge Economic History of Europe, Vol III, Cambridge University Press, Cambridge 1989, pp. 161-196.

powers. As for the Scandinavian countries, they followed Britain.²⁶ However, due to their dependence on foreign markets, and fear of retaliation, the small and open economies practiced a cautious protectionism.²⁷

Writers on the history of Norwegian economic policy claim that a change of economic policy regime took place *after* the great depression of the 1930s. More precisely the shift is often dated from 1935 onwards, the same year as the Labour Party came to office.²⁸ However, they admit, the shift was rather one of economic thought than one of actual policy. According to the conventional view a permanent shift in politics came *after* the war. This paper argues that a real change started during the depression years, more precisely around 1930. This shift did not in its original form represent a reorientation towards Keynesian fiscal policy, but a change towards government interference in the markets. The Keynesian revolution did not influence Norwegian economic policies until the post World War II era. And even at that stage classical Keynesian policy was not adopted, as the socialist government in Norway pursued a planning system more detailed than elsewhere, with direct interference in the market economy.²⁹ In addition several bi-lateral trade and payment agreements were set up, were Norway took part in an active manner.³⁰

Protectionism

As a small, open economy Norway did not profit from an international return to protectionism. To protect domestic industries and the exchange reserves, however, Norwegian customs tariffs were set up. In 1933 the average tariff on imported goods

²⁶ Kitson, Michael and Solomos Solomou, *Protectionism and economic revival: The British interwar economy*, Cambridge University Press, Cambridge 1990 and Cappie, Forrest, *Depression and Protectionism: Britain between the Wars*, Allen and Unwin, London 1983.

²⁷ Nordvik, Helge W., "Europeisk handelspolitikk i historisk lys: Proteksjonisme og frihandel gjennom 200 år", Norman, Victor D. (ed.), *Europa - forskning om økonomisk integrasjon*, SNF, Bergen 1995, pp. 37-40.

²⁸ Tore Jørgen Hanisch, Espen Sjøilen and Gunhild Ecklund argue that the period 1930-1950 constitutes a transition period from liberal economic order to a planning economic order in Norway. Hanisch, Tore Jørgen et al., *op. cit.*, pp. 91-94.

²⁹ Sjøilen, Espen, *Fra frischianisme til keynesianisme? En studie av norsk økonomisk politikk i lys av økonomisk teori 1945-1980*, Norwegian School of Economics and Business Administration, Bergen 1999.

³⁰ Hodne, Fritz og Ola Honningdal Grytten, *Norsk økonomi i det 20. århundre*, Fagbokforlaget, Bergen, pp. 166-168.

was 16 per cent, against ten per cent in 1929.³¹ Despite an increase of 60 per cent in three years, compared to other Western countries Norway together with the two other small Scandinavian states, Denmark and Sweden still maintained relatively low tariffs in the 1930s. (Table 2).

Table 2. Custom tariffs in per cent of import values.

	1929	1933/1934	1933/1934 in per cent of 1929
Finland	19	33	174
United Kingdom	12	30	250
Spain	18	29	161
Italy	11	26	236
Germany	8	25	313
USA	13	19	146
Norway	10	16	160
France	7	15	214
Sweden	9	10	111
Denmark	6	8	133

Source, Anstrin, H., "Handelspolitikens avvägar och Nordens utrikeshandel", p. 21.

The Norwegian tariffs fluctuated significantly for different kinds of goods. For traditional manufacturing goods they had been 18.3 per cent as early as 1930. They increased to 23.5 per cent in 1932 and to 24.8 per cent in 1937. For furniture, however, they were 7.8 per cent in 1930, 9.4 per cent in 1931, and were then reduced to 5.2 per cent in 1937.³² Despite this fact, modern Norwegian furniture industry was a success in the 1930s.

In addition to the increase in tariffs on several import goods, import quotas were set up for some products that could be replaced by domestically produced goods. However, these quotas were low, and it is not clear whether they had any impact, since for several products the quotas were set higher than the actual imports.

Cartellisation

The inter-war cartellisation wave started already in the 1920s both nationally and internationally. The wave was clearly stimulated in the 1930s, notably in agriculture,

³¹ Anstrin, H., "Handelspolitikens avvägar och Nordens utrikeshandel", *Industria*, 1937, p. 21.

³² Lange, Even, *Krise og vekst. Norsk treindustri i begynnelsen av 1930-årene*, Universitetet of Oslo, Oslo 1974, p. 166.

industry, and international cartels. The major problem for agricultural products was a steep fall in prices due to over-production.³³ Since the demand for agricultural products were inelastic to changes in prices, a fall in prices tended to reduce the farmer's income. In the 1920s farmers tried to solve the problems by forms of cooperation organised by themselves. However, due to the problem of free riders, the government and Parliament had to intervene. In 1928 a state-owned monopoly for imports of corn was reorganised. The monopoly was to buy all domestically produced crops. In general an excess-price was paid to the producers, financed by selling imported corn at excess-prices to consumers.

In the 1930s the government and the farmers associations recommended local boards be set up to regulate the sale and distribution of milk. The regulation was approved by law, as the so-called "Sales Act" passed the national parliament in 1930. The act regulated first-hand sales of milk, egg, and bacon. The first milk board was set up the same year. From 1931 onwards, milk producers were to pay compulsory sales duties to these boards. This was deemed necessary to ensure equal production prices for milk.

Cartellisation of the milk market did not alone solve the problems of excess supply of milk.³⁴ In June 1931, the Parliament passed a law empowering the Ministry of Agriculture to order the addition of butter into all domestically sold margarine. Thus, the milk producers and their cartels received new markets for their products.³⁵ By the end of 1939 more than half of the milk produced for the national dairy cooperation was used for the production of butter, and 64 per cent of that butter were added into margarine.³⁶ This implies that about one third of the registered milk by decree was added into margarine.

Other cartels and market regulation bodies for agriculture were organised. The regulation of the milk market served as a prototype for the regulation of the egg market, the meat market and the fruit and vegetable markets. Market regulation boards and co-ops were set up on a large scale. The farmers gained from the

³³ Timoshenko, Vladimir P., *World Agriculture and Depression*, Ann Arbor 1933, pp. 122-123.

³⁴ Skeie, J., *Organisasjon og lovgivning til hjelp i jordbrukskrisen*, Oslo 1933, pp. 17-40.

³⁵ Hovland, Edgar, "Smør og margarin blir ett fett", *Historisk tidsskrift*, No. 3, 1979, pp. 305-325.

widespread regulations of the markets. On the other hand, the consumers lost through higher prices and reduced efficiency.³⁷

As for fisheries, accounting for 25-30 per cent of the income from exports in inter-war Norway, a steep fall in the prices in the international markets demanded immediate and effective action. The first steps towards cartellisation were taken already in 1927, when the first-hand sales of herring were organised by the fishing industry itself. In December 1929 the government gave this cartel legal status. Henceforth all fresh herring for exports was to be handled by the cartel. In 1930 Parliament confirmed this decree by making it a law, the so-called *Herring Act*. From June onwards, similar acts for exports of other species of fish, basically cod, passed Parliament. In 1938 the *Raw Fish Act* came into being, regulating all commercial first-hand sales of fish and fish products in Norway through cartels.³⁸

Norwegian industry also participated in international cartels, e.g. nitrates, steel, and oil tankers.³⁹ The tanker pool may serve as an illustration of their operation. The International Tanker Owners Association Ltd, Intertanko, was organised in London in 1934. Counting for 95 per cent of the tonnage that competed in the free market for oil transports, the pool was in many ways a success for tank owners. Intertanko acted as a bargaining and hiring agency for oil tankers. The aim was to restrict the supply side of the market, in order to maintain rates that covered the ship-owners' costs of operating ships and covering the costs involved in laid-up tonnage.⁴⁰

Subsidies

Maintaining producer prices and incomes for farmers was an important aim in most European countries. Besides protectionism and cartellisation, subsidies to producers were common. According to the historical national accounts Norwegian direct

³⁶ Mork, Rasmus, *Melkeomsetning og meieridrift i Norge 1930-1940*, Oslo 1941, p. 247.

³⁷ Grytten, Ola Honningdal Grytten, "The Consumers' Burden. What did regulations of the Norwegian milk market in the 1930s cost consumers?", Basberg, Bjørn L., Helge W. Nordvik, and Gudmund Stang (eds.), *I det lange løp*, Fagbokforlaget, Bergen 1997, pp. 143-164.

³⁸ Hallenstvedt, A., *Med lov og organisasjon*, Oslo 1982, pp. 89-93 and Tande, Torvald, *Norsk fiskeripolitikk*, Oslo 1957, p. 195.

³⁹ Bergh, Trond, Tore Jørgen Hanisch, Even Lange, and Helge Pharo, *Norge fra u-land til i-land. Vekst og utviklingslinjer 1830-1980*, Gyldendal, Oslo 1983, pp. 170-175.

⁴⁰ Egeland, O. *Kongeveien*, Oslo 1968, vol II, pp. 300-308

subsidies increased from 28 million kroner in 1930 to 81 million in 1939, i.e. from 7.1 to 11.5 per cent of the expenditures of the state. The increase took place from 1934 onwards.⁴¹

In addition, indirect subsidies were even higher. From 1927 indirect subsidies were given to crop producers through price guarantees. In the 1930s interest rates in state owned banks were subsidised, and farmers received government aid to switch their excess production from products with supply surplus to products facing demand surplus. Similar kinds of subsidies were extended to the fishing industry. Two state-owned banks were established, in 1921 and in 1938, to give subsidised loans to the renewal of fishing tools and vessels. In 1936 a special state owned bank was established to support the expansion of manufacturing by granting low interest rate loans. The bank functioned as guarantor for manufacturing firms as well.

“Buy Norwegian”

A national organisation, *Norwegian Work*, was established in 1921. The purpose of the organisation was to promote import substitution. The organisation ran a series of slogans in the press, calling on consumers to buy Norwegian products to foreign ones, provided price and quality were equal. The Governor of the central bank, Nicolai Rygg, and the former Prime minister, Gunnar Knudsen, were both among the founders of this popular movement. However, as long as the economic and political agenda was “back to normal” and, thus, to restore “normal” international economic relations, the organisation made little headway in the 1920s.

From 1930 attitudes changed. In October 1931, some weeks after the suspension of gold, an appeal was published in all Norwegian newspapers. The appeal, under the slogan “Buy Norwegian” was signed by the prime minister, members of the cabinet, the president of the parliament, the director of the central bank, the rector at the University of Oslo, representatives for both sides in the labour market, several other celebrities, and 25 nation-wide organisations and even churches. The message was called on consumers to buy Norwegian goods both to secure the balance of trade and domestic labour from being laid off. The same month the king and the entire royal family took up membership in *Norwegian Work*.

⁴¹ NOS XII. 163, *op. cit.*, table 27A, pp. 196-203.

The “Buy Norwegian”-campaign continued, and its importance was often emphasised by the prime minister, other members of the government or other officials. In 1933 even the crown prince, in the first broadcasted speech by a member of the royal family, reminded the people of the importance of the campaign.

According to national newspapers, the campaign was a success. Imports of substitutable manufactures, including furniture, textiles and clothing, fell significantly in the 1930s, while domestic production of those goods increased.⁴² However, as we will see in this work, monetary policy probably was a more important factor for import substitution in the Norwegian economy in the 1930s than this campaign. Some protests against the campaign came to the surface. In particular spokesmen for the export industries voiced critical remarks, since they feared ”retaliation” abroad. However, these protests failed to change the work of the organisation, but the slogans were less stridently formulated in order not to provoke foreign exporters to Norway.

Fiscal Policy

It is often argued that 1935 marks the beginning of a paradigm shift in Norwegian economic policy and economic thought. That year the first general agreement regulating the labour market was negotiated, and Labour initiated its rule that was to last for two generations. A common view at the time was that the shift of power marked the recognition of the failure of capitalism. Henceforth unfettered markets should be replaced by a regime of planning.

In my view there was no significant shift of paradigm in Norwegian economic policy in 1935. The Labour Party did not pursue an inflationary fiscal policy to stimulate demand in the 1930s. The public expenditures did increase, but so did taxes. The balance of the budget did not change in any direction. The late Professor Helge W. Nordvik examined the fiscal policy of inter-war Norway using an IS-LM model. He concluded that the fiscal policy was neutral in the 1930s. In the period of Labour government from 1935 until the German attack on Norway in April 1940, the average annual effect of the fiscal policy is calculated to have been virtually nil, or more precisely: + 0.1 per cent of the gross domestic product.⁴³

⁴² Lange, Even, *op. cit.*, pp. 145-164.

⁴³ Nordvik, Helge W., ”Finanspolitikken og den offentlige sektors rolle i norsk økonomi i mellomkrigstiden”, *Historisk tidsskrift*, No. 3, 1979, pp. 223-237.

Most changes that did take place in economic policy, in fact happened before 1935, viz. changes in monetary regime, public subsidies, protectionism and cartellisation. One may argue that the first general agreement between the employers association and the trade unions in 1935 marked an important breakthrough for labour market planning. However, the first agreement only engaged 220.000 trade unionists, out of a total labour force of 1.3 million. The measures taken to regulate agriculture and fisheries earlier in the 1930s involved more people. According to the population census of December 1930 more than half a million people were engaged in the primary industries of the Norwegian economy at that time. In other words: agriculture and fisheries had already started the transformation process from free market industries to regulated industries when the first general agreement came to being.⁴⁴

Monetary Policy

At the time of Britain's suspension of gold on September 20th-21st 1931, speculation against the Norwegian krone forced the central bank to take action. Interest rates were raised. The official discount rate on private banks' borrowings from Bank of Norway was set up from four to five per cent on September 12th and then to six per cent on September 26th. On September 27th Bank of Norway suspended redemption at par value. The high point occurred September 28th when the bank rate was raised to eight per cent.⁴⁵ This was deemed necessary to avoid large-scale capital outflow and to protect the krone from further speculation and possible depreciation.

The bank board may have entertained an idea that it would be possible to restore gold when international currency markets had calmed down. However, it is clear that the decision to suspend gold was also made to benefit the export industries. The central bank feared they would lose competitive power, and since Britain was Norway's largest trading partner, the central bank wanted the krone to closely follow the pound sterling.⁴⁶ A tight monetary policy was pursued at first, and in September and October the krone depreciated against gold, but appreciated against sterling. However, the bank board feared the consequences of such a policy, and reduced the discount rate by two percentage points in October 1931.

⁴⁴ NOS IX. 61, *Population Census for Norway December 1st 1930*, Vol. VIII, Statistics Norway, Oslo 1935, pp. 14-15.

⁴⁵ NOS C. 188, *Historical Statistics 1994*, Statistics Norway, Oslo 1994, table 24.22, p. 650.

As a result, in November and December 1931 the krone depreciated slightly against sterling. The mid-December exchange rate of that year compared to the pre-September 1931 values reveals that the krone had depreciated by 45.2 per cent against the US dollar, 31.2 per cent against gold, and 0.4 per cent against pound sterling.⁴⁷ To protect its reserves, the Bank of Norway, the private banks and the business organisations voluntarily set up a currency committee to monitor and control the reserves through voluntary reporting.⁴⁸ During 1932 and 1933 the krone stabilised at an exchange rate that implied ten per cent depreciation against sterling, while it fluctuated significantly against the US dollar and currencies tied to dollar or gold.

The stabilisation of the krone against sterling along with a trade surplus from 1932 onwards allowed for further reductions in the discount rate. On September 1st 1932 it was back on the four per cent level, and was then cut to 3.5 per cent by the central bank in May 1933.

The countries, which first suspended gold, feared devastating consequences. However, it soon turned out that abandoning gold had its advantages. In the first place, their currencies depreciated against those still clinging to gold. Thus, they gained competitive power as their products were cheaper in international markets. Hence, exports did not fall as much as in the gold countries. In addition, foreign produced goods were more expensive for Norwegian consumers. Thus, import substitution took place in those countries abandoning gold against those holding on to gold. Hence, depreciation countries often experienced trade surpluses. Again, the suspension of gold allowed for a more relaxed monetary policy. In fact, the money stock started to increase. In Norway the money supply (M1) in current terms was stable 1928-1933, having seen a steep fall in the 1920s. It started to grow at the end of 1934. In real terms the turning point was in 1932, after the suspension of gold in September 1931.⁴⁹

An increase in the money supply caused a positive shift in demand, resulting in higher production and lower unemployment. Deflation was replaced by moderate inflation. Nominal interest rates decreased as well, and this gave a boost to investments. In 1931 real interest rates before taxes reached almost 20 per cent in

⁴⁶ Bank of Norway, *Annual Report 1931*, Oslo 1932, p. 42.

⁴⁷ Oslo Stock Exchange, "Exchange rates 1819-2000", printout, Oslo 2001.

⁴⁸ Hodne, Fritz, *God Handel*, Norges Handelstands Forbund, Oslo 1989, pp. 189-194.

⁴⁹ This is the over-all trend when looking at M0, M1, and M3.

Norway. In 1937 they were close to minus ten per cent.⁵⁰ In the years 1931-1939 investment and export volumes grew by 60 and 52 per cent respectively. GDP by volume showed a growth of 39 per cent in the same period.⁵¹

Since those countries, which left gold early, in general experienced milder depressions and more rapid recoveries than the gold countries, both their central banks and their governments lost interest in restoring par values for their currencies. In 1933 the *Sterling Area* was established. Its members were countries that aligned their currencies to pound sterling, including most of the Commonwealth and the British colonies, several Middle Eastern countries, Portugal, and the Scandinavian countries. From July onwards, the Norwegian krone was tied to pound sterling at a value of 19.90 against 18.16 under the gold standard, a devaluation of ten per cent to the pound. In reality gold was not only suspended, but also abandoned. The new currency regime was in fact a Sterling standard. Econometric tests confirm that the member states of the Sterling Area were among the best economic performers in the 1930s with regards to gross national product, investments, exports, employment, and import substitution. In Europe the *Gold Bloc* countries were the losers.⁵²

Table 5 offers the estimated correlation between currency depreciation and key variables, including GDP, investments, export, export surplus and unemployment for 15 Western national economies. The estimated regressions coefficients are calculated as simple regressions, in which currency depreciation is the decisive variable and the key economic macro indicators are the response variables. The data are based on per centage changes 1929-1935, with 1929 as 100. (Here currency depreciation gives values lower than one hundred). All key macro indicators are in real terms except for export surpluses, which are in nominal figures. The 15 countries included in the calculations are eight small economies: Austria, Belgium, Denmark, Finland, the Netherlands, Norway, Sweden and Switzerland, and seven large economies: Canada, France, Germany, Italy, Japan, the United Kingdom and the United States. Regressions are run on data of all the 15 countries, the 13 European countries and the eight small European Countries. The results are reported in table 3.

⁵⁰ Isachsen, Arne Jon., "Realrenten i Norge i et hundreårs perspektiv", *Bergen Bank kvartalskrift*, nr. 2, 1988.

⁵¹ NOS XII. 163, *op. cit.*, table 51, pp. 350-351.

Table 3. Regressions. Influence of monetary policy on macroeconomic indicators.

	N	β_1	T	R^2
GDP per capita (E)	15	-0.365	-3.159	0.434
	13	-0.342	-3.580	0.538
	8	-0.476	-3.291	0.638
Gross Investments (I)	15	-1.692	-5.919	0.729
	13	-1.667	-8.291	0.862
	8	-1.223	-8.894	0.929
Exports (X)	15	-1.022	-5.219	0.677
	13	-1.011	-5.333	0.721
	8	-0.801	-3.003	0.601
Export surplus (X-M)	15	-0.953	-9.393	0.872
	13	-0.945	-9.304	0.887
	8	-0.889	-4.800	0.793
Unemployment (U)	15	6.374	3.936	0.544
	13	6.316	4.042	0.598
	8	9.914	10.562	0.949

N=15: All 15 countries in the sample.

N=13: All European countries in the sample

N=8: The eight small European countries in the sample.

The table confirms that there was a significant positive correlation between currency depreciation and economic growth, investments, exports and export surplus, and a negative correlation between currency depreciation and the scale of unemployment. More precisely the estimated slopes of the regression lines between growth in GDP, investments exports and export surplus on the one hand, and the developments of the currency values on the other hand, are negative. There is a positive slope of the regression line between currency values and unemployment.

On the basis of these test for 15 countries we may conclude that monetary policy was a decisive factor for the economic development in the 1930s. Those countries that left gold had a milder recession and a more rapid recovery than those that remained on gold.

Apart from monetary policy, economic policies differed significantly between countries within the same monetary regime. However, the pattern of economic development followed that of monetary policy. This indicates that monetary policy may have been one of the most decisive policy factors for economic performance in the 1930s.

⁵² Eichengreen, Barry and Jeffrey Sachs, "Exchange rates and economic recovery in the 1930s", Eichengreen, Barry (ed.), *op. cit.*, 215-238.

Conclusions

The present paper examines the Norwegian policy response to the disintegration of the inter-war economy. In the 1920s efforts aimed at protecting the liberal trade order and the pre-war monetary system, with the Norwegian currency, the krone, linked to gold parity established in 1874. However, towards the end of the decade the first steps were taken towards public support for cartellisation.

In the 1930s the answer to international disintegration was quite another. Norway abandoned gold, and ran a more relaxed monetary policy. Voluntary currency controls were introduced to avoid large-scale capital outflow. Countrywide cartels were established, in particular in agriculture and fisheries. These sectors were also subsidised to protect them from the negative consequences of over-production and the break down of the world economy. Protectionism was reintroduced, especially to protect manufacturing industries.

Quantitative comparisons based on key macro variables confirm the view that monetary policy played a central role for economic performance in small, open economies. Sticking to gold had negative effects. Conversely, abandoning the fixed exchange rate system and pursuing a more inflationary monetary policy had a positive impact on economic performance. The lesson is that a flexible monetary response was the superior strategy in the circumstances.

Several writers on Norwegian economic history have often claimed that a change in economic policy regime, from a free market philosophy to an active state philosophy, occurred in 1935 when the Labour Party came into office. Admittedly, most changes were introduced after 1945. However, this article argues that significant changes in economic policy started earlier, around 1930.