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Discussion paper

# **Growth in public finances as tool for control: Norwegian development 1850-1950**

BY  
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# **Growth in public finances as tool for control: Norwegian development 1850-1950**

by

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## ***Abstract***

*By drawing on information from public accounts from the nineteenth and twentieth century the present paper aims at mapping the development of key financial indicators for the Norwegian central government sector. It concludes that growth in the size of this sector often, but clearly not always, reflects political economy regimes. The paper concludes that persistent growth in public finances as tool for control over the economy did not take place before the introduction of the social-democratic regime in 1935.*

JEL classification codes: P11, P16, N23, N24, N33, N34, N43, N44, O16, O21, O23, P11, P41

## Problem defined

After World War II, Norway developed to become an economy with a large and influential public sector. Today Norway should still be considered a social-democratic country with a capitalist production system, a considerable public sector and strong public governance, despite a wave of neo-liberalism from around 1980. The social-democratic planning model stands out as significantly different from the historical Norwegian systems.

From her independence from Denmark in 1814 and onwards, Norway arguably was a nation with strong liberalistic influences. As part of widespread liberal attitudes in the nineteenth century both local and central governments were limited to perform basic services. Hence, at that time, the size of the public sector was modest.

On the basis of existing literature on Norwegian history, including economic history, we can trace three major eras on public involvement in the society from the early 1800s until the late 1900s.<sup>1</sup> These were:

- 1) The liberal regime 1814-1884(1905)
- 2) The social-liberal regime 1884(1905)-1935
- 3) The social-democratic regime 1935(1945)-1981

The first phase starts with the Norwegian constitution in 1814 and continuous to the introduction of parliamentarism in 1884. Though, some historians argue the major shift in regime should be dated to 1905, when the royal union with Sweden was abandoned. The second phase starts with the parliamentarism from 1884 and includes the era when the social-liberal party, Venstre, was the major political force. The last phase starts with the first lasting labour party government with majority support in parliament from 1935 onwards. However,

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<sup>1</sup> Seip, Jens Arup 1963, *Fra embedsmannsstat til ettpartistat og andre essays*, Universitetsforlaget, Oslo, Hodne, Fritz 1981, *Norges økonomisk historie 1815-1870*, Universitetsforlaget, Oslo, Slagstad, Rune (1987), *Rett og politikk: Et liberalt tema med variasjoner*, Universitetsforlaget, Oslo. Hanisch, Tore Jørgen et al 1999, *Norsk økonomisk politikk i det 20 århundre*, Høyskoleforlaget, Kristiansand, Sejersted, Francis 2002, *Demokratisk kapitalisme*, Pax, Oslo and Grytten, Ola Honningdal 2012, "Statens rolle i norsk økonomi", *Stat & Styring*, 1/2012, pp. 26-29, Helle, Knut et al 2013, *Grunntrekk i norsk historie: fra vikingtid til våre dager*, Universitetsforlaget, Oslo, pp. 182-294.

in huge parts of the literature the social-democratic era or the Nordic model era is considered to start after World War II, in 1945.

The three phases have chiefly served as frameworks for describing and explaining the political development. Apart from works on the Nordic model after World War II, they have been used less as framework in economic history or political economy analyses. Also, when there is a vast qualitative literature on political processes and decision-making, little has been done in order to quantify these issues. On this background, the purpose of the present paper is threefold:

- 1) Firstly the paper aims at mapping the size of central government consistently during a good hundred-year period from the mid 1800s to the mid 1900s.
- 2) Secondly, it examines if key quantitative indicators, i.e. spending and income, mirror the three phases of public sector regimes.
- 3) Thirdly, it asks if growth of the size of the central government sector was a deliberate action in order to gain public control over the economy.

The motivation for starting and ending during the mid 1800s and 1900s is that this span of time includes a period of special interest. Firstly, it includes the period when the construction of the liberal state was “finalized” after troublesome years with the setting up of national institutions and thereof stressful central government finances. Secondly, at the end of the period under investigation, we include the introductory years of the new social-democratic regime, also called the Nordic model. Before we start with our analysis, however, it is necessary to give historical and macroeconomic backgrounds for the development.

## **Background**

During the late 1700s a liberal wave swept over the Western world. In 1776 the United States of America (US) declared its independence from the United Kingdom (UK). This move was followed up in 1787, by the establishment of a liberal American constitution. The French revolution in 1789, followed up by a

human rights declaration and a liberal constitution, marked the liberalistic wave in Europe. Up front of the European momentum Adam Smith published his path breaking book on a liberalistic political economy, *An Inquiry into the Nature and cases of the Wealth of Nations*, in 1776.<sup>2</sup>

After four centuries under Danish rule liberal attitudes gained ground in Norway. In 1779 *Wealth of Nations* was translated into Danish, on a Norwegian initiative (Danish was the official language in Norway at the time). The new wave was fuelled by the prospect of establishing an independent Norwegian national state in 1814, as Danish rule over Norway was about to meet its conclusion.

According to the Treaty of Kiel from January 14<sup>th</sup> 1814, the rule over Norway should be handed over from the Danish to the Swedish king. The reason was that the latter contributed to Napoleon's defeat before, under and after the Battle of the Nations outside Leipzig in October 16<sup>th</sup>-19<sup>th</sup> 1813. The Norwegians saw this as an opportunity to set up an independent government. They swiftly constructed a written constitution and elected their own king in May 1814.

The constitutional assembly in 1814 was clearly influenced by liberal ideas adopted from France, the UK and the US. A constitutional committee suggested eleven basic elements to make up the basis for the construction of the constitution. These were:<sup>3</sup>

1. *Norway should be a free, independent, hereditary monarchy.*
2. *Its people should maintain the legislative power through elected representatives.*
3. *The people should have the sovereign right to tax themselves through elected representatives.*
4. *Declaration of peace and war should be the regent's responsibility.*
5. *The regent should have the right to pardon convicts.*
6. *The law courts should be independent.*
7. *Printing liberty should be introduced.*

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<sup>2</sup> Smith, Adam 1776, *An Inquiry into the Nature and cases of the Wealth of Nations*, Glasgow/Edinburgh.

<sup>3</sup> Fure, Eli 1989, *Eidsvoll 1814*, Dreyer, Oslo.

*8. The Lutheran faith should be the state religion and the faith of the king.*

*9. New limitations in business activities should not be introduced*

*10. Personal and hereditary privileges should not be granted.*

*11. The citizens should be committed to protect the country, without consideration to class, birth or revenue.*

As can be seen from this list, significant democratic and liberal rights were suggested to be included in the original constitution. However, they were somewhat de-emphasised by the legislative congregation.

The Norwegian move towards independence was not supported by any of the significant powers in Europe. Thus, Sweden started an armed campaign with a 40.000 men strong force against Norway in July 1814. In order to avoid bloodshed the two powers agreed on a treaty at the Norwegian town Moss, close to the border, August 14<sup>th</sup> the same year.

During a short period of negotiations a revised written constitution was signed on November 4<sup>th</sup> 1814. The new constitution gave more power to the Norwegian parliament and the people than what was given in in the initial constitution from May the same year.

The Swedish king was to be king in a personal union of two independent states. Hence, Norway would obtain home rule with its own constitutions, parliament, government, courts, central bank, armed forces and police authority.<sup>4</sup>

### **Macro economic performance**

Contrary to popular assumptions, research reveals that Norway was not a poor country during the nineteenth century. Bairoch, Crafts, Krantz, Nilsson, Hodne and Grytten all conclude that gross domestic product per capita levelled that of Western Europe, which was one of the wealthiest regions in the world at the time.<sup>5</sup> Chart 1 shows the relative strength of the Nordic economies during the

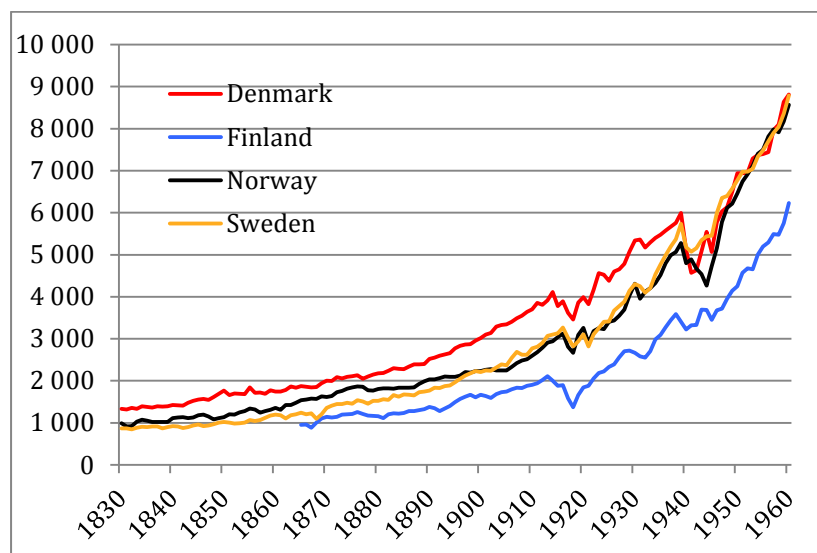
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<sup>4</sup> Rønning, Bjørn R. 2005, Stortinget og unionen med Sverige: dokumenter fra Stortingets arkiver, 1814-1905, Stortinget, Oslo.

<sup>5</sup> Krantz, Olle and Carl Axel Nilsson 1974, "Relative income levels in the Scandinavian countries, *Economy and History*, vol. 17, s. 52-69, Bairoch, P 1976, "Europe's Gross National Product 1800-

period under investigation. Norway had the second strongest per capita economy until the turn of the nineteenth century. Also, overall economic growth was significant.

Chart 1. GDP per capita in the Scandinavian countries in 2002-US\$.



Sources, Hansen 1974, pp. 229-230, Hjerppe 1996, pp. 91-92, Grytten 2004A, pp. 277-280, Grytten 2004B, pp. 102-103, Kranz and Schön 2012, pp. 24-26.

Chart 2 reports Norwegian business cycles in the period, calculated as relative output gaps ( $C_t$ ) between annual calculations of real GDP per capita ( $Y_t$ ) and smoothed GDP per capita ( $Y_T$ ).

$$(1) \quad C_t = \log Y_t - \log Y_T$$

The polynomial trend is constructed with the help of a Hodrick-Prescott filter (HP-filter). The smoothing parameter, lambda, is set to 2,500. This value is in line with previous findings in empirical research on Norwegian historical business cycles.<sup>6</sup>

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1975, *Journal of European Economic History*, vol 5, pp. 273-340, Crafts, N. F. R 1983, "Gross National Product in Europe 1870-1910: some new estimates, *Explorations in Economic History*, vol 20, pp. 387-481, Grytten, Ola Honningdal 2004, "Economic Growth and Purchasing Power Parities in the Nordic Countries, 1830-1910", Heikkinen, Sakari and Jan Luiten van Zanden (eds), *Explorations in Economic Growth*, pp. 89-105.

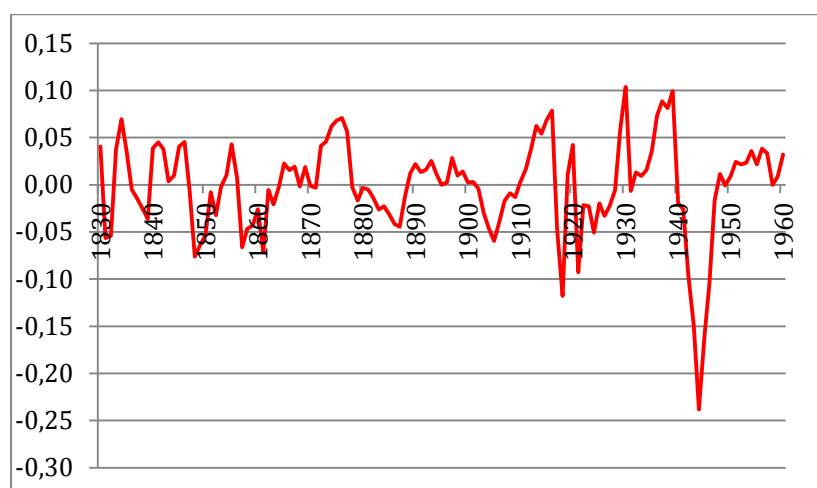
<sup>6</sup> Grytten, Ola Honningdal & Arngrim Hunnes 2012, "A long term view on the short term co-movement of output and prices in a small open economy", *International Journal of Economics and Finance*, vol 4, pp. 3-15.

In particular economic growth was strong compared to most other countries between the early 1840s and the mid 1870s. However, thereafter the long depression hit Norway hard, industrialization was slow and the Norwegian merchant fleet struggled due to a late transformation from sail to steam. In consequence, Norway's position among the economic well-doers deteriorated during the last decades of the nineteenth century.<sup>7</sup>

A national property crash and financial crisis followed in 1899-1905. Thus, again industrialization was postponed. Then from 1905, the breakthrough of hydroelectricity paved the way for rapid industrial expansion until the outbreak of World War II.

During the interwar period the Norwegian economy saw three deep crises: in the early 1920s, the mid 1920s and the early 1930s. The first one can basically be explained by the international post war depression, when the second one was due to domestic deflationary monetary policy aimed at bringing the national currency, the krone, back to its pre-war par value in gold. Parity was reached in 1928 and gold redemption was restored in May the same year.

*Chart 2. Norwegian business cycles, measured as output gaps ( $\log C_t - \log C_T$ ) 1830-1960 CT is estimated with a HP-filter, with  $\lambda=2,500$ .*



Source, Grytten 2004A, pp. 277-280.

<sup>7</sup> Bergh, Trond et al 1983, *Norge fra u-land til i-land: vekst og utviklingslinjer 1830-1980*, Gyldendal, Oslo, pp. 116-122.



Finally, the great depression of the 1930s hit the small open Norwegian economy through its foreign sector. The contraction of the economy was not as huge as in the early 1920s, as the Great Depression was modest in the Nordic countries compared to most other capitalist economies.<sup>8</sup> However, unemployment reached a peak level of eleven per cent on the annual basis in 1933, the year after the business cycle had seen its bottom level.<sup>9</sup>

Between these years of crises, significant growth took place. In sum, the overall GDP performance was in fact quite satisfactory during the interwar period, with annual per capita growth rates of 2.2 per cent. However, the years of crises were devastating. In 1921 alone, GDP per capita fell by eleven per cent.

German forces attacked Norway in April 9<sup>th</sup> 1940. After two months of war, the government capitulated and the country was occupied until May 8<sup>th</sup> 1945. During this period the country hosted up to half a million occupants and prisoners of war, accounting up to almost 18 per cent of the domestic population.

The war economy and the occupation made public spending rocket. After the war the huge public sector was never demolished, but deliberately kept large and even increasing.<sup>10</sup> Economic growth reached its highest long-term levels ever. However, since Norway had escaped from the war easier than most other countries engaged directly in combat, reconstruction needs were relatively moderate. Thus, economic growth was lower than in most other Western economies until the 1960s.

### **Quantifying the central government**

Surprisingly little has been done to quantify the different nineteenth and twentieth century public sector regimes. In order to do so, the present paper offers new and persistent estimates of key indicators for the size of the central

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<sup>8</sup> Grytten, Ola Honningdal 2008, "Why was The Great Depression not so Great in the Nordic Countries?", *Journal of European Economic History*, vol 37, pp. 369-403.

<sup>9</sup> Grytten, Ola Honningdal 1995, "The scale of interwar unemployment in international perspective", *Scandinavian Economic History Review*, vol 48, pp. 226-250 and Klovland, Jan Tore 1998, "Monetary policy and business cycles in the interwar years: The Scandinavian experience", *European Review of Economic History*, vol 2, pp. 309-344.

<sup>10</sup> Lie, Einar 2012, *Norsk økonomisk politikk etter 1905*, Universitetsforlaget, Oslo, pp. 99-122.

government. Firstly, annual series of total incomes and spending are put together for the entire period 1840-1960. This is done on the basis of available sources from Statistics Norway and previous research carried out by Elisabeth Bjørsvik and Fritz Hodne.

In 1984 Fritz Hodne published series of the Norwegian central government's annual income and spending 1825-1914.<sup>11</sup> The series were compiled from governmental and parliamentary reports from the time kept by Statistics Norway and the National Archive. Then, in 2004 Elisabeth Bjørsvik used the same sources in order to construct value added in the public sector in the frameworks of historical national accounts. She offered some refined series of central government income and spending 1830-1865.<sup>12</sup>

To be able to construct persistent annual series of central government key financial indicators, we have traced the data in the original sources and publications and spliced them when new standards and definitions of accounting have been introduced. From 1860 and onwards we find annual accounts for the central government made by the Ministry of Finance.<sup>13</sup> These are quite detailed and exists both on disaggregated and aggregated levels. A problem with these sources, are that standards, procedures and definitions change over time. Thus, they are difficult to splice.

However, in 1878 The Ministry of Finance published an overview of the central government's finances covering the period 1850-1876.<sup>14</sup> Persistent series are given both on semi-aggregated and aggregated levels on incomes, spending, assets and debts. Thereafter, the Ministry of Finance published similar publications, until 1920.<sup>15</sup>

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<sup>11</sup> Hodne 1984, *Stortingssalen som markeds plass: Statens grunnlagsinvesteringer 1840-1914*, Universitetsforlaget, Oslo, pp. 306-312.

<sup>12</sup> Bjørsvik 2004, *Offentlige tjenester i Norge 1830-1865 innenfor rammen av historiske nasjonalregnskaper*, NHH, Bergen pp. 288-310.

<sup>13</sup> Norges Offisielle Statistikk D. No. 1, *Oversigt over Kongeriget Norges Indtægter og Udgifter*, hvert år 1860-1878, Finants-Departmentet, Christiania 1862-1880.

<sup>14</sup> Norges Offisielle Statistikk D. No. 1b, *Kongeriget Norges Finantser i Aarene 1850-1876*, Finants-Departmentet, Kristiania 1878.

<sup>15</sup> Norges Offisielle Statistikk No. 38, *Statistik over Den Norske Statskasses Finantser*, Den Kongelige Norske regjerings Finants- og Told-Department, Norges Offisielle Statistikk VII. 59, *Den norske statskasses finanser*, Finans og Tolldepartementet, Kristiania 1922.

The figures are compiled by the statistical office of the ministry, and include the total accounts of money transactions carried out by the state. According to the office itself the accuracy of the series is “very good”, i.e. close to perfect, given the standards and definitions at the time. One challenge, though, is that before 1880 the accounts had more net components on the spending side than from thereafter, when a strict gross accounting regime was maintained. However, with the help of the more detailed annual accounts it has been possible to reconcile the pre-1880 figures with the rest of the series.

From 1920 onwards, we compile central government series on key financial figures from Statistics Norway, which have put together relevant series on the basis of accounts from the Ministry of Finance.<sup>16</sup> A problem for parts of our series is that the fiscal years cover the period from July 1<sup>st</sup> in one year to June 30<sup>th</sup> next year. For these periods we calculate averages for the two budget years covering the calendar year, following the equation beneath:

$$(2) \quad x_{ct} = \frac{x_{bt} + x_{bt+1}}{2}$$

Where  $x_{ct}$  is fiscal value (x) in calendar year (ct),  $x_{bt}$  is fiscal value (x) in budget year (bt) and t+1 is next year.

Thus, we report continuous and persistent annual series of key financial indicators for the Norwegian central government 1840-1960 by drawing on previous research by Hodne and Bjørsvik until 1849. Thereafter we use publications by the Ministry of Finance until 1920 and thereafter Statistic Norway until 1960. Thus, we end up with fairly valid and reliable series of the size of the central government administration in Norway for the time in question.

### **Size of the central government sector**

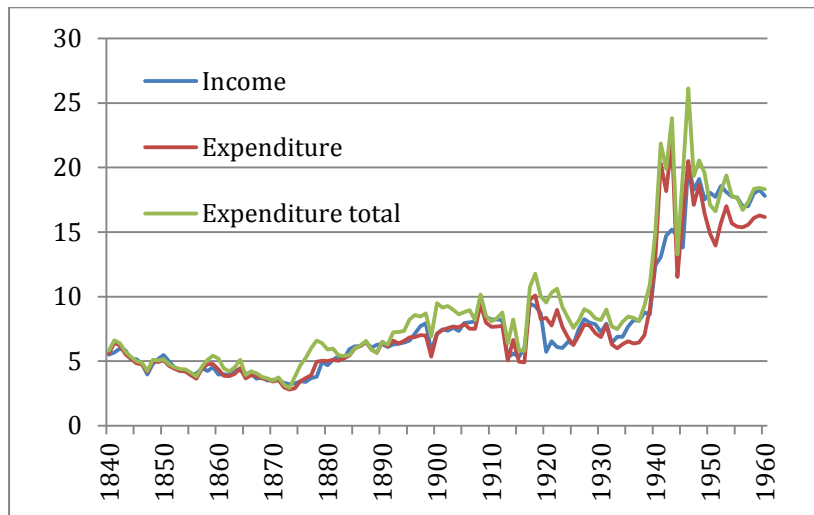
Chart 3 reports the annual calculated size of the central government sector in per cent of total GDP for Norway 1840-1960, presented for the first time. The GDP

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<sup>16</sup> Norges Offisielle Statistikk C 188, *Historical Statistics 1994*, Statistics Norway, Oslo, pp. 586-610.

series are taken from the Norwegian central banks' database on historical monetary statistics. The series have previously been considered reliable both by Norwegian and international scholars.<sup>17</sup>

*Chart 3. Central government sector income and spending in per cent of GDP 1840-1960.*



Sources, Ministry of Finance and Statistics Norway.

As can be seen from the graph there is a long-term development upwards in the size of the central government sector during this period from around five per cent in the mid 1800s to between 15 and 20 per cent in the mid 1900s.

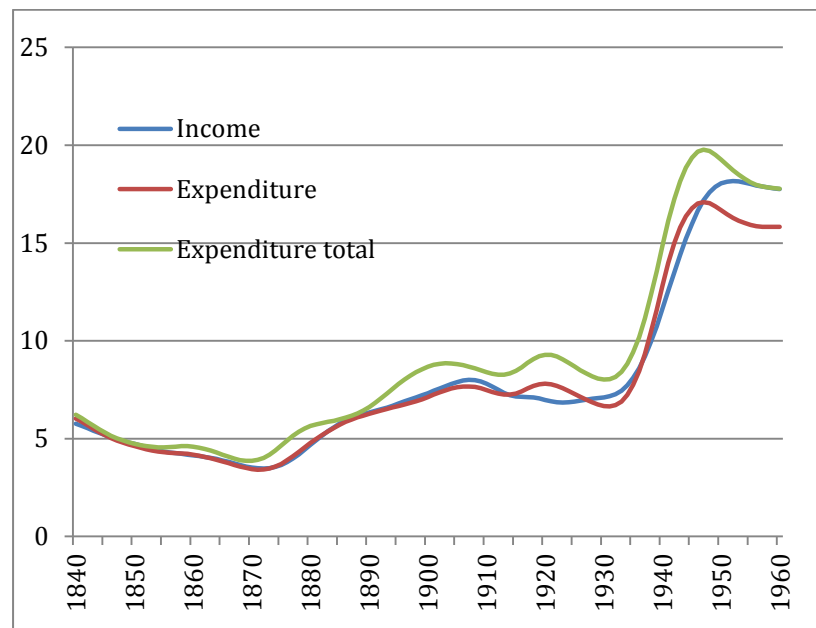
Looking at the composition of spending we find that defence had a long-term decline as share of the total, when basic investments increased rapidly. Administration and debt service were quite stable as share of total central government spending in the long run.

### **Size of central government reflected in policy regimes?**

After we have quantified the size of the public sector we ask if this development mirror the three above mentioned policy regimes. In order to exclude trends from annual fluctuations, we again use the HP-filter. We use the standard smoothing parameter of 100 for the annual series presented here.

<sup>17</sup> Grytten, Ola Honningdal 2004, "The gross domestic product for Norway 1830-2003", Eitrheim, Øyvind et al (eds), *Historical Monetary Statistics for Norway*, Norges Bank, Oslo, pp. 241-288.

Chart 4. HP-trend of Central government sector income and spending in per cent of GDP 1840-1960, lambda=100.



Sources, Ministry of Finance and Statistics Norway.

As can be seen from the graph both income and spending as share of GDP fell until the early 1870s from around six to close to three per cent. Thereafter we find a significant trend upwards until the aftermath of World War II. We also find a consolidation period until the early 1930s, before we trace a moderate increase until the outbreak of World War II in 1939, when both income and spending are rocketing until the aftermaths of World War II. Thereafter, we find another more stabilizing pattern in our figures.

In table 1 we compare the breaks in these series with the commonly claimed phases of policy regimes according to the literature. We find that they do not totally co-exist.

As can be seen in the table, the quantification suggests that the peaks and bottoms in the series do not at all perfectly coincide with the common periodization of policy regimes. The significant increase in public spending and income started between 1871 and 1873, and not when parliamentarism was

introduced in 1884. This is in line with what some historians have identified as a modernization process from around 1870.<sup>18</sup>

*Table 1. Central government policy regimes according to literature and according to quantification of sector.*

	Break between liberal and social-liberal regime	Break between social-liberal and social-democratic regime
Literature dating	1884 (1905)	1935 (1945)
Expenditure dating		
Current figures	1873	1933
HP-trend	1871	1931
Income dating		
Current figures	1873	1932
HP-trend	1871	1931

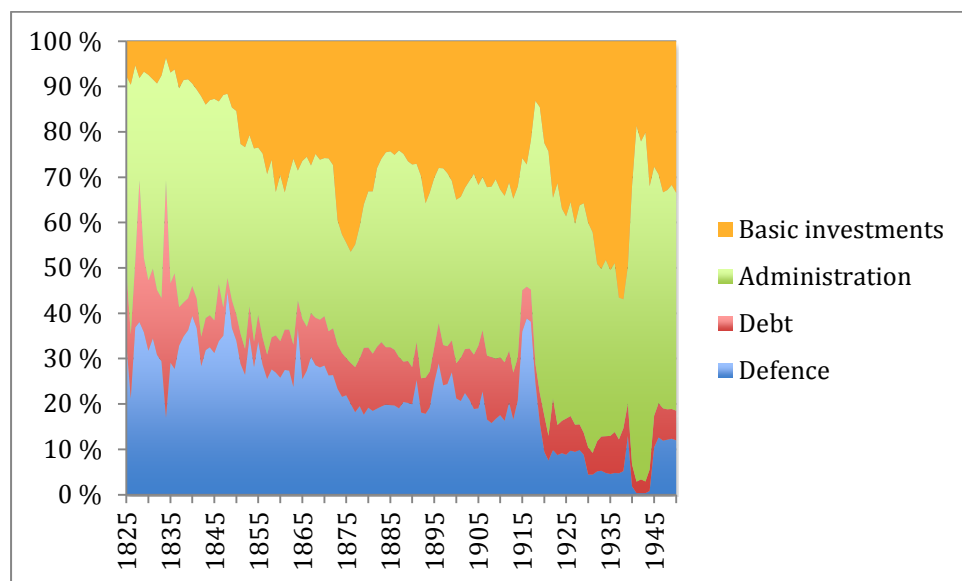
We also find that a new wave of a fiscally more active state was introduced between 1931 and 1933, i.e. before the labor party came into office. Thus, when it comes to the size of the central government sector it seems clear the increase started before the common dating of the political paradigm shifts. Hence, we go to the third problem raised in the paper. Was the increase in the central government finances a tool for gaining more control over the economy?

### **Patterns of spending**

The sources allow us to disaggregate spending into four major posts: basic investments (infrastructure), administration, debt services and defence. These are reported in chart 5. The chart clearly shows that defence was rapidly declining as share of total spending during most of the period under investigation, when basic investments, chiefly in physical and educational infrastructure increased dramatically.

<sup>18</sup> Myhre, Jan Eivind 2012, *Norsk historie 1814-1905. Å bygge ein stat og skape ein nasjon*, Universitetsforlaget, Oslo

Chart 5. Central government spending by composition as share of total in per cent, 1825-1950.



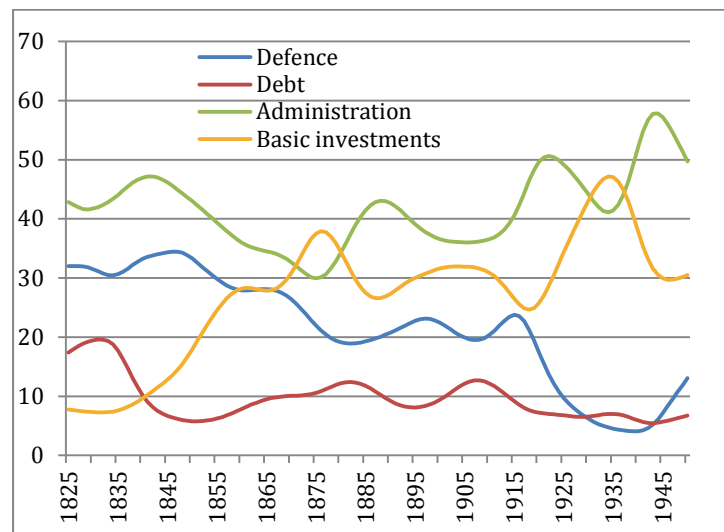
Sources, Ministry of Finance and Statistics Norway.

In chart 6 decomposed spending as percentages of total spending are reported as HP-trends with the standard annual smoothing parameter set at 100. As shown here, the real increase in basic investment spending as share of total spending came previous to 1884 and not after. In fact, basic investments did not regain its 1880 level before the early 1920s. It is also interesting to see that spending on basic investments took off as debt payments decreased rapidly. On the other hand spending on administration increased significantly after the next parliamentary regime and the social-liberal state was introduced in 1884.

Another important pattern is the almost symmetric increase in basic investments and decrease in defence spending in the 1920s and early 1930s. The first as result of central government investment policy during a depressed economy with a large number of bankrupt local governments. The latter in consequence of a stressed financial situation and a strong pacifist political movement.<sup>19</sup>

<sup>19</sup> Nordvik, Helge 1979, "Finanspolitikken og den offentlige sektors rolle I norsk økonomi I mellomkrigstiden", *Historisk tidsskrift*, 1/58, pp. 223-238.

Chart 6. Central government spending by composition as share of total in per cent, 1825-1950, HP-trends, lambda = 100.



Sources, Ministry of Finance and Statistics Norway.

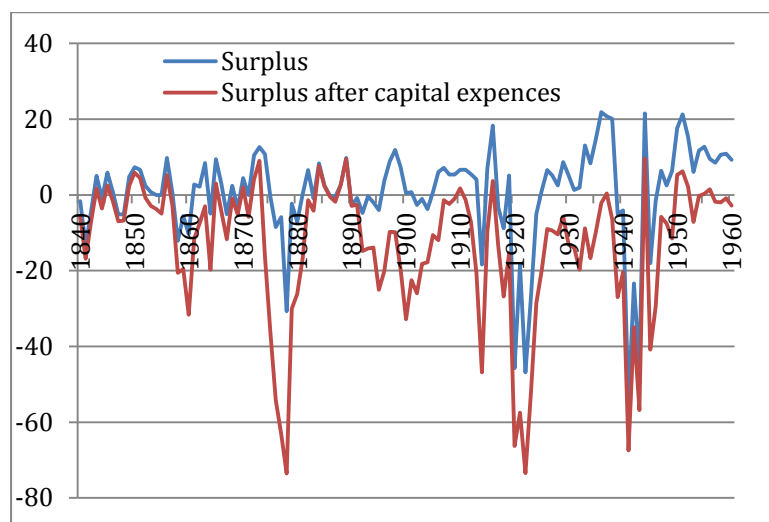
The fiscal balance of the central government provides us with important information related to when huge deficits occurred. Where these deliberate? In case they were, it's a signal of a planned fiscal development.

Chart 7 reveals that deficits in the state finances basically occurred during turbulent years, like wars or financial crises, i.e. the Crimean financial crises in the late 1850s, the Kristiania crisis 1899-1905, and the two world wars, including the post World War I depression. This indicates that the deficits were not planned, but came as ad hoc reactions on macro economic shocks. Thus, they were not deliberate actions in order to increase the central government sector to gain better control of the economy.

One exception from the macro economic shock patterns seems to be during the 1870s. During this decade, a large public investment program in infrastructure, basically railways, ports and roads can best explain the huge deficit.



Chart 7. Fiscal balance central government in per cent of income 1840-1960



Sources, Ministry of Finance and Statistics Norway.

In order to investigate more deeply into the pattern, we will look at the development during different central government policy regimes.

### **The liberal regime**

The Norwegian political paradigm until the late nineteenth century has been seen as an era of the liberal state. Individual rights were emphasized, and the central government was supposed to defend these rights. Constitutional rights were given to the citizens, but with some limitations. The Lutheran state church was still the public religion, and free churches and Jews were not allowed until 1842 and 1851 respectively.<sup>20</sup>

There were several reasons why Norway maintained a fairly liberal order during the 1800s. Firstly, as already stated, the Norwegian constitution of 1814 was considered liberal for its time. This attitude was reflected in contemporary views on governmental involvement.

<sup>20</sup> Supphellen, Steinar 2012, *Konventikkelpakatens historie 1741-1842*, Tapir, Trondheim, pp. 100-121.

Secondly, Norwegians saw the defence of this national sovereignty as one of their most important tasks during the entire nineteenth century. It was done both by building national institutions and by emphasizing liberal rights to the people.

Thirdly, Norwegians had learned to appreciate distance to the central government in Copenhagen during the union with Denmark. Now they wanted to keep the distance to Stockholm in order to be their own rulers.

Fourthly, it was beneficial for a small open economy, depending on foreign trade to wish liberalism, and in particular free trade, welcome. Norway could not survive without imports of basic food products, and one had to export other products in order to finance this import.<sup>21</sup> What was more natural than going for free trade?

Together with the international liberal wave, these factors influenced the way both the state and the economy was to be organized during the personal union with Sweden until 1905.

From the 1850s and onwards the liberal attitudes were dominant in most respects of governance. By 1842 the toll tariffs were reduced significantly. Thereafter, several new laws were made in order to liberalise the capital, labour and product markets. The most important of these are listed in table 2.

*Table 2. Liberal laws concerning the economy introduced in the 19<sup>th</sup> century.*

Law on	Year	Law on	Year
Swedish-Norwegian trade	1827	mining	1842
crafts	1839	herring fisheries	1851
tariffs	1842	abolishment of saw mill privileges	1854
domestic trade	1842	cod fisheries (Lofotloven)	1857
free interest rates	1842	Swedish-Norwegian trade	1874

During this period public servants were key figures in representing the central governments interests in the local communities. They were commonly highly respected, as their basic job was to see too that the system with significant

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<sup>21</sup> Hodne, Fritz 1981, *An Economic History of Norway, 1815-1970*, Tapir, Trondheim, pp. 23-34.

liberties to the people, were maintained. Local interests, represented by industrialists, merchants and local councils, also challenged them. Two of the upcoming challenges came from farmers and the so-called Haugeans, followers of the most important religious, social and economic entrepreneurs of his time, Hans Nielsen Hauge (1771-1824). Both these groups, often united in their efforts, were often spokesmen for liberalism.

Norwegian farmers were more often independent and self-owning than in other European countries. They fought for liberty and limitation of public spending and involvement.<sup>22</sup> The Haugeans were building networks of entrepreneurs within industry, labour welfare, popular education and social and community based innovations. Hence, they were spokesmen for economic liberalism and freedom of speech, religion, and individual independency.<sup>23</sup> It has been argued that these two groups together dominated the parliament for decades during the nineteenth century.<sup>24</sup>

## **Institutions**

As a new independent national state it was imperative for Norway to build her own institutions from 1814 onwards. These were primarily meant to serve the people. They were supposed to offer the best possible infrastructure to the lowest possible cost. The state was not supposed to dictate, but maintain good and stable frameworks for such a development.

The local governments were to finance the state church, schooling and poverty relief. However, most services, which are presently considered public, were offered by the private sector. Families, employers and the church had the major responsibility for welfare and social support. Thus, a lot of companies introduced unemployment benefits, retirement pensions and other kinds of welfare

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<sup>22</sup> Pettersen, Petter Bech 1982, *Liberaleren fra Lista: Et nytt syn på Søren Jaabæk, Ideer om frihet*, 2/3, pp. 4-21.

<sup>23</sup> Grytten, Ola Honningdal 2013, "The Protestant Ethic and the Spirit of Capitalism: Entrepreneurship of the Norwegian Puritan Leader Hans Nielsen Hauge", *Review of European Studies*, 1/5, pp. 31-44.

<sup>24</sup> Skullerud, Aage 1971, *Bondeopposisjonen og religionsfriheten I 1840-årene*, Universitetsforlaget, Oslo.

arrangements long before the state cautiously started with such measures in the late 1930s.

The Norwegian central bank, Norges Bank, was founded as a limited private company in 1816. The speciedaler, was reintroduced as national currency. Typical for the Norwegian egalitarian state with strong local interests, the bank's headquarters were first located to Trondheim, far from the hands of the central government. However, the money was to be printed in the capital, Christiania. Due to fiscal problems and lack of confidence the speciedaler did not reach its par value until 1842.

The silver standard was exchanged for the international gold standard January 1<sup>st</sup> 1874. Thereafter the speciedaler gave way to the krone, as Norway entered the Scandinavian Currency Union three years later. The rationale behind both the silver and the gold standard was to give money fixed values without disturbing interference from politicians. By maintaining fixed currency rates it would also be easier to attract foreigners to invest in and trade with Norway. In addition the central bank was responsible for maintaining an efficient credit market and bank industry, and was a significant lender, both to banks and to the business community.<sup>25</sup>

## **Taxes**

After pressure from the farmers, heavily represented in the Parliament, direct taxes to the state were abolished for rural areas in 1836. The decision lasted until 1892. Within this period export tariffs were totally abolished and import tariffs reduced to a minimum. In consequence, the central government income was at a very low level. And there was limited room for financial manoeuvring.<sup>26</sup>

As late as 1880 the staffs of the national central administration was no more than 550. With a population of 1.915 million, that meant close to 3,500 inhabitants per central administration employee. They were basically lawyers,

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<sup>25</sup> Klovland, Jan Tore & Lars Fredrik Øskendal 2013, "The decentralised central bank : regional bank rate autonomy in Norway, 1850-1892", *Discussion Paper*, SAM NHH, 6.

<sup>26</sup> Gerdrup, Karsten R. 1998, "Skattesystem og skattestatistikk i historisk perspektiv", *Rapporter*, Statistics Norway, 6, pp. 8-17.

whose main task was to secure the rule of law according to the liberal era. The bureaucracy in itself should in principle not take initiatives, but see to that the decisions made by the people through their elected representatives were carried out, as they should.

### **New ideas**

The end of the deflationary policy in order to reach par value of the speciedaler came to its conclusion in 1842. From then on more emphasis was put on building physical and educational infrastructure. In consequence, from the 1840s more technical expertise was recruited to the central administration. These were, until the establishment of the Norwegian School of Technology in 1910, educated abroad. The entrance of the engineers marked a new phase in the tasks carried out by the state. More emphasis was put on building practical frameworks to fuel the economy. Infrastructure became more important.

Educational and health related investments, construction of roads, post- and public steamship services took off already from the 1840s. Thereafter, railroads, ports and the telegraph, followed from the 1850s.<sup>27</sup>

Since the population growth was close to one per cent per anno, it also became important to take measures for the agricultural sector, in order to secure domestic food supplies. Hence, the state welcomed private schools for agricultural education. This was followed up with the establishment of the Norwegian School of Agriculture in 1854. Investments in infrastructure peaked in 1877, when railway construction stood at its highest. From then on its relative share was reduced.

To sum up, during the liberal era, the size of the central government sector fell relative to the economy until the early 1870s. From then on, the significant growth in basic investments, which started as early as the 1840s, made the sector to grow faster than the overall economy. The Norwegian parliament definitely saw a special responsibility for building infrastructure long before the

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<sup>27</sup> Hodne 1984, pp. 306-312.

social-liberal era came to being around 1884. However, it was no deliberate action in order to gain more control over the economy.

### **Social-liberal regime**

Democracy was extended in line with the political development. In 1814 only 6.5 per cent of the population was granted the right to vote in parliamentary elections. In 1884 parliamentarism was introduced after a long-lasting conflict with the king. From then on, the national government was basically responsible to the national assembly, and needed its majority support in order to govern. Voting was extended to all men who paid a certain amount of tax. From 1898 all adult men were included. Finally, women gained their right to vote in central elections from 1913.<sup>28</sup>

As part of the new system, politics changed. Since in reality the national assembly, and not the Swedish king, now appointed the national government, the importance of limiting his influence had been reduced. Hence, there was room for a more active central government administration. The modernization of central administrations in Europe also implied strengthening of the bureaucracy.

The social liberal party, Venstre, gained significant political power as the major force in the centre of Norwegian policy. This power was used to introduce new laws and a more active budget policy. The state became more active within welfare, education and health services.<sup>29</sup> At the same time liberal principles on individual freedom, local government, and market liberalism were maintained. All in all, we find a deliberate political effort put into a more active public sector aimed at benefitting both the individual and the society at large.

Economic growth and modernization of the economy also demanded a more active state in order to motivate industrialization, protect natural resources and increase human resources through schooling and education. The increase of the standard of living came along with an increasing attention on health services.<sup>30</sup>

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<sup>28</sup> Sørensen, Øystein 1984, *1880-årene: Ti år som rystet Norge*, Universitetsforlaget, Oslo.

<sup>29</sup> Grebstad, Ottar & Jostein Nærbøvik (eds) 1984, *Venstres hundre år*, Gyldendal, Oslo, pp. 21-124.

<sup>30</sup> Larsen, Øyvind et al 1986, *Legene og samfunnet*, DnL, Oslo, pp. 109-150.

When Norway finally abandoned the personal union with Sweden in 1905 more spending had to be used on diplomacy and foreign services.

After a period of relative stagnation and deflation from the mid 1870s until 1887, a new wave of industrialization gained pace from the mid 1890s. This was connected to hydroelectricity. There was a huge need for capital to construct power stations and related industry. Both local and central authorities were engaged in capital imports from the UK, Germany, Denmark and Sweden. The creation of Norsk Hydro in 1905, with central government support, became a benchmark in this industrialization process. The company soon became one of the world's biggest exporters of fertilisers, and later also within ferroalloys.<sup>31</sup>

From the 1890s a new protectionist wave swept in over Europe. Partly as result of fierce competition, partly due to the race on political and economical control by the great powers. Influential alliances from both the political and the business community in Norway started to question the huge influx of foreign capital. During the first years of the 1900s as much as 75 per cent of the regulated Norwegian waterfalls and 80 per cent of the chemical industry belonged to foreigners.<sup>32</sup>

After a heated debate, Prime Minister Gunnar Knutsen and his social-liberal Party, Venstre, gained majority for introducing protective concession laws between 1906 and 1917. Both local and central governments were able to restrict foreign ownership connected to domestic natural resources.<sup>33</sup> In many ways this marked the will of the new social-liberal political paradigm. As result of the actions taken, the public sector, in particular local governments became grand investors and owners of power plants. In hunt for national control this made the public sector grow.

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<sup>31</sup> Venneslan, Christian 2009, "Electrification and Industrialisation: An assessment of the industrial breakthrough in Norway", *Scandinavian Economic History Review*, 2/57, pp. 124-155.

<sup>32</sup> Stonehill, Arthur 1965, "Foreign ownership in Norwegian enterprises", *Samfunnsøkonomiske studier*, 14, pp. 44-47.

<sup>33</sup> Thue, Lars 1992, "The state and the dual structure of the power supply industry in Norway 1890-1940", Trédé, M (ed), *Électricité et électrification dans le monde 1880-1980*, Paris.

## Crisis response

As tool of a counter-cyclical policy both key industries and consumers were subsidised during World War I. Inflation was deliberately moderated, by letting the state finance negative price gaps for producers. In consequence, the central government administration reached a financial peak level around 1920.

The deflationary policy aimed at restoring the par value of the krone after the war, gave an extraordinary deflationary pressure on the economy during the post-war depression in the early 1920s. The policy was in line with liberal ideals at the time and included a substantial tightening of credit and money volumes. Product demand fell and the war inflation was turned into strong deflation. Nominal interest rates were increased and real wages before tax reached astonishing close to 40 per cent in the early 1920s. At the same time currency depreciation was turned to appreciation. Debt became increasingly expensive and products were difficult to sell.<sup>34</sup>

GDP per capita fell by eleven per cent in 1921 alone. Unemployment rocketed to around eight per cent in the years to come, and more than a hundred commercial banks went bankrupt.<sup>35</sup>

Due to highly indebted local municipalities, the national government had to take action to stimulate the economy alone. Banks and municipalities were bailed out, and the central administration had to take over significant parts of the infrastructure responsibilities. Also, public works programs were introduced, employing up to a good per cent of the labour force. At the same time the central administration's fiscal power was limited, despite a considerable increase in spending on infrastructure.

When The Great Depression hit the world economy from 1929, the central government again had to take action. The public sector saw a new wave of relative increase from the early 1930s, and important markets were regulated. In

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<sup>34</sup> Hanisch, Tore Jørgen 1979, "Om virkninger av paripolitikken", *Historisk tidsskrift*, 3/58, pp. 239-268.

<sup>35</sup> Nordvik, Helge 1995, "Norwegian Banking in the Inter-War Period: A Scandinavian Perspective", Feinstein, Charles H (ed), *Banking, Currency and Finance in Europe between the Wars*, Clarendon, London.



1929, first hand supply of herring was monopolized by law. First hand supply of cod followed with a similar law in 1938.

As for agriculture, producers of crops were subsidized by the state from 1927 and guaranteed a minimum price one year later. In 1930 the parliament decided on introducing a law regulating the markets of dairy products, eggs and bacon. From 1931 all milk producers had to pay a fee to a regulatory body in order to level the price of milk for consumption and milk for dairy production. This was followed up the same year by a law demanding butter to be mixed into margarine, in order to get solve the problem of access production of milk.<sup>36</sup>

In result, the central government sector again started to increase as share of GDP between 1931 and 1933. This can partly be explained by the huge contraction in industrial output, and partly by a more active policy, making the public sector grow relatively to the private.

### **Planning for a larger public sector**

The huge political and economic crises of the period 1914-1945 paved the way for a greater state intervention than the social-liberal state offered. Thus, one saw the birth of a social-democratic regime. The so-called Crisis Agreement between the Labor Party and the Farmers Party established the new era in 1935. Norway's second labor government ever, came to office under the leadership of Johan Nygaardsvold. He stayed in office until 1945, when his successor, Einar Gerhardsen, also from the Labor Party took over. He stayed in office until 1965, only interrupted by a one-month's centre-right government in 1963.

The public sector intentionally grew stronger under the social-democratic rule in the 1930s. The budget discipline was, nevertheless, maintained. Thus, the fiscal policy should not be considered typical Keynesian. In September 21<sup>st</sup> 1931 the gold standard regime was in practise abandoned. This implied a transformation from deflationary to inflationary monetary policy. The krone depreciated against

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<sup>36</sup> Hovland, Edgar 1979, "Smør og margarin blir et fett", *Historisk tidsskrift*, 1/58, pp. 305-325.

other currencies and both domestic and foreign demand revived.<sup>37</sup> However, despite the recovery, unemployment stayed persistently high until World War II.<sup>38</sup> Nevertheless, the foundations for a more active state, under a social-democratic rule, were laid.

### **Social-democratic regime**

Until World War II Norway still had a small public sector, counting for eleven per cent of GDP in the late 1930s. During the German occupation, April 1940-May 1945, it grew rapidly. When the war was over the Labor Party took the opportunity to increase the size of the sector.

This policy choice also implied increased centralization. Clear strategic goals were set, both politically and economically. Detailed regulations played an important role. The parliament, the central government and the central administration set out the direction of the economy.

The era marked the entrance of the economists into the central administration. They were educated in, and believed in, economic planning. Hence, the economy became regulated in detail. Until 1952 it was basically to avoid strong inflation, lack of hard currency and economic crisis. Thereafter, the planning model was basically used in order to out-level the business cycles, reduce income differences and market failures, secure tax incomes and social security programmes, and monitor the economic development into a planned track. Our Scandinavian neighbours, Denmark, Finland and Sweden, followed a similar pattern, which has been called the Nordic Model.<sup>39</sup>

The idea of a free market was out, planning was in. A new homogenous society became a consensus society under the wings of the state. The public sector

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<sup>37</sup> Venneslan, Christian 2010, "Norway's recovery from the Great Depression - an act of balancing?", i *Scandinavian Economic History Review*, 58/2.

<sup>38</sup> Grytten, Ola Honningdal 2008, "A Small Country's Policy Response to Global Economic Disintegration during the Interwar years of Crisis, Müller, Margrit & Timo Myllyntaus (eds), *Pathbreakers: Small European Countries Responding to Globalisation and Deglobalisation*, Peter Lang, Bern, pp. 271-298.

<sup>39</sup> Sjøilen, Espen (2002), *Hvorfor gikk det galt? Statens rolle i utviklingen av norsk næringsliv etter 1945*, Gyldendal, Oslo.

grabbed the responsibility for welfare from the family, the local community, employers and the church. The welfare *state* was created.

Thus, we see that the increase of the central government sector after World War II was a continuation of a process that started in the early 1930s. Under social-democratic rule from 1935 the development became more cautious and was part of a political agenda. During this period growth of the public sector definitely was part of a deliberate plan in order to gain control over the Norwegian economy.

## **Conclusions**

On the basis of literature on Norwegian history, including economic history, this paper divides the time span from Norway's dependence in 1814 until 1980 into three different political regimes. The liberal regime until 1884 (1905), the social-liberal regime until 1935 (1945), and thereafter the social-democratic regime. Little has been done in order to map these periods quantitatively.

By drawing on central government accounts from the early and mid 1800s until the mid 1900s, this paper is able to quantify the size of the central government sector during the transition periods of these regimes. We find that during the liberal era the central government sector decreased relative to the over all economy until the early 1870s. Thereafter it increased rapidly, due to heavy investments in infrastructure, which started as early as the 1840s.

The relative size of the sector continued to increase under the social-liberal era, until 1920. However, more emphasis was put in expanding the central administration during this period. Thereafter the relative share of the sector stagnated until the early 1930s. Thereafter, it started to grow. This process continued under the social-democratic rule from 1935 with the building of the Nordic model after World War II.

Hence, and somewhat surprisingly, we find that the growth of the central government does not necessarily coincide with the introduction of political

regimes. The fiscal transition in fact seems to start in front of the political transitions.

The paper also concludes that the growth in central government finances during the last part of the liberal era was not a tool for gaining control over the economy, but to fuel economic growth and development. During the social-liberal era the sector seem to have grown faster than the economy due to ambitions of a more active and responsible state. When in the social-democratic era growth in the public sector became a goal in itself to gain control over the economy.

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